CIMA F1 Financial Reporting

Mock exam: 60 questions in 90 minutes, with an answer key and explanations

How to use this mock

- Set a timer for **90 minutes** and answer every question without notes. Write your answers in the grid on the next page.
- Mark your answers using the answer key, then read the explanation for every question you got wrong or guessed.
- The questions cover every section of the syllabus, in proportion to the GoQualified question bank for F1.
- Prefer to sit it on screen? The **Exam Sim** on **goqualified.co.uk/cima/f1/** times you, marks the paper and shows your weakest section.
- All questions are original GoQualified practice questions, not past exam questions.

Free from GoQualified. Questions start on page 3; the answer key and explanations follow them. Download the latest version from goqualified.co.uk/cima/f1/.

Your answers

1 _____	13 _____	25 _____	37 _____	49 _____
2 _____	14 _____	26 _____	38 _____	50 _____
3 _____	15 _____	27 _____	39 _____	51 _____
4 _____	16 _____	28 _____	40 _____	52 _____
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10 _____	22 _____	34 _____	46 _____	58 _____
11 _____	23 _____	35 _____	47 _____	59 _____
12 _____	24 _____	36 _____	48 _____	60 _____

Questions

Question 1

Some countries' corporate governance frameworks operate on a 'comply or explain' basis, while others impose governance requirements directly through statute (company law). What is the key difference between these two regulatory approaches?

A There is no real difference between the two approaches — both are legally identical in every respect

B A 'comply or explain' code has no consequence at all for non-compliance, and companies are never required to disclose whether they have complied

C Under a 'comply or explain' code, companies are expected to comply with the code's provisions, or publicly explain their reasons for departing from them, giving flexibility while maintaining transparency; under a statutory approach, governance requirements are legally mandated and non-compliance can carry direct legal consequences

D A statutory approach to governance is only ever used in relation to environmental regulation, never corporate governance

Question 2

What is a central aspect of the board's role in corporate governance, relevant to financial reporting?

A The board has no responsibility for financial reporting at all, since this is delegated entirely and exclusively to the external auditor

B The board's only function relevant to financial reporting is to approve the level of dividends to be paid

C The board's role is limited to representing shareholders in litigation, with no involvement in financial oversight

D The board is collectively responsible for the stewardship of the company, including oversight of the integrity of financial reporting, setting the tone for the control environment, and ensuring appropriate systems of risk management and internal control are in place

Question 3

Alongside the IASB and the IFRS Foundation, two further bodies play a role in the international standard-setting structure: the IFRS Advisory Council and the IFRS Interpretations Committee. What do these bodies broadly do?

A Both bodies have identical functions and simply duplicate each other's work

B The IFRS Advisory Council provides formal advice to the IASB and Trustees on strategy and major projects from a wide range of stakeholders, while the IFRS Interpretations Committee reviews specific accounting issues and provides authoritative guidance on how existing IFRS should be applied where diversity in practice has emerged

C The IFRS Advisory Council has the sole legal power to issue new IFRS standards, replacing the IASB's role entirely

D The IFRS Interpretations Committee is responsible only for translating IFRS standards into different languages

Question 4

What is the key difference between a rules-based and a principles-based approach to accounting regulation?

A A principles-based approach has no requirements at all, leaving preparers entirely free to do as they wish

B A rules-based approach is only ever used for tax law, and a principles-based approach is only ever used for financial reporting

C A rules-based approach sets out detailed, specific requirements to follow for particular situations, while a principles-based approach sets out broader objectives and requires the preparer to exercise judgement in applying them to the specific facts and circumstances

D The two approaches are identical in practice, with no meaningful difference in how they are applied

Question 5

How does the CGMA Code of Ethics relate to the preparation of financial reporting information?

A It has no bearing on financial reporting at all, since it deals only with personal conduct outside the workplace

B It replaces the need to comply with IFRS, since ethical behaviour alone is sufficient for financial reporting purposes

C It sets out fundamental ethical principles — including integrity, objectivity, professional competence and due care, confidentiality, and professional behaviour — that a CGMA member preparing or reporting on financial information is expected to uphold, for example by not knowingly being associated with information that is false or misleading

D It applies only to members working in public practice audit firms, not to those working within a company's own finance function

Question 6

The IFRS Foundation is the organisation that:

A Directly sets all national tax legislation in countries that use IFRS

B Provides oversight and governance for the IASB, appointing members and funding standard-setting

C Audits the financial statements of all companies reporting under IFRS globally

D Investigates and prosecutes companies that fail to comply with IFRS

Question 7

Under IAS 1, a complete set of financial statements for a company includes which of the following?

A A management commentary report together with a full corporate governance statement

B Statement of financial position and statement of profit or loss only

C Statement of financial position, statement of profit or loss, and an auditor's report

D SFP, statement of profit or loss and OCI, statement of changes in equity, statement of cash flows, and notes

Question 8

Under the historical cost basis of measurement, assets are recorded at:

A The present value of future cash flows they are expected to generate

B Their current estimated market value as at the reporting date

C The cost at which they were originally acquired, less any accumulated depreciation or impairment

D Their estimated replacement cost as at the current reporting date

Question 9

Opening inventory: 200 units at £8. During the period, 300 units were purchased at £10. If 400 units were sold during the period, what is the value of closing inventory under the weighted average cost (AVCO) method?

A £920

B £1,000

C £800

D £1,600

Question 10

Information is material if:

A It specifically relates to an amount exceeding 5% of total revenue

B It has been specifically required to be disclosed by an accounting standard

C It is disclosed in a note to the financial statements

D Omitting, misstating or obscuring it could reasonably influence primary users' decisions

Question 11

An item of plant has a carrying amount of £120,000. Its fair value less costs of disposal is £95,000 and its value in use is £104,000. What impairment loss, if any, should be recognised under IAS 36?

A £25,000
B £9,000
C £16,000
D No impairment loss — the asset is not impaired

Question 12

Under IFRS 16, the right-of-use asset is initially measured at cost. Which of the following is correctly included in that initial cost?

A Only the total of the future lease payments still to be made, with no adjustment for anything else
B The amount of the initial measurement of the lease liability, plus any lease payments made at or before commencement, plus initial direct costs incurred by the lessee, less any lease incentives received
C The fair value of the asset if it were purchased outright, regardless of the lease terms actually agreed
D Nothing — the right-of-use asset is always initially recognised at zero and built up only through subsequent payments

Question 13

At the year-end, a company was a defendant in an ongoing court case relating to a dispute that existed at that date, and had recognised a provision based on its best estimate of the likely outcome. After the year-end, but before the financial statements are authorised for issue, the court reaches its final judgment, awarding damages higher than the amount originally provided. How should this be treated under IAS 10?

A As a non-adjusting event, since the judgment was only handed down after the year-end
B It should be ignored, since provisions are never revisited once the year-end accounts are drafted
C As an adjusting event — the judgment provides evidence of a condition (the obligation arising from the dispute) that existed at the reporting date, so the provision should be adjusted to reflect the confirmed amount
D The event can only be treated as adjusting if the additional damages exceed 50% of the original provision

Question 14

Under IAS 16, how does an entity choose between the cost model and the revaluation model for a class of property, plant and equipment?

A The choice is made once for the entire entity and can never subsequently be changed for any asset
B An entity selects either the cost model or the revaluation model as its accounting policy, applied consistently to an entire class of assets (e.g. all land and buildings), not asset-by-asset within that class
C The revaluation model must always be used for property but is never permitted for plant and equipment
D The choice is determined automatically by the asset's useful life, with no policy election available

Question 15

The enhancing qualitative characteristic of 'verifiability' means that:

A Financial information must be available before the end of the reporting period
B Different knowledgeable, independent observers could agree the information faithfully represents what it purports to
C All users of financial statements arrive at the same investment decisions
D Financial information is presented completely without any error or bias whatsoever

Question 16

A company plans to sell an entire division, comprising several items of plant, related inventory, and associated liabilities, as a single package to one buyer. How does IFRS 5 refer to this collection of assets and liabilities to be disposed of together?

