**Accounting for Corporate Combinations and Associations, 8th edition**

**Test Bank: Chapter 1: Text objectives and introduction to consolidation**

**Multiple Choice Questions**

1. A subsidiary may be:
2. a company.
3. a partnership.
4. an individual.
5. all of the above.

Answer: D

Difficulty: 1

AACSB: Application of Knowledge

Learning Objective: LO 1.1 Explain the concept of a group.

Topic: 1.1 Introduction

1. A ‘controlled group’ includes:
2. controlled entities.
3. associates.
4. joint ventures.
5. all the above.

Answer: D

Difficulty: 1

AACSB: Application of Knowledge

Learning Objective: LO 1.1 Explain the concept of a group.

Topic: 1.1 Introduction

1. (T/F): A trust cannot be an entity.

Answer: F

 Difficulty: 1

 AACSB: Application of Knowledge

 Learning Objective: LO 1.1 Explain the concept of a group.

 Topic: 1.1 Introduction

1. (T/F): All groups have the same basic organizational structure.

Answer: F

Difficulty: 1

AACSB: Analytical Thinking

Learning Objective: LO 1.2 Describe the different classifications for investments in other entities and the accounting methods that apply to each.

Topic: 1.2 Some basic concepts and terminology

1. Explain why percentage of ownership an investor has in an investee is not the only consideration when determining which entities must create financial statements.

Answer:

This determination depends largely on the extent to which the investor entity can direct the key relevant activities of the investee. In the case where the investor can ‘control’ the investee, then for accounting purposes the treatment is as two separate entities as though they were one ‘economic entity’ and the preparation one set of ﬁnancial statements for the economic entity, often called the ‘group’ ﬁnancial statements, is appropriate.

Difficulty: 2

AACSB: Reflective Thinking

Learning Objective: LO 1.2 Describe the different classifications for investments in other entities and the accounting methods that apply to each.

Topic: 1.2 Some basic concepts and terminology

1. (T/F): One of the advantages of forming a group is the potential for reducing legal liability.

Answer: T

Difficulty: 1

AACSB: Analytical Thinking

Learning Objective: LO 1.3 Outline the historical development of consolidated financial reporting and demonstrate the importance of proper consolidation accounting.

Topic: 1.3 Why do entities form groups?

1. Discuss the potential benefits of conducting economic activity through a group structure

Answer:

Potential benefits:

* Diversification—reducing risk and potentially increasing returns
* Attracting capital without loss of control
* Using corporate veil to manage risk
* Lowering cost of borrowing
* Better compliance with sovereign regulatory requirements
* Reducing tax via transfer pricing opportunities

Difficulty: 2

AACSB: Written and Oral Communication

Learning Objective: LO 1.1 Explain the concept of a group.

Topic: 1.3 Why do entities form groups?

1. List the potential benefits of group formation.

Answer:

• Reducing commercial risk or maximising potential returns by diversiﬁcation.

• Attracting capital without forfeiting control. Management may not wish to allow outside investors to increase their level of ownership in the parent company, but want outside investment as part of their overall business.

 • Lowering the risks of legal liability, including environmental and consumer liability. By setting up a number of separate subsidiaries, certain assets can be isolated and protected from high-liability risks. Effectively, this amounts to using the ‘corporate veil’ to manage risk.

 • Providing better security for proposed loans. By transferring assets into a separate company, a potential lender will have the opportunity to obtain a ﬁrst charge over speciﬁc assets. This could beneﬁt the group by facilitating a lower cost of borrowing, particularly through project ﬁnancing.

 • Complying with regulatory requirements. Some multinational groups need to comply with the domestic rules that require business operations to be conducted through local subsidiaries.

 • Minimising taxation. Different countries have different company tax rates, which can be exploited (within certain constraints) using transfer pricing.

Difficulty: 1

AACSB: Analytical Thinking

Learning Objective: LO 1.3 Outline the historical development of consolidated financial reporting and demonstrate the importance of proper consolidation accounting.

Topic: 1.3 Why do entities form groups?

1. 3 X Ltd has a wholly (100%) owned subsidiary, Y Ltd. If Y Ltd went into liquidation, X Ltd would be entitled to:
2. 100% of any surplus of Y Ltd’s assets over its liabilities.
3. 100% of profits made by Y Ltd since its acquisition by X Ltd.
4. nothing.
5. none of the above.

 Answer: A

 Difficulty: 2

 AACSB: Application of Knowledge

Learning Objective: LO 1.1 Explain the concept of a group.

Topic: 1.4 Overview of accounting for different investor-investee relationships

1. (T/F): Joint control can exist where share ownership by investing companies is not equal.

 Answer: T

 Difficulty: 2

 AACSB: Application of Knowledge

 Learning Objective: LO 1.4 Determine the entities that must prepare consolidated

 financial statements.

 Topic: 1.4.2 Investments in jointly controlled entities and operations

1. Discuss the concepts of ‘shared control’ and ‘joint control’ in relation to the requirements of Accounting Standard AASB 127.

