CIMA F2 Advanced 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 F2.
- Prefer to sit it on screen? The **Exam Sim** on **goqualified.co.uk/cima/f2/** 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/f2/.

Your answers

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

Questions

Question 1

Which of the following correctly distinguishes long-term debt from equity as sources of long-term finance?

A Debt has contractual interest and repayment obligations; equity holders have a residual claim with no guaranteed return
B Equity holders receive fixed contractual interest; debt holders share profits only
C Debt always costs less than equity after all adjustments
D Both debt and equity rank equally on liquidation

Question 2

A company has issued irredeemable 8% debentures with a par value of £100. The market price is £95 and the tax rate is 25%. What is the post-tax cost of debt?

A 6.3%
B 8.4%
C 6.0%
D 8.0%

Question 3

Why is the yield to maturity (YTM) a more appropriate measure of the cost of redeemable debt than simply looking at the coupon rate?

A The coupon rate is always higher than the YTM for redeemable debt
B YTM is identical to the coupon rate under all circumstances
C YTM captures both interest payments and the capital gain or loss on redemption, reflecting total investor return
D Coupon rates are not disclosed to investors so YTM is the only observable measure

Question 4

When calculating WACC for investment appraisal purposes, why should market values rather than book values be used to weight the cost of each component?

A Book values are equally accurate for WACC and easier to obtain
B Market values overstate true cost by including speculative premiums
C Book values are required by accounting standards and therefore are the appropriate weights
D Market values reflect current financing cost, whereas book values reflect historical amounts

Question 5

A company raises new equity through a rights issue. Which of the following correctly describes a key feature of a rights issue?

A Existing shareholders are offered new shares in proportion to their current holdings, usually at a discount to the current market price
B Rights issues are available only to new investors, not to existing shareholders
C A rights issue does not dilute the ownership percentage of existing shareholders who take up their rights
D Rights issues must be priced at a premium to market price to attract shareholder support

Question 6

What is the key advantage of convertible debt from the issuing company's perspective?

A Convertible debt always converts into equity automatically, removing any repayment obligation from the outset
B Convertible bonds typically carry a lower coupon rate than equivalent non-convertible bonds, since the conversion option has value to investors
C Convertible bonds are classified as equity on the issuer's balance sheet from the date of issuance
D Convertible debt reduces the company's total debt-to-equity ratio immediately, before any conversion occurs

Question 7

A company is financed 50% equity (Ke = 14%), 10% preference shares (Kp = 8%), and 40% long-term debt (post-tax Kd = 5%), all by market value. What is the WACC?

A 9.0%
B 11.2%
C 8.5%
D 9.8%

Question 8

A company considering a major acquisition is evaluating whether to fund it with a new share issue or a new bank loan. Which factor would favour using a share issue over debt?

A The company already has high gearing and increased debt would breach existing loan covenants or raise financial distress risk
B Share issues always cost less than debt in every circumstance
C A rights issue raises money faster than arranging a bank loan
D Debt must always be repaid in the same year it is borrowed

Question 9

How does a lessor account for an operating lease, and how does this differ from finance lease accounting?

A Under an operating lease the lessor derecognises the asset; under a finance lease it stays on the balance sheet
B Both lease types are accounted for identically by the lessor under IFRS 16
C Under an operating lease the lessor retains the asset and recognises rental income straight-line; under a finance lease the asset is derecognised and a receivable recognised
D The lessor never recognises any income from an operating lease

Question 10

An asset has a carrying amount of £200,000 and a tax base of £120,000. The income tax rate is 25%. What deferred tax liability should be recognised?

A £50,000
B £20,000
C £30,000
D £80,000

Question 11

A company holds bonds that it intends to collect contractual cash flows (principal and interest) and potentially sell before maturity. The bonds pass the SPPI test. How should they be classified under IFRS 9?

A Amortised cost, since the bonds pass the SPPI test
B Fair value through profit or loss, since sale before maturity is possible
C Classification depends on whether the bonds are exchange-listed
D Fair value through OCI — business model is both collect and sell, and SPPI test passes

Question 12

A company sells a product (standalone price £12,000) and a one-year service contract (standalone price £8,000) as a bundle for £17,000. How much revenue should be allocated to the product?

A £12,000
B £10,200
C £8,500
D £9,000

Question 13

An asset was purchased for £500,000. At the revaluation date, accumulated depreciation is £150,000, giving a carrying amount of £350,000. The asset is revalued to £420,000. Where is the revaluation gain of £70,000 recognised?