A A disposal group
B A cash-generating unit
C A reportable segment
D A joint operation

Question 17

A non-current asset with a carrying amount of £180,000 is reclassified as held for sale. Its fair value is £210,000 and the estimated costs to sell are £15,000. At what amount should the asset be measured immediately after classification?

A £210,000
B £195,000
C £180,000
D £165,000

Question 18

Under IAS 36, which of the following is an example of an EXTERNAL indicator that an asset may be impaired?

A A significant decline in the asset's market value that is clearly more than would be expected from the mere passage of time or normal use
B Evidence that the physical condition of the asset has deteriorated more than expected
C Evidence that the asset is idle, or part of a plan to discontinue or restructure the operation to which it belongs
D Internal management reports showing the asset's economic performance is worse than expected

Question 19

Under the accruals (or matching) basis of accounting, expenses are recognised:

A When the cash payment is actually made to the supplier
B In the period incurred and matched to the revenue they help generate, regardless of cash timing
C When the expense happens to be invoiced by the supplier, regardless of delivery timing
D Only once the expense exceeds a specific material threshold amount

Question 20

The Conceptual Framework for Financial Reporting identifies two fundamental qualitative characteristics of useful financial information. These are:

A Relevance and faithful representation
B Comparability and verifiability
C Timeliness and understandability
D Materiality and consistency

Question 21

Under IAS 36, when should an entity test an individual asset for impairment on its own, rather than as part of a larger group of assets?

A Always — IAS 36 never permits grouping assets together for impairment testing purposes
B Only where the asset generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets; where this is not the case, the asset is tested for impairment as part of the smallest identifiable group of assets that does generate largely independent cash inflows — its cash-generating unit
C Only if the asset was individually insured, since insurance status determines whether individual or group testing applies
D Never — all assets must always be grouped into a single, entity-wide cash-generating unit

Question 22

A company buys new equipment for £150,000. It pays £100,000 in cash, and the remaining £50,000 is financed by a loan paid directly to the supplier. How should this be presented in the statement of cash flows?

A Cash used in investing activities: £50,000
B Cash used in investing activities: £100,000 only — the loan is disclosed as a non-cash item
C Cash used in investing activities: £150,000; financing inflow: £50,000
D No cash flow — no net cash has changed

Question 23

An asset with a carrying amount of £90,000 is reclassified as held for sale. At a later reporting date, before the asset is sold, its fair value less costs to sell has increased to £110,000, with no impairment loss having previously been recognised on the asset. At what amount should the held-for-sale asset now be measured?

A £110,000, recognising the full increase as a gain
B The asset must be reclassified out of held-for-sale simply because its value has increased
C £100,000, being the average of the two figures
D £90,000, the original carrying amount at classification — a subsequent increase in fair value less costs to sell above this original amount is not recognised where there is no prior impairment loss to reverse

Question 24

The enhancing qualitative characteristic of 'understandability' in financial reporting means that:

A Financial statements must always be presented in simple language with no technical terms
B Information should be classified and presented clearly, understandable to users with reasonable business/reporting knowledge
C All users of financial statements, regardless of background, should be able to understand all information without assistance
D Financial statements must be translated into every language of the countries in which the company operates

Question 25

Under IAS 10, what is the significance of the 'date of authorisation for issue' of a set of financial statements?

A It is simply the date the annual general meeting is held to approve the financial statements to shareholders
B It has no defined significance under IAS 10 and is purely an internal administrative date
C It marks the end of the period during which events after the reporting period must be considered for possible adjustment or disclosure
D It is always exactly 12 months after the reporting date, regardless of when the statements are actually finalised

Question 26

Under IAS 2, the cost of manufactured inventories includes which of the following?

A Selling and distribution costs incurred after manufacture
B Only direct materials count — overhead is always expensed in the period it is incurred, never capitalised
C All overheads of the business are included, covering both administrative and selling cost categories
D Direct materials, direct labour and a systematic allocation of fixed/variable production overhead at normal capacity

Question 27

Under IAS 1, which of the following is a correct basis for classifying a liability as current rather than non-current?

A The entity does not have the right, at the end of the reporting period, to defer settlement of the liability for at least twelve months after the reporting period
B The liability is owed to a related party rather than a third party
C The liability first arose more than twelve months before the reporting date
D The liability is denominated in a foreign currency

Question 28

Under IAS 1, how may an entity present its profit or loss and other comprehensive income (OCI) for the period?

A Only ever as two entirely separate, unrelated statements with no permitted alternative
B OCI may never be presented in the same document as the statement of profit or loss under any circumstances
C Either as a single statement of profit or loss and other comprehensive income, or as two statements — a separate statement of profit or loss followed by a statement beginning with profit or loss and displaying items of OCI
D As a note to the financial statements only, never on the face of a primary statement

Question 29

Under the direct method of presenting operating cash flows in the statement of cash flows, the information shown is:

A Profit adjusted for non-cash items and working capital changes
B Only capital expenditure and asset disposals
C A theoretical reconstruction of the cash account from the income statement
D Actual cash receipts from customers and actual cash payments to suppliers and employees

Question 30

A non-current asset was classified as held for sale in the prior year. During the current year, the criteria for held-for-sale classification are no longer met (for example, the planned buyer withdraws and no new buyer is found within the required timeframe). How should the asset be treated?

A It remains classified as held for sale indefinitely, regardless of whether a sale is still expected
B It is reclassified out of held-for-sale, and measured at the lower of (i) its carrying amount had it never been classified as held for sale (i.e. adjusted for depreciation that would have been charged had classification not occurred), and (ii) its recoverable amount at the date of the decision not to sell
C It is written off to nil, since the failed sale is treated as an impairment to zero
D No adjustment is needed; it simply continues to be measured at the amount last recognised while held for sale

Question 31

Under the IFRS Conceptual Framework, an asset should be recognised in the statement of financial position when:

A It meets the definition of an asset, and recognising it provides users with relevant information and a faithful representation
B The entity holds full legal ownership title over the asset in question
C The asset has already been paid for in full by the entity
D Any future outflow associated with holding the asset is entirely certain

Question 32

The statement of changes in equity (SOCE) shows movements in which components of equity during the period?

A Only the movements occurring within the retained earnings reserve specifically
B Only movements caused by transactions with owners (shares issued, dividends paid)
C Movements in share capital, premium, retained earnings and all other reserves including revaluation surplus and OCI
D Only the opening and closing total equity balances shown on the statement

Question 33

Between a company's year-end and the date the financial statements are authorised for issue, the market value of a portfolio of listed investments the company holds falls sharply, due to general market conditions unrelated to conditions existing at the year-end. How should this be treated under IAS 10?

A As an adjusting event, requiring the investments to be written down to their new, lower market value in the year-end financial statements
B As a non-adjusting event — the figures in the financial statements are not changed, though disclosure may be required if the decline is material
C It should be entirely ignored, since share price movements are never relevant under IAS 10
D The financial statements must be delayed until markets stabilise before they can be authorised for issue

Question 34

Which of the following best distinguishes a direct tax from an indirect tax?

A A direct tax is levied on and paid directly by the person or entity who bears its economic burden; an indirect tax is collected by an intermediary and passed on, often within the price of goods or services
B A direct tax is always collected monthly, while an indirect tax is always collected annually
C A direct tax applies only to individuals, while an indirect tax applies only to companies
D A direct tax is optional depending on income level, while an indirect tax is compulsory for everyone

Question 35

A country's tax authority reports its 'tax gap' for the year. What does this figure represent?

A The difference between the highest and lowest marginal tax rates in the tax system
B The total amount of tax refunds issued during the year
C The difference between the amount of tax theoretically owed under the law and the amount actually collected
D The gap in time between a company's year-end and its tax filing deadline

Question 36

Adam Smith's classical 'canons of taxation' set out characteristics a good tax system should have. Which set of characteristics reflects these canons?

A Profitability, growth, liquidity and solvency
B Equity, certainty, convenience and economy (efficiency)
C Progressivity, universality, secrecy and flexibility
D Simplicity, popularity, low cost and voluntary compliance

Question 37

A company reports accounting profit of £300,000. This includes £15,000 of entertaining costs that are not tax-deductible, and depreciation of £40,000. Capital allowances permitted for tax purposes are £60,000. The tax rate is 20%. What is the current tax charge?