Answer:

Shared control—joint control:

* Shared control is joint control where there is a contractual arrangement within the scope of accounting standard AASB 131 *Interest in Joint Ventures.*
* For purposes of AASB 127 control must be non-shared because shared control is no control according to the AASB 127 implementation guidelance.

Difficulty: 2

AACSB: Application of Knowledge

Learning Objective: LO 1.4 Determine the entities that must prepare consolidated financial statements.

Topic: LO 1.4.2 Investments in jointly controlled entities and operations

1. (T/F): If a company has control over the financial policies of another entity, it is deemed to have control over the operating policies.

Answer: F

Difficulty: 2

AACSB: Application of Knowledge

Learning Objective: LO 1.4 Describe the definition of control and the indicators of control as set out in AASB 10 *Consolidated Financial Statements*.

Topic: 1.4.3 Investments in significantly influenced entities (associates)

1. In substance, investments in equity securities may be classified as:
2. trading investments at fair value, where increments and decrements in the fair value of the investments are recognised in the income statement.
3. available-for-sale investments.
4. equity investments in subsidiaries, associates and joint venture entities.
5. all of the above.

Answer: D

 Difficulty: 1

 AACSB: Written and Oral Communication

 Learning Objective: LO 1.1 Explain the concept of a group.

 Topic: 1.4.4 Investments in other equity interests

1. (T/F): Equity investments falling within the scope of AASB 139 *Financial Instruments: Recognition and Measurement* can be measured at fair value.

 Answer: T

 Difficulty: 1

 AACSB: Written and Oral Communication

 Learning Objective: LO 1.4 Determine the entities that must prepare consolidated

 financial statements.

 Topic: 1.4.4 Investments in other equity interests

1. (T/F): Accounting Standard AASB 127 applies only to the consolidated financial statements of a group.

 Answer: F

 Difficulty: 2

 AACSB: Written and Oral Communication

 Learning Objective: 1.5 Describe the definition of control and the indicators of control

 as set out in AASB 10 *Consolidated Financial Statements*.

 Topic: 1.5.6 Changes introduced by AASB 127 and AASB 3

1. (T/F): All companies must prepare separate financial statements.

 Answer: F

 Difficulty: 2

 AACSB: Written and Oral Communication

 Learning Objective: LO 1.5 Describe the definition of control and the indicators of

 control as set out in AASB 10 *Consolidated Financial Statements*.

 Topic: 1.5.6 Changes introduced by AASB 127 and AASB 3

1. Discuss the requirements for the preparation of separate financial statements under AASB 127.

Answer:

Separate financial statements:

* Definition: financial statements of parent, investor or venturer in which investments are accounted for on the basis of the direct equity interest
* The concept of separate financial statements does not apply to entities that are not parents, investors or venturers.
* In certain circumstances a parent may be exempted from preparing consolidated financial statements and will then present separate financial statements.

Difficulty: 3

AACSB: Written and Oral Communication

Learning Objective: 1.5 Describe the definition of control and the indicators of control as set out in AASB 10 *Consolidated Financial Statements*.

Topic: 1.5.6 Changes introduced by AASB 127 and AASB 3

1. (T/F): A reporting entity is a single entity that meets certain criteria.

 Answer: F

 Difficulty: 1

 AACSB: Written and Oral Communication

 Learning Objective: LO 1.6 Apply the definition of control to examples likely to be

 found in practice (including the not-for-profit sector).

 Topic: 1.6.1 The requirement to prepare consolidated financial statements

1. (T/F): If a parent entity is a reporting entity the group must also be a reporting entity.

 Answer: F

 Difficulty: 2

 AACSB: Written and Oral Communication

 Learning Objective: LO 1.6 Apply the definition of control to examples likely to be

 found in practice (including the not-for-profit sector)

 Topic: 1.6.1 The requirement to prepare consolidated financial statements

1. What is the application of the reporting entity concept to consolidation accounting?

Answer:

Reporting entity concept:

* Definition: entity where there are users reliant on general purpose financial reports (GPFRs)
* SAC 1 provides factors to be considered in determining the existence of a reporting entity.
* A group that is a reporting entity must prepare consolidated financial statements.
* Some group structures may contain more than one reporting entity.

Difficulty: 2

AACSB: Application of Knowledge

Learning Objective: LO 1.6 Apply the definition of control to examples likely to be found in practice (including in the not-for-profit sector).

Topic: 1.6.1 The requirement to prepare consolidated financial statements

1. For a company to be required to present consolidated financial statements, it must be:
2. a parent entity.
3. a reporting entity.
4. part of a group that is a reporting entity.
5. any of the above.

 Answer: B

 Difficulty: 2

 AACSB: Written and Oral Communication

 Learning Objective: LO 1.6 Apply the definition of control to examples likely to be found in practice (including in the not-for-profit sector).

 Topic: 1.6.2 A group that is a reporting entity

1. A Ltd controls B Ltd who in turn controls C Ltd. B Ltd and the B Ltd group are not reporting entities. A Ltd is a reporting entity. Consolidated financial statements will be required to be prepared for:
2. the A group
3. the B group
4. both the A group and the B group.
5. none of the groups.