A In profit or loss for the period
B Split equally between OCI and profit or loss
C In other comprehensive income (OCI), credited to the revaluation surplus in equity
D As a reduction in the asset's cost rather than recognised separately

Question 14

A bond is purchased at £95,000 (below par of £100,000). The effective interest rate is 6.2% and the coupon rate is 5% on par. What is the carrying amount of the bond at the end of year 1 under the amortised cost method?

A £95,000
B £100,000
C £94,110
D £95,890

Question 15

A company has an outstanding trade receivable of $50,000 arising from a sale made when the rate was $1.50:£1. At the year end the rate is $1.40:£1. Under IAS 21, how is the exchange difference treated?

A As a gain in other comprehensive income — exchange differences on trading items are always taken to OCI
B As a gain recognised in profit or loss — the receivable is a monetary item retranslated at the closing rate
C No adjustment is needed since the original transaction rate is used throughout
D As a reduction in revenue for the period in which the receivable arose

Question 16

Under IAS 38, which criteria must be met for an intangible asset to be recognised on the balance sheet?

A It must be identifiable and controlled, with probable future economic benefits and a reliably measurable cost
B It must have a physical form and be legally owned by the entity
C It must have been acquired externally — internally generated intangibles are never recognised
D It must have an indefinite useful life to qualify for recognition

Question 17

Under IAS 36, when is an entity required to test a non-current asset for impairment?

A Every year without exception for all non-current assets, regardless of any indication of impairment
B When there is an indication of impairment (or annually for goodwill and certain indefinite-life intangibles regardless of indications)
C Only when the asset is fully depreciated and has a carrying amount of nil
D Only when the external auditor specifically requests an impairment review

Question 18

A construction company has a fixed-price contract worth £1,000,000. Costs incurred to date are £300,000 and total estimated costs are £800,000. Revenue is recognised based on costs incurred as a percentage of total costs. How much revenue should be recognised to date?

A £300,000
B £700,000
C £375,000
D £1,000,000

Question 19

A lessor leases a machine for a period covering the major part of the machine's economic life, and the present value of the lease payments amounts to substantially all of the machine's fair value. How should the lessor classify this lease under IFRS 16, and why?

A As an operating lease, because the lessor retains legal title to the machine throughout the lease term
B As a finance lease, because the lease term and present value indicators show that substantially all the risks and rewards of ownership transfer to the lessee
C As an operating lease, because all leases of machinery are operating leases by default
D Classification is not required — lessors account for all leases identically under IFRS 16

Question 20

Under IFRS 9, a company acquires an equity investment that is not held for trading. What measurement choice is available at initial recognition?

A The investment must always be measured at amortised cost like other debt-type financial assets
B The investment must be held at historical cost with no subsequent remeasurement permitted
C It may irrevocably elect to present fair value changes in OCI, instead of the default FVTPL
D The company may switch freely between FVTPL and FVTOCI at each reporting date

Question 21

A government enacts a reduction in the corporate income tax rate from 25% to 22%, effective for future periods. How does this affect an entity's existing deferred tax balances under IAS 12?

A Deferred tax balances are never adjusted for tax rate changes once they have been initially recognised
B Only deferred tax assets are remeasured; deferred tax liabilities remain at the old rate
C The change is applied prospectively to new temporary differences only, leaving existing balances at 25%
D Existing deferred tax balances are remeasured at the newly enacted 22% rate expected to apply on reversal

Question 22

A company has 5,000,000 ordinary shares in issue. It holds 200,000 of these as treasury shares (bought back). For the purpose of calculating basic EPS under IAS 33, which share count is used?

A 5,000,000 — all issued shares are included regardless of treasury share status
B 4,800,000 — treasury shares are excluded from the weighted average since they carry no rights to earnings or dividends
C 200,000 — only the treasury shares are used since they represent the float held by management
D 5,200,000 — total shares including an estimate of shares held by institutional investors

Question 23

Under IAS 1, which of the following must be presented as a separate component of other comprehensive income (OCI)?

A Revenue from the sale of goods and services
B Finance costs on bank borrowings
C Revaluation gains on property, plant and equipment under the revaluation model
D Depreciation charges on non-current assets

Question 24

Under IFRS 15, when can incremental costs of obtaining a contract (such as sales commissions) be capitalised as an asset?

A They must always be expensed immediately as incurred, regardless of recoverability
B Only when the contract has a duration of more than 5 years
C Only when the costs exceed 10% of total contract value
D When the entity expects to recover those costs through revenue earned under the contract or separately

Question 25

Parent acquires 80% of Subsidiary for £800,000. At acquisition the NCI is measured at fair value of £200,000 and the fair value of Subsidiary's identifiable net assets is £750,000. What is the goodwill recognised under IFRS 3?