A £59,000
B £60,000
C £57,000
D £64,000

Question 38

A government introduces a new tax on soft drink manufacturers. Manufacturers respond by raising the price consumers pay by the full amount of the tax. What does this illustrate about the incidence of the tax?

A The tax has no incidence at all, since manufacturers remain legally liable to pay it
B The formal and effective incidence are always identical for any tax
C The formal (legal) incidence falls on manufacturers, but the effective (economic) incidence has been shifted to consumers
D This proves the tax is a direct tax rather than an indirect tax

Question 39

A company based in Country A pays interest to a lender based in Country B. Country A's tax rules require the company to deduct tax from the interest payment before it is paid over, and remit that amount directly to Country A's tax authority. What is this mechanism called?

A Transfer pricing adjustment
B Value added tax
C Double taxation relief
D Withholding tax

Question 40

Which statement correctly distinguishes a residence basis of taxation from a source basis?

A Under a residence basis, a country only taxes income arising within its own borders, regardless of who earns it
B Under a source basis, a country taxes its residents on their worldwide income, wherever it arises
C Under a residence basis, a country taxes its residents on some or all of their worldwide income; under a source basis, a country taxes income arising within its borders regardless of the recipient's residence
D The two bases always produce identical tax outcomes, so the distinction has no practical effect

Question 41

A fully VAT-registered business purchases a car for business use at a VAT-inclusive price of £18,000 (VAT rate 20%). Under common VAT rules, input tax on cars purchased for mixed business and private use is:

A Fully recoverable because the car is used for business
B Recoverable only if the car originally cost more than £10,000 to purchase
C Only recoverable on the business-use proportion of total mileage
D Fully blocked — input tax on cars typically isn't recoverable if there's any private use

Question 42

A company's foreign branch profits have already been taxed in the country where the branch operates. Its home country also seeks to tax the same profits. Which of the following is a recognised method of relieving this double taxation?

A Granting a tax credit in the home country equal to (or capped at) the foreign tax already suffered on that income
B Simply ignoring the existence of the foreign tax and taxing the full profit again in the home country
C Requiring the branch to permanently relocate to avoid the issue
D Suspending the home country's own tax system entirely for that accounting period

Question 43

A business makes both taxable and exempt supplies. In relation to input VAT recovery, it is described as:

A Fully taxable — all input VAT is recoverable
B Partially exempt — it can recover only the portion of input VAT attributable to taxable supplies
C Exempt from VAT entirely, meaning no input VAT can be recovered at all
D Outside the scope — VAT does not apply to any of its transactions

Question 44

A government introduces a new fuel duty and legislates that all revenue raised from it must be spent on road maintenance and cannot be used for any other government spending. What is this arrangement known as?

A A regressive tax
B A withholding tax
C A hypothecated (or ring-fenced) tax
D A tax avoidance scheme

Question 45

Which of the following is correctly classified as an indirect tax?

A Corporation tax on a company's taxable profits
B Income tax deducted from an employee's salary
C A capital gains tax charged on an individual's disposal of an asset
D Value added tax (VAT) charged on the sale of goods

Question 46

Current assets are £150,000 (including inventory of £30,000) and current liabilities are £100,000. What are the current ratio and quick (acid test) ratio respectively?

A 1.5 and 1.5
B 1.2 and 1.5
C 1.5 and 1.2
D 2.0 and 1.5

Question 47

Invoice factoring differs from invoice discounting primarily because:

A In factoring, the factor manages and collects receivables; invoice discounting leaves the client in control
B Factoring is always significantly more expensive to arrange than invoice discounting
C Factoring is only ever available to very large companies with strong credit ratings
D Invoice discounting is only available to manufacturing companies

Question 48

Average inventory is £50,000 and cost of sales is £365,000. What is the inventory days figure?

A 50 days
B 60 days
C 40 days
D 73 days

Question 49

A supplier offers a 2% settlement discount if payment is made within 10 days instead of the normal 60-day credit period. If the company's cost of short-term borrowing is 10% per year, should the discount be taken?

A No — settlement discounts should always be declined to preserve cash
B Yes — the annualised cost of not taking the discount (14.9%) exceeds the borrowing rate (10%), so it is cheaper to borrow and pay early to capture the discount
C Yes — 2% is always worth taking regardless of borrowing costs
D No — the annualised cost of not taking the discount (14.9%) is below the borrowing rate (10%), so it is cheaper to continue using the trade credit

Question 50

Just-in-time (JIT) inventory management aims to:

A Hold maximum inventory to ensure production is never interrupted
B Order inventory in very large batches specifically to minimise ordering costs incurred
C Guarantee that inventory levels always exactly equal the calculated EOQ figure
D Receive materials exactly when needed for production, eliminating storage costs and tied-up working capital

Question 51

Commercial paper as a source of short-term finance is:

A An unsecured short-term debt instrument, typically 1-270 days, issued by creditworthy companies
B A cheque simply issued by a company directly to one of its suppliers
C A government-backed loan facility specifically designed for small businesses
D A type of long-term bond typically issued by banks directly to companies

Question 52

Invoice discounting, as distinct from factoring, provides a business with:

A Full credit management services including collection of debts
B Advance finance against invoices, with the business retaining control of its sales ledger
C A guarantee that every single invoice raised will ultimately be paid in full
D Only financing for inventory, not for trade receivables

Question 53

The matching principle for working capital financing suggests that:

A All assets should be financed entirely by equity capital to minimise financial risk
B Short-term financing should always be used for non-current assets as it is cheaper
C Current assets financed by current liabilities, non-current assets by long-term finance, matching maturities
D All financing should be at a fixed interest rate to avoid rate risk

Question 54

The treasury function within a company is primarily responsible for:

A Preparing the annual statutory financial statements
B Managing cash, short-term investments, borrowings, FX risk and banking relationships
C Setting the company's pricing strategy for products and services
D Preparing management accounts for operational departments

Question 55

A company considers extending its payables days from 30 to 60 days without supplier agreement. The main risk of this approach is:

A It will improve cash flow immediately with absolutely no downside at all
B The company's current ratio will automatically and immediately improve
C Suppliers may respond by withdrawing credit terms, increasing prices, or reducing priority of supply
D The company will automatically qualify for settlement discounts

Question 56

A conservative working capital financing policy differs from an aggressive policy in that it:

A Minimises working capital investment to reduce cost
B Uses more long-term funding and holds higher current assets, reducing risk but raising cost
C Relies heavily on short-term financing including overdraft and trade credit
D Never uses any form of external financing under any circumstances at all

Question 57

A company offers its customers a 2% early settlement discount to improve cash collection. Which cost does this impose on the company?

A No real cost at all — the discount is purely a marketing tool for the business
B Only the administrative cost of processing the discount
C Cost of the discount (2% of invoice value) reduced by the benefit of receiving cash earlier
D A cost of 2% of annual revenue regardless of how many customers take it

Question 58

Poor working capital management can lead to:

A Higher share prices due to improved operating efficiency
B Automatic and guaranteed improvement in the company's external credit ratings
C Lower tax liabilities arising purely from improved cash flow timing
D Over-trading, where rapid growth creates cash flow problems despite the business being profitable

Question 59

A company's quick ratio has fallen from 1.4 to 0.9 over the past year. This most likely indicates:

A Short-term liquidity has deteriorated — current liabilities growing relative to liquid assets
B The company has simply become more profitable during the period overall
C The company's inventory management has improved significantly
D The company has fully repaid all of its outstanding long-term debt

Question 60

Which of the following ratios would typically show the signs of over-trading (under-capitalisation) in a rapidly growing business?

A Rising current ratio and falling payables days
B A declining current ratio, rising payables days and rising receivables days
C No change in working capital ratios — over-trading only affects profits
D A current ratio that remains consistently above 3.0 at all times

Answer key

1 C	**13** C	**25** C	**37** A	**49** B
2 D	**14** B	**26** D	**38** C	**50** D
3 B	**15** B	**27** A	**39** D	**51** A
4 C	**16** A	**28** C	**40** C	**52** B
5 C	**17** C	**29** D	**41** D	**53** C
6 B	**18** A	**30** B	**42** A	**54** B
7 D	**19** B	**31** A	**43** B	**55** C
8 C	**20** A	**32** C	**44** C	**56** B
9 A	**21** B	**33** B	**45** D	**57** C
10 D	**22** B	**34** A	**46** C	**58** D
11 C	**23** D	**35** C	**47** A	**59** A
12 B	**24** B	**36** B	**48** A	**60** B

Score: count your correct answers out of 60. Then work through the explanations below.