 Answer: A

 Difficulty: 2

 AACSB: Written and Oral Communication

 Learning Objective: LO 1.6 Apply the definition of control to examples likely to be found in practice (including in the not-for-profit sector).

 Topic: 1.6.2 A group that is a reporting entity

1. In the separate financial statements of a parent entity, investments not classified as held for sale are accounted for:
2. at cost.
3. at fair value.
4. at either cost or fair value.
5. not recorded.

 Answer: C

 Difficulty: 2

 AACSB: Written and Oral Communication

 Learning Objective: LO 1.6 Apply the definition of control to examples likely to be found in practice (including in the not-for-profit sector).

 Topic: 1.6.2 A group that is a reporting entity

1. (T/F): Investments in associates (other than those classified as held for sale) will be measured at cost in the consolidated financial statements.

 Answer: F

 Difficulty: 2

 AACSB: Written and Oral Communication

 Learning Objective: LO 1.6 Apply the definition of control to examples likely to be

 found in practice (including the not-for-profit sector).

 Topic: 1.6.3 Accounting for investments in separate financial statements

1. (T/F): Ownership of more than 50% of the voting power will always represent control.

Answer: F

Difficulty: 2

AACSB: Application of Knowledge

Learning Objective: LO 1.7 Identify the main uses and limitations of consolidated financial statements.

Topic: 1.7.2 The definition of control

1. (T/F): Company B is bound by contract to sell all its output to Company A. Company A is deemed to control Company B.

Answer: F

Difficulty: 2

AACSB: Application of Knowledge

Learning Objective: LO 1.7 Identify the main uses and limitations of consolidated financial statements.

Topic: 1.7.3 Power over the investee

1. (T/F): Control of a subsidiary must be actively exercised (i.e., the capacity to control does not meet the definition of control).

Answer: F

Difficulty: 2

AACSB: Reflective Thinking

Learning Objective: LO 1.7 Identify the main uses and limitations of consolidated financial statements.

Topic: 1.7.3 Power over the investee

1. Cassius Ltd and Brutus Ltd agreed to merge by forming another company, Casca Ltd, which acquired all the issued capital of the two companies in a share exchange. Cassius Ltd was a much larger company than Brutus Ltd, with several large equity stakeholders, so that the board of Cassius Ltd emerged from the business combination with the power to dominate the operating and financial policies of the merged entity. Based on these facts:
2. Casca Ltd must be the acquiring entity because it acquired the issued capital of Cassius Ltd and Brutus Ltd.
3. Cassius Ltd is the acquiring entity because its management emerges as the dominant power in the merged entity.
4. neither Cassius Ltd nor Brutus Ltd can be the acquiring entity because their equity securities have been acquired by Casca Ltd.
5. none of the above.

 Answer: B

 Difficulty: 2

 AACSB: Written and Oral Communication

 Learning Objective: LO 1.7 Identify the main uses and limitations of consolidated

 financial statements.

 Topic: 1.7.6 Investment entities

1. (T/F): If a parent loses control of a subsidiary during a financial year, that subsidiary’s results are ignored for consolidation purposes.

Answer: F

Difficulty: 2

AACSB: Application of Knowledge

Learning Objective: LO 1.7 Identify the main uses and limitations of consolidated financial statements.

Topic: 1.7.8 The effect of loss of control

1. In AASB 3, the indicia of an acquiring entity’s power to control the other combining entities in a business combination do not include the power to:
2. exercise more than half of the voting rights in another entity through the site of the voting power or by virtue of an agreement with other investors.
3. appoint or remove a majority of the members of the governing body of the acquired entities.
4. cast the majority of votes at meetings of the governing body.
5. none of the above.

 Answer: D

 Difficulty: 1

 AACSB: Written and Oral Communication

 Learning Objective: LO 1.7 Identify the main uses and limitations of consolidated

 financial statements.

 Topic: 1.7.9 Criticisms of the control definition

1. Assume that Scipio Ltd has a controlling interest in Africanus Ltd. As a result of this relationship:
2. the directors of Africanus Ltd have a fiduciary duty to act in the best interests of Scipio Ltd.
3. because of its controlling interest in Africanus Ltd, Scipio Ltd will take over the management of Africanus Ltd from the board of that company.
4. the board of Africanus Ltd will be dissolved as they no longer have any real power in Africanus Ltd.
5. none of the above.

 Answer: D

 Difficulty: 2

 AACSB: Written and Oral Communication

 Learning Objective: LO 1.7 Identify the main uses and limitations of consolidated

 financial statements.

 Topic: 1.7.9 Criticisms of the control definition

1. What are the major criticisms of the control criterion applied to the definition of the group?

Answer:

Criticisms of control criterion:

* Lack of clear guidelines as to what constitutes control where there is less than 50% ownership
* Current proposals attempt to clarify this ambiguity.

Difficulty. 2

AACSB: Analytical Thinking

Learning Objective: LO 1.7 Identify the main uses and limitations of consolidated financial statements.

Topic: 1.7.9 Criticisms of the control deﬁnition