A £200,000
B £50,000
C £250,000
D £800,000

Question 26

Using the same acquisition facts (80% acquired for £800,000, net assets £750,000), but using the proportionate (partial goodwill) NCI method, what is the goodwill recognised?

A £250,000
B £50,000
C £150,000
D £200,000

Question 27

An entity acquires 30% of an associate for £250,000. In the period after acquisition, the associate earns profit of £60,000 and pays no dividends. What is the carrying amount of the investment under the equity method?

A £250,000
B £268,000
C £310,000
D £232,000

Question 28

Under IFRS 11, what is the key distinction between a joint operation and a joint venture?

A Joint operations and joint ventures are legally identical and are accounted for in exactly the same way
B In a joint venture, each party recognises its proportionate share of the venture's individual assets and liabilities
C Joint operation parties have rights to assets and obligations for liabilities; joint venture parties have rights only to net assets
D Joint operations must involve at least three parties, while joint ventures require exactly two

Question 29

At acquisition, NCI was measured at fair value of £200,000. Since acquisition, the subsidiary has generated post-acquisition profit of £100,000. NCI holds 20% of the subsidiary. What is the NCI balance on the consolidated balance sheet at the year end?

A £220,000
B £200,000
C £100,000
D £180,000

Question 30

Basic earnings are £1,200,000 and the weighted average shares are 4,000,000. There are 500,000 potentially dilutive shares from convertible bonds. If converted, interest saved (net of tax) would be £37,500. What is the diluted EPS?

A 30.0p
B 29.2p
C 26.1p
D 27.5p

Question 31

An investor holds a 25% interest in an associate and accounts for it using the equity method. The associate makes a loss of £400,000 in the year. What is the maximum loss the investor can recognise if the associate has no other funding obligations?

A £400,000 — the investor's full share of the associate's loss
B £0 — losses are never recognised under the equity method
C £100,000 — the investor's 25% share, provided it does not reduce the carrying amount below zero
D £100,000 regardless of the carrying amount of the investment

Question 32

How does a joint venturer account for its interest in a joint venture under IFRS 11?

A Using proportionate consolidation — recognising a share of each asset and liability line by line
B At cost, without any ongoing adjustment for the venture's profit or loss
C At fair value through profit or loss, remeasured at each reporting date
D Using the equity method — recognising a single investment line and updating it for the venturer's share of profit or loss

Question 33

A company had 2,000,000 shares in issue at the start of the year and made a 1-for-4 bonus issue on 1 July. The prior year basic EPS was 30p. What is the restated prior year EPS that should be presented for comparison purposes?

A 24p
B 30p
C 37.5p
D 25p

Question 34

A company acquires a subsidiary and agrees to pay an additional £500,000 in two years if the subsidiary achieves certain profit targets. How should this contingent consideration be treated under IFRS 3 at the acquisition date?

A Ignored until the profit targets are achieved or confirmed
B Recognised only if the probability of achievement exceeds 50%
C Recognised at fair value at the acquisition date, as part of the total consideration transferred
D Treated as a post-acquisition expense, charged to profit or loss in the year the payment is made

Question 35

A parent has a £500,000 receivable from its foreign subsidiary. The subsidiary's functional currency is the US dollar. At the year end, an exchange difference arises on retranslation of this balance. Where is the exchange difference recognised in the consolidated financial statements?

A In OCI only — all intragroup balances produce translation differences in OCI on consolidation
B Fully eliminated on consolidation, leaving no exchange difference in any statement
C In profit or loss — monetary item retranslation goes to P&L unless part of the net investment
D In retained earnings as a prior period adjustment recognised under IAS 8

Question 36

A company makes a 1-for-4 rights issue at a price below market value part way through the year. How does IAS 33 require the weighted average shares to be adjusted for the EPS calculation?

A Add all new shares from 1 January as though the issue occurred at the start of the year
B Include only the new shares from the issue date with no bonus fraction adjustment
C Apply rights issue shares retrospectively with no time-weighting
D Apply a bonus fraction to pre-issue shares, then add new shares weighted from the issue date

Question 37

A subsidiary has issued irredeemable preference shares (classified as equity) held entirely by external investors (not by the parent). These preference shares are not part of the parent's controlling equity interest. How are they treated in the consolidated financial statements?