Answers and explanations

Question 1: C Under a 'comply or explain' code, companies are expected to comply with the code's provisions, or publicly explain their reasons for departing from them, giving flexibility while maintaining transparency; under a statutory approach, governance requirements are legally mandated and non-compliance can carry direct legal consequences

A 'comply or explain' governance code (a common approach in some jurisdictions) sets out recommended governance practices which companies are expected to follow, but rather than an absolute legal mandate, companies that choose to depart from a provision are required to publicly explain their reasoning — giving flexibility to accommodate different circumstances while preserving transparency and accountability to shareholders. A statutory approach instead writes governance requirements directly into company law, making compliance a legal obligation with the potential for direct legal consequences for breach. The two approaches genuinely differ in their mechanism and consequences, 'comply or explain' still requires public disclosure of any departure (it isn't a consequence-free approach), and statutory regulation is a general regulatory technique used across many areas of law, not one confined to environmental matters.

Section A, Governance regulation approaches — comply-or-explain vs statutory · Ref A2b · f1026

Question 2: D The board is collectively responsible for the stewardship of the company, including oversight of the integrity of financial reporting, setting the tone for the control environment, and ensuring appropriate systems of risk management and internal control are in place

A core element of the board's corporate governance role is stewardship of the company on behalf of shareholders, which includes oversight of the integrity of the financial reporting process, setting the tone from the top for the organisation's control environment and ethical culture, and ensuring adequate systems of risk management and internal control are established and monitored. The external auditor provides independent assurance on the financial statements, but this doesn't remove the board's own oversight responsibility — the two roles are complementary, not a substitute for one another. The board's responsibilities are far broader than simply approving dividend levels, and go well beyond a narrow litigation-representation function.

Section A, Role of the board in corporate governance · Ref A2a · f1027

Question 3: B The IFRS Advisory Council provides formal advice to the IASB and Trustees on strategy and major projects from a wide range of stakeholders, while the IFRS Interpretations Committee reviews specific accounting issues and provides authoritative guidance on how existing IFRS should be applied where diversity in practice has emerged

The IFRS Advisory Council provides a formal channel for a wide range of organisations and individuals with an interest in international financial reporting to advise the IASB and the IFRS Foundation Trustees on strategic direction and major technical projects. The IFRS Interpretations Committee's role is different: it reviews specific accounting issues arising in practice — often where diversity in how a standard is being applied has emerged — and issues interpretive guidance to promote consistent application of existing IFRS. The two bodies have distinct, complementary roles rather than duplicating one another, neither replaces the IASB's standard-setting authority, and translation of standards is an entirely separate administrative matter unrelated to either body's core function.

Section A, Roles of the IFRS Advisory Council and IFRS Interpretations Committee · Ref A1b · f1051

Question 4: C A rules-based approach sets out detailed, specific requirements to follow for particular situations, while a principles-based approach sets out broader objectives and requires the preparer to exercise judgement in applying them to the specific facts and circumstances

A rules-based approach to regulation provides detailed, specific requirements intended to cover particular situations as precisely as possible, which can reduce ambiguity but may also create scope for structuring transactions to technically comply with the letter of a rule while avoiding its underlying intent. A principles-based approach (the philosophy IFRS is generally considered to follow) instead sets out broader objectives and requires preparers to exercise professional judgement in applying them faithfully to the specific facts and circumstances, aiming for the substance of the requirement to be met rather than just its technical wording. Principles-based regulation still imposes real requirements (it isn't a free-for-all), and the rules/principles distinction is a general regulatory design choice relevant well beyond just tax or financial reporting specifically — the two approaches are genuinely different in practice, not interchangeable.

Section A, Rules-based vs principles-based regulation · Ref A1c · f1076

Question 5: C It sets out fundamental ethical principles — including integrity, objectivity, professional competence and due care, confidentiality, and professional behaviour — that a CGMA member preparing or reporting on financial information is expected to uphold, for example by not knowingly being associated with information that is false or misleading

The CGMA Code of Ethics sets out fundamental principles — integrity, objectivity, professional competence and due care, confidentiality, and professional behaviour — that apply directly to how a member prepares, reviews, or reports on financial information. For example, the integrity principle means a member should not knowingly be associated with financial information they believe is false or misleading, and objectivity requires guarding against bias or undue influence when exercising judgement in applying accounting standards. It doesn't replace compliance with IFRS (technical compliance and ethical conduct are both required, not one instead of the other), and it applies to CGMA members generally, in whatever role or sector they work, not solely to those in public practice.

Section A, CGMA Code of Ethics — relationship to financial reporting · Ref A1c · f1103

Question 6: B Provides oversight and governance for the IASB, appointing members and funding standard-setting

The IFRS Foundation is the parent body of the IASB: it appoints IASB members, oversees the standard-setting due process, raises funding for the IASB's work and promotes the adoption of IFRS globally. It is accountable to a monitoring board composed of public authorities. The IASB itself sets the standards; the Foundation provides the governance. Enforcement is the role of national securities regulators and auditors. Tax legislation is entirely separate from IFRS.

Section A, IFRS Foundation and oversight · Ref A1b · f1126

Question 7: D SFP, statement of profit or loss and OCI, statement of changes in equity, statement of cash flows, and notes

IAS 1 requires a complete set of financial statements to include: a statement of financial position (balance sheet) at the end of the period; a statement of profit or loss and other comprehensive income (which may be presented in one or two statements); a statement of changes in equity; a statement of cash flows; and notes (including significant accounting policies and other explanatory information). The auditor's report and management commentary are not components of the financial statements themselves — they accompany but are separate from the statements.

Section B, IAS 1 — components of financial statements · Ref B1 · f1004

Question 8: C The cost at which they were originally acquired, less any accumulated depreciation or impairment

Historical cost records assets at the price paid (or consideration given) at the time of acquisition, adjusted downward only for accumulated depreciation (for depreciable assets) and impairment losses. It does not incorporate changes in market value after acquisition. Historical cost is verifiable, objective and conservative — it prevents recording unrealised gains — but may result in balance sheet values that diverge significantly from current values over time. It remains the most widely used basis under IFRS, though many standards also permit or require fair value or other bases for specific asset classes.

Section B, Measurement bases — historical cost · Ref B0 · f1007

Question 9: A £920

Total units available = 200 + 300 = 500. Total cost = (200 × £8) + (300 × £10) = £1,600 + £3,000 = £4,600. Weighted average cost per unit = £4,600 ÷ 500 = £9.20. Units remaining after 400 sold = 100 units. Closing inventory value = 100 × £9.20 = £920. Under FIFO, closing inventory would be valued at the most recent cost: 100 × £10 = £1,000. The £800 figure applies the opening price (£8) to the closing units. AVCO blends all available costs.

Section B, IAS 2 — AVCO closing inventory · Ref B3 · f1009

Question 10: D Omitting, misstating or obscuring it could reasonably influence primary users' decisions

Materiality is defined in relation to the decisions of users: information is material if its omission or misstatement could reasonably be expected to influence users' decisions. There is no universal percentage threshold — materiality is judged in the context of the entity's size, nature and circumstances. Both quantitative size and qualitative nature (e.g., illegal transactions) affect materiality judgements. Information required by standards must be disclosed if material; standards do not override materiality. Note disclosure is a presentation choice, not the definition of materiality.

Section B, Materiality · Ref B0 · f1012

Question 11: C £16,000

Recoverable amount is the higher of fair value less costs of disposal (£95,000) and value in use (£104,000) — so £104,000. An impairment loss is recognised only where the carrying amount exceeds the recoverable amount: £120,000 − £104,000 = £16,000 impairment loss. £25,000 incorrectly compares the carrying amount with fair value less costs of disposal (the lower of the two figures, when the standard requires the higher). £9,000 is simply the difference between the two recoverable-amount candidates, which has no meaning in the impairment test. And since £120,000 exceeds £104,000, the asset is genuinely impaired — 'no impairment' would only be right if the recoverable amount were at least equal to the carrying amount.