A As a liability of the parent company, since the parent controls the subsidiary
B Eliminated on consolidation since all subsidiary balances are removed
C As a contingent liability of the group, disclosed in the notes only
D As part of the non-controlling interest in the consolidated balance sheet — they represent an external interest in the subsidiary

Question 38

Why are intragroup balances (such as a loan between a parent and subsidiary) eliminated in consolidation?

A The subsidiary's assets and liabilities are never recognised in consolidated accounts
B The group is presented as one entity — internal transactions should not inflate reported assets and liabilities
C IAS 27 prohibits group companies from lending to each other
D Elimination increases total assets of the group

Question 39

A parent sells its entire 80% holding in a subsidiary during the year, losing control. Consideration received is £5.2m; the subsidiary's identifiable net assets at disposal were £4m, and goodwill (fair value method) was £0.6m, with no prior impairment. The non-controlling interest at disposal was £0.9m. What is the group's gain or loss on disposal?

A Gain of £1.5m
B Gain of £0.6m
C Loss of £0.3m
D Gain of £2.1m

Question 40

A parent sells 10% of its 80% holding in a subsidiary, retaining a 70% controlling stake — control is not lost. How is this partial disposal accounted for in the consolidated financial statements?

A As a disposal generating a gain or loss in the consolidated statement of profit or loss, calculated the same way as a full disposal
B As a transaction between owners, recognised directly in equity — no gain or loss is recognised in profit or loss, since the group retains control throughout
C The subsidiary is deconsolidated immediately, even though control is retained
D No accounting entries are required at all until control is eventually lost in a future period

Question 41

Which of the following correctly lists all six capitals in the Integrated Reporting Framework?

A Financial, technological, human, marketing, legal, and environmental capital
B Financial, physical, intangible, workforce, community, and sustainability capital
C Revenue, cost, brand, people, environment, and governance capital
D Financial, manufactured, intellectual, human, social and relationship, and natural capital

Question 42

What is the primary objective of IFRS S1 (General Requirements for Disclosure of Sustainability-related Financial Information)?

A To replace all existing financial reporting standards with a sustainability-focused framework
B To require disclosure of every environmental impact regardless of financial materiality
C To require disclosure of sustainability-related risks and opportunities that could affect cash flows, financing, or cost of capital
D To set carbon emission reduction targets entities must achieve and report against

Question 43

IFRS S2 Climate-related Disclosures is described as building on the recommendations of the TCFD. What does TCFD stand for, and what is its relationship to IFRS S2?

A Total Capital and Funding Disclosure — a voluntary reporting initiative with no connection to IFRS

B Task Force on Climate-related Financial Disclosures — IFRS S2 uses the same four-pillar structure and was built to be consistent with TCFD recommendations

C Tax-related Carbon Finance Directive — a European regulatory framework now superseded by IFRS S2

D Total Capital and Funding Directive — the original 2010 disclosure framework now replaced by ISSB standards

Question 44

IFRS S1 requires disclosure across the same four content areas as IFRS S2. Which are they?

A Revenue, costs, assets, and liabilities

B Financial performance, social impact, environmental impact, and governance

C Governance, strategy, risk management, and metrics and targets

D Customer satisfaction, employee wellbeing, supplier relations, and community engagement

Question 45

What does the 'outlook' content element of an integrated report require?

A A five-year financial forecast with precise numerical projections

B A guarantee of the organisation's ability to continue as a going concern for the foreseeable future

C A comparison of the organisation's performance against all listed industry peers

D An assessment of the challenges and uncertainties the organisation is likely to encounter and the potential implications for its business model and future performance

Question 46

IFRS S2 requires an entity to disclose its greenhouse gas emissions using the Scope 1, 2 and 3 categories. What do these three categories represent?

A Scope 1, 2 and 3 refer to three alternative measurement bases the entity may freely choose between, with no requirement to disclose more than one

B Scope 1 = emissions from the current year only; Scope 2 = emissions from the prior year; Scope 3 = a forecast of next year's emissions

C The three scopes apply only to the energy sector and are not relevant to other industries

D Scope 1 = direct emissions from sources the entity owns or controls; Scope 2 = indirect emissions from purchased energy (e.g. electricity); Scope 3 = all other indirect emissions occurring in the entity's value chain (e.g. purchased goods, business travel, use of sold products)

Question 47

A company earns profit after tax of £180,000 on revenue of £1,200,000, and has total assets of £2,000,000. What are the net profit margin and asset turnover?