Section B, IAS 36 — recognising an impairment loss · Ref B5 · f1014

Question 12: B The amount of the initial measurement of the lease liability, plus any lease payments made at or before commencement, plus initial direct costs incurred by the lessee, less any lease incentives received

The right-of-use asset's initial cost comprises the initial measurement of the lease liability, any lease payments made at or before the commencement date (less any lease incentives received from the lessor), any initial direct costs incurred by the lessee in obtaining the lease, and an estimate of any dismantling or restoration costs the lessee is obliged to incur (IFRS 16.24). This ties the asset's initial value to the specific liability and cash flows of that particular lease, not to an unrelated market fair-value figure or to a simple future-payments total, and it is recognised as a real asset from commencement — not at zero.

Section B, IFRS 16 — initial measurement of right-of-use asset · Ref B8 · f1031

Question 13: C As an adjusting event — the judgment provides evidence of a condition (the obligation arising from the dispute) that existed at the reporting date, so the provision should be adjusted to reflect the confirmed amount

The dispute and the resulting obligation existed at the year-end — the court judgment received afterwards simply provides evidence that clarifies the amount of an obligation that was already present at the reporting date, rather than describing a new condition arising after it. IAS 10 treats this as a classic adjusting event, requiring the provision to be updated to reflect the now-confirmed damages figure, even though the confirmation itself arrived after the year-end. It is not ignored, and there is no materiality-percentage threshold in IAS 10 that determines whether an event of this kind is adjusting or not — the test is always about when the underlying condition existed, not the size of the amount involved.

Section B, IAS 10 — adjusting event example (litigation confirmed after year-end) · Ref B7 · f1032

Question 14: B An entity selects either the cost model or the revaluation model as its accounting policy, applied consistently to an entire class of assets (e.g. all land and buildings), not asset-by-asset within that class

IAS 16 requires the cost or revaluation model to be chosen as an accounting policy applied to an entire class of assets (such as land and buildings, or plant and machinery), rather than being decided individually for each asset within a class — this consistency prevents selective revaluation of only the assets management wishes to revalue. It isn't a one-off, entity-wide, never-changeable choice (a change from cost to revaluation model is possible, applied to the whole class going forward), the revaluation model isn't restricted to only property, and the choice is a genuine accounting policy election, not something automatically determined by an asset's useful life.

Section B, IAS 16 — cost model vs revaluation model · Ref B2 · f1038

Question 15: B Different knowledgeable, independent observers could agree the information faithfully represents what it purports to

Verifiability means that different knowledgeable, independent observers can confirm that a depiction faithfully represents the economic phenomena it purports to represent — either by direct verification (checking the physical existence of an asset) or indirect verification (recalculating figures using the same inputs and methods). It supports faithful representation by providing assurance to users. Timeliness (not verifiability) concerns the availability of information before it loses its relevance. Freedom from error and neutrality are aspects of faithful representation, not verifiability. Verifiability does not require consensus on decisions.

Section B, Verifiability · Ref B0 · f1053

Question 16: A A disposal group

IFRS 5 uses the term 'disposal group' for a group of assets to be disposed of together, as a group, in a single transaction, along with any directly associated liabilities that will also be transferred. The held-for-sale classification and measurement rules apply to the disposal group as a whole rather than to each asset individually. A cash-generating unit is an IAS 36 impairment-testing concept (the smallest group of assets generating largely independent cash inflows), a reportable segment relates to segmental disclosure requirements, and a joint operation is a type of joint arrangement — none of these is the IFRS 5 term for a group of items being sold together.

Section B, IFRS 5 — disposal group · Ref B9 · f1054

Question 17: C £180,000

IFRS 5 requires an asset held for sale to be measured at the lower of its carrying amount and fair value less costs to sell. Fair value less costs to sell here is £210,000 − £15,000 = £195,000, which is higher than the existing carrying amount of £180,000. Since the carrying amount (£180,000) is the lower of the two figures, that is the amount at which the asset continues to be measured — no gain is recognised for the excess of fair value less costs to sell over carrying amount. £210,000 ignores costs to sell, £195,000 is fair value less costs to sell but is not the lower figure here, and £165,000 incorrectly deducts selling costs from the carrying amount rather than from fair value.

Section B, IFRS 5 — measurement of held-for-sale assets · Ref B9 · f1055

Question 18: A A significant decline in the asset's market value that is clearly more than would be expected from the mere passage of time or normal use

IAS 36 distinguishes external indicators of impairment (arising from the entity's external environment — significant declines in market value beyond normal expectations, adverse changes in the technological, market, economic or legal environment, increases in market interest rates affecting discount rates, or the entity's market capitalisation falling below its net asset carrying amount) from internal indicators (evidence of physical damage or obsolescence, evidence the asset is idle or part of a restructuring or discontinuance plan, and internal reporting showing worse-than-expected economic performance). Physical deterioration, idle/restructuring status, and internal performance reporting are all internal indicators, not external ones.

Section B, IAS 36 — indicators of impairment · Ref B5 · f1060

Question 19: B In the period incurred and matched to the revenue they help generate, regardless of cash timing

The accruals basis requires that transactions and events are recognised when they occur and matched to the period they relate to, not when cash is received or paid. For example, wages earned by employees in December but paid in January are an expense of December. This is the fundamental alternative to cash-basis accounting and underlies financial statements prepared under IFRS. Cash payment, invoice receipt and materiality thresholds do not determine when an expense is recognised under the accruals basis.

Section B, Accruals basis of accounting · Ref B0 · f1061

Question 20: A Relevance and faithful representation

The Conceptual Framework identifies relevance (information that is capable of making a difference to decisions, including predictive and confirmatory value) and faithful representation (information that is complete, neutral and free from error) as the two fundamental qualitative characteristics. Comparability, verifiability, timeliness and understandability are enhancing qualitative characteristics — they improve usefulness but cannot make information useful if it lacks relevance or faithful representation. Materiality is an aspect of relevance, not a separate characteristic.

Section B, Qualitative characteristics — fundamental · Ref B0 · f1078

Question 21: B Only where the asset generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets; where this is not the case, the asset is tested for impairment as part of the smallest identifiable group of assets that does generate largely independent cash inflows — its cash-generating unit

IAS 36 requires an asset's recoverable amount to be estimated for the individual asset only where it generates cash inflows that are largely independent of other assets. In practice, most individual assets within a business don't generate cash flows independently of other assets they work alongside, so IAS 36 requires them instead to be tested for impairment as part of a cash-generating unit — the smallest identifiable group of assets that does generate largely independent cash inflows. This is a defined test based on independence of cash flows, not an absolute rule that grouping is never or always used, and has nothing to do with whether an asset happens to be individually insured.

Section B, IAS 36 — definition of a cash-generating unit · Ref B5 · f1081

Question 22: B Cash used in investing activities: £100,000 only — the loan is disclosed as a non-cash item

Only £100,000 of cash left the company, so the investing outflow is £100,000. The £50,000 loan was paid straight to the supplier, so no cash passed through the company for that part of the purchase. IAS 7 excludes investing and financing transactions that do not use cash from the statement of cash flows and requires them to be disclosed elsewhere in the financial statements. Showing £150,000 invested with a £50,000 financing inflow would report cash flows that never happened; that treatment applies only when the company receives the loan in cash and then pays the supplier itself. £50,000 nets the loan against the cost, which is not a cash figure, and there is clearly a cash flow because £100,000 was paid.

Section B, IAS 7 — capital expenditure in cash flows · Ref B10 · f1083

Question 23: D £90,000, the original carrying amount at classification — a subsequent increase in fair value less costs to sell above this original amount is not recognised where there is no prior impairment loss to reverse

IFRS 5 does permit a gain for a subsequent increase in fair value less costs to sell, but only up to the extent of any impairment losses previously recognised on that asset — it does not permit remeasurement above the original carrying amount recognised at the date of classification as held for sale. Here there was no prior impairment loss to reverse, so the increase in fair value less costs to sell to £110,000 is simply not recognised, and the asset remains measured at its original £90,000 carrying amount. An increase in value on its own is not a trigger to reclassify the asset out of held for sale, and averaging the two figures has no basis in the standard.