A Net profit margin 9%; asset turnover 0.9 times

B Net profit margin 15%; asset turnover 0.6 times

C Net profit margin 15%; asset turnover 1.7 times

D Net profit margin 12%; asset turnover 0.6 times

Question 48

A company's ROCE has declined from 20% to 15% year-on-year. EBIT margin is unchanged. What must have caused the ROCE decline?

A Asset turnover has declined — the company is generating less revenue per pound of capital employed

B The effective tax rate has increased, reducing post-tax returns

C The cost of equity has increased, raising the minimum required return

D The dividend payout ratio has changed, affecting retained earnings

Question 49

A company with a current ratio above 1 deliberately arranges to repay a short-term loan just before the year-end date and redraws it shortly after. What effect does this have on the current ratio and what concern does it raise?

A It decreases the current ratio by increasing current liabilities just before year-end
B It has no effect on the current ratio since year-end cash balances are unaffected
C It artificially increases the current ratio at year-end by reducing current liabilities, raising concerns about window dressing
D It is a required accounting treatment under IAS 7 to present the true liquidity position

Question 50

A company has inventory days of 60, receivables days of 55, and payables days of 40. What is the cash conversion cycle?

A 115 days
B 40 days
C 75 days
D 155 days

Question 51

A company has long-term debt of £600,000 and equity of £900,000. What is the debt-to-total capital gearing ratio?

A 66.7%
B 60%
C 150%
D 40%

Question 52

A company has a return on equity (ROE) of 18% and a dividend payout ratio of 40%. What is the sustainable growth rate?

A 18.0%
B 7.2%
C 4.5%
D 10.8%

Question 53

A company maintains a current ratio significantly above 2.0. From an efficiency perspective, why might this be suboptimal?

A A ratio above 2.0 always indicates excellent working capital management
B The ratio is only suboptimal when it falls below 1.0
C Excess current assets may earn low returns when capital could be deployed more productively
D Higher current ratios are always preferable regardless of level

Question 54

Company X uses the revaluation model for PP&E while Company Y uses the cost model. Company X has a lower ROCE. What concern arises when comparing their ROCEs?

A The cost model always produces a lower ROCE than the revaluation model in all circumstances
B ROCE is unaffected by the choice of PP&E accounting policy
C Revaluation increases capital employed, mechanically reducing ROCE — the difference may reflect accounting policy rather than operational performance
D Both companies must use the same model under IFRS so no comparison issue arises

Question 55

Why does diluted EPS present a more cautious picture of earnings per share than basic EPS?

A It shows the EPS that would result if all potentially dilutive instruments (convertibles, options) were exercised, increasing the share count and reducing EPS
B Diluted EPS uses a lower earnings figure by deducting preference dividends not in basic EPS
C Diluted EPS always shows a higher EPS than basic EPS since it adds potential future earnings
D Diluted EPS and basic EPS are always identical for listed companies

Question 56

A company's dividend yield is 3% and its share price has risen by 8% during the year. What is the approximate total shareholder return for the year?

A 8% — only capital gains count as shareholder return
B 3% — dividends are the only measure of return under all circumstances
C 11% — combining the dividend yield with the capital gain
D 5% — the difference between the capital gain and the dividend yield

Question 57

A company reports a healthy profit but operating cash flow is significantly lower than profit. Which factor most commonly explains this divergence?

A Rising working capital — growing receivables and inventory absorb cash even as revenue and profit rise
B Depreciation — it increases profit while reducing cash
C Tax payments — corporation tax reduces cash but not profit
D Interest received — this adds to profit but reduces cash

Question 58

What does horizontal analysis of financial statements involve?

A Comparing a single company's ratios against industry peers in the same period
B Calculating the proportional contribution of each line item to total revenue within one period
C Comparing financial data across multiple periods to identify trends in revenue, costs, and key ratios over time
D Comparing subsidiary performance against parent company performance in one year

Question 59

Why does the market value of a listed company typically exceed its book value (net assets per share)?

A Market value always equals book value in an efficient market
B Market price reflects expected future earnings and unrecognised intangibles — accounting does not fully capture these
C Book value always exceeds market value since it is based on conservative historical costs
D Market value exceeds book value only when a company is being acquired

Question 60

A rapidly growing company has falling current ratio, rising receivables days, rising payables days and very low or negative cash balances. What financial condition does this most likely indicate?

A Over-capitalisation — the company has too much equity relative to its assets
B Conservative working capital management — all the indicators point to efficiency
C Overtrading — the company is growing revenue faster than its working capital can support, risking a cash flow crisis despite profitable trading
D Strong liquidity — the combination of these ratios is a positive signal for creditors

Answer key

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

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

Answers and explanations

Question 1: A Debt has contractual interest and repayment obligations; equity holders have a residual claim with no guaranteed return

Debt carries a contractual obligation — interest must be paid and principal repaid regardless of profit, and debt ranks ahead of equity on liquidation. Equity holders are residual claimants: they receive distributions (dividends) only after all obligations are met, and there is no guaranteed return. Equity does not receive fixed interest; that is a characteristic of debt. Debt is usually cheaper than equity because it carries less risk for investors, and the tax deductibility of interest reduces its post-tax cost further, though this does not hold in every situation. Debt and equity do not rank equally on liquidation — debt has priority.

Section A, Characteristics of long-term debt vs equity · Ref A1a · f2001

Question 2: A 6.3%

Post-tax cost of irredeemable debt = I × (1 − t) ÷ market price = £8 × (1 − 0.25) ÷ £95 = £6 ÷ £95 = 6.3%. The pre-tax cost is £8 ÷ £95 = 8.4%, which ignores the tax deductibility of interest. Using par value as denominator instead of market price gives £6 ÷ £100 = 6.0%, a common error. The coupon rate of 8% is the nominal rate on par, not the actual cost to the company at market price.

Section A, Cost of irredeemable debt — post-tax · Ref A1c · f2005

Question 3: C YTM captures both interest payments and the capital gain or loss on redemption, reflecting total investor return

For redeemable debt, the investor receives not just periodic interest payments but also a lump sum at redemption — which may differ from what they paid for the bond. YTM captures both the interest income stream and the capital gain (if bought at a discount) or loss (if bought at a premium), giving the total return demanded by the market on that debt. The coupon rate only reflects the interest relative to par value and ignores these capital flows. YTM and the coupon rate are equal only when the bond trades at par; they diverge at premium or discount prices. Coupon rates are publicly disclosed.

Section A, Redeemable debt and YTM · Ref A1c · f2007

Question 4: D Market values reflect current financing cost, whereas book values reflect historical amounts

WACC is used to discount future cash flows at the rate the company needs to earn to satisfy investors at today's market prices. Market values reflect what investors currently require for their capital — the opportunity cost of finance today — whereas book values reflect what was raised historically and may be very different from current reality. Market values are more appropriate for forward-looking investment decisions. The argument that book values are easier to obtain does not make them equally accurate; they can distort WACC significantly. Accounting standards govern the book values reported in financial statements, not the inputs for WACC calculations.

Section A, WACC — market vs book values · Ref A1d · f2008

Question 5: A Existing shareholders are offered new shares in proportion to their current holdings, usually at a discount to the current market price

A rights issue offers new shares to existing shareholders in proportion to their existing holding — for example, a 1-for-4 rights issue allows shareholders to buy one new share for every four they already hold — typically at a price below the current market price to provide an incentive to subscribe. Existing shareholders who take up their rights maintain their proportionate ownership; those who do not face dilution. The price is set at a discount, not a premium, to incentivise participation — and the issue is reserved for existing shareholders, not new investors.

Section A, Rights issue and equity characteristics · Ref A1a · f2009

Question 6: B Convertible bonds typically carry a lower coupon rate than equivalent non-convertible bonds, since the conversion option has value to investors

Investors value the conversion option — the right to exchange bonds for shares if the share price rises sufficiently — which means they accept a lower interest rate (coupon) in compensation for this potential upside. This lowers the issuing company's interest cost relative to non-convertible debt. Conversion is typically at the investor's option and may never occur (if the share price does not reach the conversion threshold). Under IAS 32, convertible debt is split into its liability and equity components from issuance — the liability component is not reclassified as equity until conversion. Before conversion, the debt component increases the debt-to-equity ratio, not reduces it.

Section A, Convertible debt — issuer perspective · Ref A1c · f2010

Question 7: D 9.8%

WACC = (weight × cost) for each component = (0.50 × 14%) + (0.10 × 8%) + (0.40 × 5%) = 7.0% + 0.8% + 2.0% = 9.8%. Note that preference share dividends are not tax-deductible (unlike debt interest), so the 8% cost is already the post-tax cost. 9.0% leaves out the preference shares (7.0% + 2.0%), and 8.5% does not follow from the costs and weights. 11.2% overstates the result, for example by using a pre-tax cost of debt or the wrong weights.