Section B, IFRS 5 — no upward remeasurement above original carrying amount · Ref B9 · f1085

Question 24: B Information should be classified and presented clearly, understandable to users with reasonable business/reporting knowledge

Understandability requires that financial information is presented clearly and concisely. However, the Conceptual Framework acknowledges that users are assumed to have a reasonable knowledge of business, economic activities and financial reporting — preparers are not expected to simplify to the point of removing complex but necessary information. Excluding complex information simply to improve apparent clarity would reduce usefulness. Language simplification, universal comprehension and translation are not what understandability means in the context of financial reporting qualitative characteristics.

Section B, Understandability · Ref B0 · f1098

Question 25: C It marks the end of the period during which events after the reporting period must be considered for possible adjustment or disclosure

The date of authorisation for issue is the point up to which management must consider whether events occurring after the reporting period require the financial statements to be adjusted (for conditions existing at the year-end) or disclosed (for significant conditions arising afterwards). It is not the same as the AGM date — authorisation for issue typically happens well before shareholders formally approve the statements — and it is not a fixed 12-month point; it depends on the entity's own reporting and governance timetable. Far from being an arbitrary internal date, it is the specific cut-off IAS 10 uses to define the review period for subsequent events.

Section B, IAS 10 — date of authorisation for issue · Ref B7 · f1099

Question 26: D Direct materials, direct labour and a systematic allocation of fixed/variable production overhead at normal capacity

IAS 2 requires that the cost of manufactured inventory includes cost of purchase (raw materials, import duties, transport) plus costs of conversion — direct labour and a systematic allocation of production overheads (both fixed and variable), based on normal production capacity. Fixed production overheads are allocated at the normal (not actual) level of production to prevent under-utilised capacity inflating inventory costs. Selling, distribution and administrative overheads are period costs, expensed as incurred, not included in inventory cost.

Section B, IAS 2 — cost of conversion · Ref B3 · f1108

Question 27: A The entity does not have the right, at the end of the reporting period, to defer settlement of the liability for at least twelve months after the reporting period

IAS 1 classifies a liability as current if the entity expects to settle it within its normal operating cycle, holds it primarily for trading, is due to settle it within twelve months after the reporting period, or — critically — does not have the right at the end of the reporting period to defer settlement for at least twelve months after the reporting period. That last test matters in practice: even a long-term loan can become current if a covenant breach at the year-end removes the right to defer repayment. Whether a liability is owed to a related party, how long ago it first arose, or its currency of denomination have no bearing on the current/non-current classification test itself.

Section B, IAS 1 — current vs non-current classification · Ref B1 · f1110

Question 28: C Either as a single statement of profit or loss and other comprehensive income, or as two statements — a separate statement of profit or loss followed by a statement beginning with profit or loss and displaying items of OCI

IAS 1 gives entities a choice: they may present a single combined statement of profit or loss and other comprehensive income, or two statements — a statement of profit or loss on its own, followed immediately by a statement that begins with the profit or loss figure and then presents the components of OCI (such as gains on revaluation of property, plant and equipment, or remeasurements of a defined benefit pension plan) to arrive at total comprehensive income. Either approach is acceptable and both keep OCI on the face of a primary statement rather than relegating it to a note, so the 'note only' and 'never together' options both misstate the actual requirement.

Section B, IAS 1 — statement of profit or loss and other comprehensive income · Ref B1 · f1123

Question 29: D Actual cash receipts from customers and actual cash payments to suppliers and employees

The direct method presents actual cash flows: the gross cash collected from customers, the gross cash paid to suppliers, the cash paid to employees, and other operating cash payments. It provides information not available directly from the income statement and is considered more transparent than the indirect method. However, it requires access to detailed cash flow records and is therefore more costly to prepare. IAS 7 encourages the direct method but permits the indirect method (starting from profit and adjusting for non-cash items), which is more commonly used in practice.

Section B, IAS 7 — direct method of cash flows · Ref B10 · f1128

Question 30: B It is reclassified out of held-for-sale, and measured at the lower of (i) its carrying amount had it never been classified as held for sale (i.e. adjusted for depreciation that would have been charged had classification not occurred), and (ii) its recoverable amount at the date of the decision not to sell

IFRS 5 requires an asset that no longer meets the held-for-sale criteria to be reclassified back to its original category and measured at the lower of what its carrying amount would have been had it never been classified as held for sale (i.e. reinstating the depreciation that was suspended during the held-for-sale period) and its recoverable amount at the date of the decision not to sell. It does not remain held for sale indefinitely once the criteria are no longer met, it is not automatically written off to nil, and the carrying amount cannot simply be left unchanged since depreciation must be caught up.

Section B, IFRS 5 — asset ceasing to meet held-for-sale criteria · Ref B9 · f1132

Question 31: A It meets the definition of an asset, and recognising it provides users with relevant information and a faithful representation

Under the 2018 Conceptual Framework, an item that meets the definition of an asset is recognised when recognising it provides users of the financial statements with relevant information and a faithful representation of the asset (option A). The earlier tests of a probable inflow of benefits and reliable measurement are no longer the Framework's recognition criteria, although some individual standards, such as IAS 16, still use them. Legal ownership is not required (B): substance matters, which is why a lessee recognises a right-of-use asset under IFRS 16 even though the lessor keeps legal title. Full payment is not required (C), and certainty of future flows is not a recognition threshold (D).

Section B, Recognition criteria · Ref B0 · f1134

Question 32: C Movements in share capital, premium, retained earnings and all other reserves including revaluation surplus and OCI

The statement of changes in equity provides a complete reconciliation of every equity component from the opening to the closing balance. It includes: profit or loss for the period; each item of OCI; transactions with owners (shares issued or bought back, dividends paid); and any reclassifications between equity components. It covers share capital, share premium, retained earnings, revaluation surplus, translation reserve and any other OCI balances. Both owner transactions and total comprehensive income appear in the SOCE, making it an essential bridge between the income statement/OCI and the balance sheet.

Section B, IAS 1 — statement of changes in equity · Ref B1 · f1135

Question 33: B As a non-adjusting event — the figures in the financial statements are not changed, though disclosure may be required if the decline is material

A general decline in market values after the year-end, caused by market conditions arising after that date rather than a condition that existed at the year-end, is a textbook non-adjusting event — the fall in value doesn't reflect something that was true at the reporting date, so the year-end figures are not changed. Disclosure of the nature and estimated financial effect is required only if the event is material enough that omitting it could influence users' decisions. It isn't ignored outright (materiality still needs assessing), and there's no requirement or mechanism under IAS 10 to delay authorisation of the financial statements until markets settle.

Section B, IAS 10 — non-adjusting event example (investment value decline) · Ref B7 · f1149

Question 34: A A direct tax is levied on and paid directly by the person or entity who bears its economic burden; an indirect tax is collected by an intermediary and passed on, often within the price of goods or services

A direct tax (e.g. corporation tax, income tax) is charged on and paid directly by the entity whose income or gains are being taxed — the legal and economic burden fall on the same party. An indirect tax (e.g. VAT, customs duty) is collected by an intermediary, such as a retailer, and passed on to the tax authority, with the economic burden ultimately borne by the end consumer through the price paid. Collection frequency, the individual/company distinction, and any notion of tax being 'optional' are not what separates the two categories — the defining feature is who bears the burden versus who remits the tax.

Section C, Direct vs indirect tax — classification · Ref C1 · f1015

Question 35: C The difference between the amount of tax theoretically owed under the law and the amount actually collected

The tax gap measures the shortfall between the tax that should be collected if everyone fully complied with the law and what is actually collected. It captures losses from evasion, avoidance, error, non-payment, and the hidden economy, and is a key metric tax authorities use to target enforcement resources and assess the health of the tax system. It has nothing to do with the spread of marginal rates, refund volumes, or filing deadlines — those are separate administrative or rate-structure concepts entirely unrelated to compliance shortfall.

Section C, The tax gap — concept · Ref C1 · f1019

Question 36: B Equity, certainty, convenience and economy (efficiency)

Adam Smith's four canons are: equity (tax should relate to ability to pay), certainty (the taxpayer should clearly know what, when and how much to pay), convenience (payment should be timed and structured to suit the taxpayer), and economy/efficiency (the cost of collecting the tax should be low relative to what it raises). These principles are still used today to evaluate whether a tax or tax system is well designed. The other option sets mix in unrelated financial-statement or governance concepts, or invent characteristics (secrecy, voluntary compliance) that are not part of the classical framework.

Section C, Canons of taxation (Adam Smith) · Ref C1 · f1039

Question 37: A £59,000

Taxable profit = accounting profit + disallowed expenses + accounting depreciation − capital allowances = £300,000 + £15,000 + £40,000 − £60,000 = £295,000. Current tax = £295,000 × 20% = £59,000. Depreciation must be added back because it is replaced by capital allowances. The £60,000 figure uses £300,000 taxable profit (ignoring the entertaining add-back and the depreciation/capital allowance adjustment). Entertaining expenses are frequently disallowed for tax purposes as they are viewed as conferring a private benefit. £57,000 deducts the entertaining instead of adding it back ((£300,000 − £15,000) × 20%), and £64,000 does not follow from the adjustments.

Section C, Corporation tax — taxable profit · Ref C2 · f1041

Question 38: C The formal (legal) incidence falls on manufacturers, but the effective (economic) incidence has been shifted to consumers

Formal (or legal) incidence identifies who is legally required to pay the tax to the authority — here, the manufacturer. Effective (or economic) incidence identifies who actually bears the cost after any price adjustments — here, the consumer, since the full increase has been passed on through higher prices. The two can differ significantly depending on how easily the cost can be shifted along the supply chain, which is precisely the scenario described. This doesn't mean there's no incidence at all, that the two measures are always the same, or that it reclassifies the tax as direct rather than indirect.

Section C, Incidence of taxation — formal vs effective · Ref C1 · f1064

Question 39: D Withholding tax

Withholding tax requires the payer of certain types of income (commonly interest, dividends and royalties) to deduct tax at source and pay it directly to the tax authority, rather than paying the recipient in full and relying on the recipient to declare and pay tax themselves. It is a common mechanism for taxing cross-border payments, since the paying country may otherwise have limited ability to collect tax from a non-resident recipient. It is unrelated to transfer pricing (which concerns pricing of transactions between connected parties), VAT (a tax on the supply of goods/services), or double taxation relief (a mechanism to prevent income being taxed twice, which may interact with withholding tax but is a separate concept).

Section C, Withholding tax — concept · Ref C1 · f1065

Question 40: C Under a residence basis, a country taxes its residents on some or all of their worldwide income; under a source basis, a country taxes income arising within its borders regardless of the recipient's residence

A residence-based system taxes a company or individual on income wherever in the world it arises, because they are resident in that country. A source-based system instead taxes income that arises within the country's borders, regardless of where the recipient is resident. Many countries use a hybrid of both, which is exactly why the distinction matters in practice — it determines whether the same income could potentially be taxed in two different countries, which is the origin of the need for double taxation relief. The first two options simply swap the definitions around, and the outcomes are clearly not identical given how differently the two bases operate.

Section C, Residence vs source basis of taxation · Ref C1 · f1068

Question 41: D Fully blocked — input tax on cars typically isn't recoverable if there's any private use

Under most VAT regimes (including the UK), input VAT on cars with any element of private use is fully blocked — the business cannot recover any of the input VAT. This is a policy measure to prevent abuse, since it is difficult to distinguish business from private car use. The VAT amount = £18,000 × 20/120 = £3,000 is irrecoverable. For commercial vehicles (vans, trucks) with no realistic private use, full input tax recovery is available. Input tax on fuel for cars with private use may be recoverable with a scale charge. Thresholds and proportional recovery based on mileage do not generally apply to car purchase input tax.

Section C, VAT — input tax recovery · Ref C2 · f1088

Question 42: A Granting a tax credit in the home country equal to (or capped at) the foreign tax already suffered on that income

Double taxation relief is commonly given either as a tax credit (the home country reduces its own tax charge by the foreign tax already paid, usually capped at the home country's tax on that same income) or as an exemption (the home country simply excludes the foreign income from its tax base). Both mechanisms exist specifically to prevent the same profit being taxed twice. Ignoring the foreign tax and taxing the full amount again is exactly the double-taxation outcome relief is designed to prevent, and the other two options describe drastic, non-standard responses that have no basis in normal tax relief mechanisms.

Section C, Double taxation relief — methods · Ref C1 · f1089

Question 43: B Partially exempt — it can recover only the portion of input VAT attributable to taxable supplies

When a business makes both taxable supplies (standard-rated, reduced-rated or zero-rated) and exempt supplies, it is 'partially exempt'. Input VAT directly attributable to taxable supplies is fully recoverable; input VAT directly attributable to exempt supplies is blocked; and residual input VAT (relating to both activities) is apportioned using an agreed method, typically based on the ratio of taxable to total turnover. A fully taxable business recovers all input VAT; an exempt business recovers none; and outside-the-scope transactions are not supplies for VAT purposes at all, so no VAT arises on them.

Section C, VAT — partial exemption concept · Ref C2 · f1090

Question 44: C A hypothecated (or ring-fenced) tax

A hypothecated tax (sometimes called a ring-fenced tax) is one where the revenue raised is legally earmarked for a specific area of spending, rather than going into general government funds to be allocated as the government sees fit. Whether fuel duty is regressive is a separate question about its distributional impact across income levels, unrelated to how the revenue is earmarked. Withholding tax concerns deduction at source on payments, and tax avoidance concerns legal minimisation of a taxpayer's own liability — neither describes how collected revenue is subsequently allocated by government.

Section C, Hypothecated tax — concept · Ref C1 · f1113

Question 45: D Value added tax (VAT) charged on the sale of goods

VAT is an indirect tax: it is collected by the seller (an intermediary) as part of the sale price and passed on to the tax authority, while the economic burden ultimately falls on the end consumer through the price paid. Corporation tax, income tax and capital gains tax are all direct taxes — in each case, the entity or individual whose profits, earnings or gains are being taxed pays the tax directly to the authority (or has it withheld directly on their behalf), rather than the burden being built into the price of a good or service and passed along a supply chain.

Section C, Direct and indirect taxes — examples · Ref C1 · f1141

Question 46: C 1.5 and 1.2

Current ratio = current assets ÷ current liabilities = £150,000 ÷ £100,000 = 1.5. Quick ratio = (current assets − inventory) ÷ current liabilities = (£150,000 − £30,000) ÷ £100,000 = £120,000 ÷ £100,000 = 1.2. The quick ratio excludes inventory as the least liquid current asset. A current ratio above 1.0 means current assets exceed current liabilities; the quick ratio gives a more conservative liquidity measure. A ratio of 1.2 and 1.5 reverses the two measures.

Section D, Liquidity ratios · Ref D1 · f1023

Question 47: A In factoring, the factor manages and collects receivables; invoice discounting leaves the client in control

In factoring, the factor provides finance against invoices and also takes over the administration and collection of the receivables ledger — chasing customers for payment on the client's behalf. In invoice discounting, the client borrows against the value of its invoices but retains responsibility for managing and collecting its own sales ledger, so customers may be unaware of the arrangement (confidential invoice discounting). Both involve raising finance against receivables; the key distinction is who manages collection. Factoring is often more expensive due to the additional credit management service.

Section D, Receivables management — factoring · Ref D1 · f1025

Question 48: A 50 days

Inventory days = (average inventory ÷ cost of sales) × 365 = (£50,000 ÷ £365,000) × 365 = 50 days. Inventory days measure how long on average goods are held in stock before being sold. A high figure indicates slow-moving or excess inventory, tying up cash; a very low figure could indicate risk of stockouts. The calculation uses cost of sales (not revenue) in the denominator because inventory is measured at cost. When calculating working capital cycle: cash conversion cycle = inventory days + receivables days − payables days. 60, 40 and 73 days do not follow from the figures; with cost of sales of £365,000, each £1,000 of inventory represents one day.