Section A, WACC — three-component calculation · Ref A1d · f2076

Question 8: A The company already has high gearing and increased debt would breach existing loan covenants or raise financial distress risk

When a company already has high gearing, taking on additional debt raises the risk of breaching existing loan covenants and increases the probability of financial distress — at this point, the cost of debt may be very high and equity may be preferable despite its higher normal cost. Share issues are not always cheaper than debt — debt is typically cheaper in absolute terms due to the tax shield and lower required return. Rights issues take considerable time to arrange (documentation, regulator approval, subscription period), so speed is not an advantage over debt. Debt maturity varies — many loans are medium or long-term.

Section A, Sources of finance — debt vs equity choice · Ref A1a · f2093

Question 9: C Under an operating lease the lessor retains the asset and recognises rental income straight-line; under a finance lease the asset is derecognised and a receivable recognised

Under an operating lease, the lessor retains substantially all the risks and rewards of ownership, so the asset remains on the lessor's balance sheet (subject to its normal depreciation policy) and rental income is recognised on a straight-line basis over the lease term. Under a finance lease, the lessor transfers risks and rewards to the lessee, so the asset is derecognised and replaced with a lease receivable. These are genuinely different accounting treatments, not identical. The lessor does recognise income from an operating lease — it is simply recognised as rental income rather than as finance income on a receivable.

Section B, IFRS 16 — operating vs finance lease (lessor) · Ref B1b · f2015

Question 10: B £20,000

Deferred tax liability = taxable temporary difference × tax rate = (carrying amount − tax base) × tax rate = (£200,000 − £120,000) × 25% = £80,000 × 25% = £20,000. The £80,000 figure is the taxable temporary difference itself, not the DTL. The £50,000 would arise from applying 25% to the full carrying amount (£200,000 × 25% = £50,000). The £30,000 might come from applying 25% to the tax base (£120,000 × 25% = £30,000). The DTL arises because recovering the £200,000 carrying amount will create taxable income of which only £120,000 is deductible, so tax is payable on £80,000 in future.

Section B, IAS 12 — deferred tax liability · Ref B1d · f2018

Question 11: D Fair value through OCI — business model is both collect and sell, and SPPI test passes

IFRS 9 classifies financial assets based on two criteria: the business model for managing the asset and whether its cash flows are solely payments of principal and interest (SPPI test). If the business model is 'both collecting contractual cash flows AND selling' (a 'hold to collect and sell' model) and the asset passes SPPI, classification is FVTOCI. Amortised cost applies only when the business model is exclusively 'hold to collect' (not to sell). FVTPL is the residual category or where the SPPI test fails. Exchange listing does not determine classification.

Section B, IFRS 9 — financial asset classification · Ref B1e · f2020

Question 12: B £10,200

IFRS 15 Step 4 requires the transaction price to be allocated to each performance obligation in proportion to its relative standalone selling price. Total standalone prices = £12,000 + £8,000 = £20,000. Product allocation = £17,000 × (£12,000 ÷ £20,000) = £17,000 × 0.60 = £10,200. Service allocation = £17,000 × (£8,000 ÷ £20,000) = £6,800. Recognising the full standalone price of £12,000 ignores the bundle discount. Equal allocation (£8,500 each) ignores the different standalone prices. The £9,000 figure might arise from dividing the total incorrectly.

Section B, IFRS 15 — transaction price allocation · Ref B1a · f2022

Question 13: C In other comprehensive income (OCI), credited to the revaluation surplus in equity

Under IAS 16, an upward revaluation is recognised in other comprehensive income (OCI) and accumulated in a revaluation surplus (a component of equity), unless it reverses a previous revaluation decrease that was recognised in profit or loss — in which case it is taken to the income statement to the extent of that previous decrease. The gain here (£70,000) is a first-time revaluation upward, so it goes entirely to OCI. An equal split between OCI and P&L has no basis; a split arises only where part of the gain reverses a previous P&L decrease, which is not the case here. The gain is not netted against the asset's cost directly.

Section B, IAS 16 — revaluation model · Ref B1f · f2023

Question 14: D £95,890

Amortised cost (effective interest method): interest income = carrying amount × effective rate = £95,000 × 6.2% = £5,890. Cash received (coupon) = £100,000 × 5% = £5,000. Carrying amount at end of year 1 = £95,000 + £5,890 − £5,000 = £95,890. The bond accretes towards par over its life. Leaving the value at £95,000 treats it as though no time has passed. Par value (£100,000) is only reached at maturity. £94,110 deducts the £890 discount amortisation instead of adding it (£95,000 − £890), treating the bond as if it had been bought at a premium.