Section D, Inventory days · Ref D1 · f1045

Question 49: B Yes — the annualised cost of not taking the discount (14.9%) exceeds the borrowing rate (10%), so it is cheaper to borrow and pay early to capture the discount

Annualised cost of not taking the discount = (discount % ÷ (1 − discount %)) × (365 ÷ days saved) = (0.02 ÷ 0.98) × (365 ÷ 50) = 2.041% × 7.3 = 14.9%. This represents the implicit interest cost of continuing to use the full 60-day trade credit instead of paying early to capture the discount. Since this cost (14.9%) exceeds the cost of short-term borrowing (10%), it is cheaper to borrow at 10% and pay within 10 days than to forgo the discount and pay at the normal 60-day date — the company should take the discount. Always declining settlement discounts to preserve cash ignores that the cash can be sourced more cheaply through borrowing than the discount actually costs to forgo. Treating 2% as always worth taking regardless of borrowing costs happens to reach the right conclusion here but for the wrong reason — the flat 2% figure is not comparable to an annual borrowing rate until it is annualised, and in other scenarios (a smaller gap in days, or a higher borrowing rate) this shortcut would give the wrong answer. The reversed comparison (treating 14.9% as below 10%) simply misstates the two figures, which is why the direction of the conclusion is wrong.

Section D, Settlement discount — cost of taking it · Ref D1 · f1048

Question 50: D Receive materials exactly when needed for production, eliminating storage costs and tied-up working capital

JIT aims to receive materials and produce goods exactly when needed, eliminating (or minimising to the practical minimum) inventory at every stage. Benefits include: zero or near-zero storage costs, no capital tied up in stock, reduced obsolescence risk, and a focus on quality (defects cannot be hidden in buffer stock). The main risk is supply chain disruption causing production stoppages — JIT requires highly reliable suppliers and precise demand forecasting. JIT does not use the EOQ model, which assumes batch ordering; JIT implies very small, frequent deliveries.

Section D, Just-in-time inventory management · Ref D1 · f1072

Question 51: A An unsecured short-term debt instrument, typically 1-270 days, issued by creditworthy companies

Commercial paper is an unsecured, short-term promissory note issued at a discount and redeemed at face value, typically used by large, creditworthy companies to raise short-term funds directly from investors in the money market. It bypasses banks, often at lower cost than an overdraft. Maturities are short (typically 1–270 days). Only companies with strong credit ratings can issue commercial paper, as there is no collateral. It is not a payment instrument, a government scheme, or a long-term bond.

Section D, Commercial paper · Ref D1 · f1073

Question 52: B Advance finance against invoices, with the business retaining control of its sales ledger

Invoice discounting provides the business with a cash advance (typically 80–90% of invoice value) against its outstanding trade receivables, while the business continues to manage its own sales ledger and collect debts. Customers are usually unaware of the arrangement (confidential invoice discounting). Factoring, by contrast, transfers the receivables management function to the factor. Both provide working capital finance against receivables, but they differ in who manages collection. Neither guarantees payment (bad debt protection requires additional 'non-recourse' factoring).

Section D, Invoice discounting vs factoring · Ref D1 · f1074

Question 53: C Current assets financed by current liabilities, non-current assets by long-term finance, matching maturities

The matching principle holds that the maturity of financing should correspond to the maturity of the assets being financed: non-current (fixed) assets should be funded by long-term sources (equity, long-term debt); permanent current assets (the irreducible minimum level of inventory and receivables) by medium-term finance; and fluctuating current assets by short-term, flexible sources like overdraft. Funding long-term assets with short-term finance creates rollover risk (the funding cannot be renewed). Funding short-term assets with long-term finance is costly and inefficient. This is the basis of the moderate working capital financing strategy.

Section D, Working capital — non-current asset financing · Ref D1 · f1075

Question 54: B Managing cash, short-term investments, borrowings, FX risk and banking relationships

Treasury manages the company's financial resources: ensuring adequate liquidity (cash management and forecasting), managing short-term investments of surplus funds, negotiating and managing borrowings, managing foreign exchange and interest rate exposures, and maintaining banking relationships. In larger companies, treasury also manages longer-term capital structure decisions. Financial statements, management accounts and pricing strategy are responsibilities of other finance and commercial functions. The treasury function operates at the interface between the business and the financial markets.

Section D, Treasury management — role · Ref D1 · f1094

Question 55: C Suppliers may respond by withdrawing credit terms, increasing prices, or reducing priority of supply

Unilaterally extending payment beyond agreed terms (stretching creditors) conserves short-term cash but damages supplier relationships. Suppliers may react by withdrawing credit terms entirely (requiring upfront payment), increasing prices to compensate for late payment, reducing the quality or priority of supply, or pursuing legal action. In extreme cases, key suppliers may stop supplying altogether, disrupting operations. The cash flow benefit is real but short-term; the reputational and operational risks can be severe. Settlement discounts become unavailable when paying late, and because payables rise by the same amount as the cash retained, the current ratio will usually fall (where it is above 1), not improve.

Section D, Payables management — stretching creditors · Ref D1 · f1095

Question 56: B Uses more long-term funding and holds higher current assets, reducing risk but raising cost

A conservative working capital policy holds higher current asset levels (more inventory, longer credit to customers, larger cash buffers) and funds them with a greater proportion of long-term finance. This reduces the risk of stockouts, customer dissatisfaction and liquidity crises, but costs more because long-term finance is generally more expensive than short-term and idle current assets earn poor returns. An aggressive policy does the opposite — minimise current assets and rely on short-term, cheaper funding — accepting higher risk for lower cost. Most businesses adopt a moderate approach between these extremes.

Section D, Working capital policy — conservative · Ref D1 · f1118

Question 57: C Cost of the discount (2% of invoice value) reduced by the benefit of receiving cash earlier

The settlement discount costs the company 2% of the invoice value for each customer who takes it. However, the company benefits from receiving cash earlier — this earlier receipt can be used to reduce overdraft borrowing (saving interest), or invested (earning a return). The net cost is the discount given less the financial benefit of early receipt. Whether offering the discount makes economic sense depends on comparing the annualised cost of the discount (similar to the calculation from the customer's perspective) with the company's cost of capital or overdraft rate. If early receipt saves more than the discount costs, it is worthwhile.

Section D, Receivables — settlement discount from company perspective · Ref D1 · f1119

Question 58: D Over-trading, where rapid growth creates cash flow problems despite the business being profitable

Over-trading (also called under-capitalisation) occurs when a business expands rapidly but does not have sufficient working capital to fund the growth — it becomes profitable on paper but runs out of cash. Expanding businesses need more inventory, make more sales on credit (increasing receivables), and face increased operational costs before cash is collected. If growth is not properly financed, the business can fail despite being profitable. Poor working capital management can also lead to the reverse — excessive working capital tied up in slow-moving inventory or overdue receivables, reducing returns and potentially triggering a liquidity crisis.

Section D, Working capital — overall importance · Ref D1 · f1120

Question 59: A Short-term liquidity has deteriorated — current liabilities growing relative to liquid assets

The quick (acid test) ratio = (current assets − inventory) ÷ current liabilities. A fall from 1.4 to 0.9 means the liquid current assets no longer fully cover current liabilities (below 1.0). This signals deteriorating short-term liquidity — possibly because receivables are growing (slower collection), cash has been used up, short-term borrowings have increased, or a combination. It has no direct relationship with profitability or long-term debt repayment. Improving inventory management would reduce inventory (which is excluded from the quick ratio anyway) and might improve cash but is not the direct cause of a falling quick ratio.

Section D, Working capital ratios — interpretation · Ref D1 · f1121

Question 60: B A declining current ratio, rising payables days and rising receivables days

Over-trading shows up in working capital ratios as the business stretches its finance to fund growth: the current ratio declines as current liabilities grow faster than current assets; payables days rise as suppliers are stretched; and receivables days and inventory levels rise as sales and stock grow faster than cash comes in (option B). A rising current ratio with falling payables days (A) suggests a business with spare liquidity, the opposite of over-trading. Over-trading does affect working capital ratios (C), and a consistently high current ratio (D) is not a sign of it.

Section D, Working capital — over-trading · Ref D1 · f1142