Section B, IFRS 9 — amortised cost (effective interest method) · Ref B1e · f2024

Question 15: B As a gain recognised in profit or loss — the receivable is a monetary item retranslated at the closing rate

Trade receivables are monetary items (a right to receive a fixed amount of cash) and must be retranslated at the closing rate. Original: $50,000 ÷ 1.50 = £33,333. Closing: $50,000 ÷ 1.40 = £35,714. Gain = £35,714 − £33,333 = £2,381. Under IAS 21, exchange differences on monetary items are recognised in profit or loss in the period they arise. OCI treatment applies only to exchange differences on the net investment in a foreign operation, not to individual trading monetary items. The closing rate must be applied — using the original transaction rate throughout would freeze a stale value.

Section B, IAS 21 — monetary vs non-monetary items · Ref B1g · f2026

Question 16: A It must be identifiable and controlled, with probable future economic benefits and a reliably measurable cost

IAS 38 requires an intangible asset to be: identifiable (separable or arising from contractual rights); controlled by the entity (able to restrict others from accessing the benefits); expected to generate probable future economic benefits; and its cost must be capable of reliable measurement (IAS 38.21). Physical form is not required — by definition, intangible assets lack physical substance. Internally generated assets are not always excluded: development costs meeting specific criteria (technical feasibility, intention to complete, ability to use/sell, probable future benefits, adequate resources, ability to measure expenditure) can be capitalised. An indefinite life is neither required nor the norm — most intangibles have finite useful lives and are amortised.

Section B, IAS 38 — intangible assets recognition criteria · Ref B1i · f2029

Question 17: B When there is an indication of impairment (or annually for goodwill and certain indefinite-life intangibles regardless of indications)

IAS 36 requires impairment testing when there is an indication that an asset may be impaired — both external indicators (e.g. market value decline, adverse changes in environment) and internal indicators (e.g. physical damage, worse performance than expected) are considered. Goodwill and intangible assets with indefinite useful lives are tested annually regardless of whether indications exist, since they are not amortised and may otherwise go unreviewed. For other assets, annual testing without indication is not required. Auditor requests do not trigger the IAS 36 test — the standard itself defines the triggers.

Section B, IAS 36 — impairment review trigger · Ref B1b · f2030

Question 18: C £375,000

Percentage of completion = costs incurred ÷ total estimated costs = £300,000 ÷ £800,000 = 37.5%. Revenue recognised to date = 37.5% × £1,000,000 = £375,000. Recognising revenue equal to costs incurred (£300,000) applies only when progress cannot be reasonably measured but the costs are expected to be recovered (IFRS 15.45). £700,000 wrongly deducts the costs incurred from the contract price (£1,000,000 − £300,000). Full contract revenue (£1,000,000) is recognised only on completion, not throughout the contract.

Section B, IFRS 15 — percentage of completion revenue · Ref B1a · f2047

Question 19: B As a finance lease, because the lease term and present value indicators show that substantially all the risks and rewards of ownership transfer to the lessee

IFRS 16 requires lessors (unlike lessees) to classify each lease as either a finance lease or an operating lease. A lease is a finance lease when it transfers substantially all the risks and rewards incidental to ownership. Two of the standard indicators are present here: the lease term covers the major part of the asset's economic life, and the present value of the lease payments amounts to substantially all of the asset's fair value. Retention of legal title does not prevent finance lease classification — substance overrides legal form. There is no default classification by asset type, and lessor accounting depends fundamentally on this classification: finance leases produce a receivable, operating leases keep the asset on the lessor's books.

Section B, IFRS 16 — lessor lease classification indicators · Ref B1b · f2098

Question 20: C It may irrevocably elect to present fair value changes in OCI, instead of the default FVTPL

Equity investments cannot be measured at amortised cost under IFRS 9 because their cash flows are not solely payments of principal and interest. The default treatment is fair value through profit or loss. However, for an equity instrument that is not held for trading, the entity may make an irrevocable election at initial recognition to present fair value changes in other comprehensive income (FVTOCI). Under this election, gains and losses stay in OCI and are never recycled to profit or loss, even on disposal (though dividends are generally recognised in profit or loss). The election is irrevocable — switching between categories at each reporting date is not permitted, and historical cost without remeasurement is not an available treatment.

Section B, IFRS 9 — FVTOCI election for equity investments · Ref B1e · f2099

Question 21: D Existing deferred tax balances are remeasured at the newly enacted 22% rate expected to apply on reversal

IAS 12 requires deferred tax assets and liabilities to be measured at the tax rates expected to apply in the period when the asset is realised or the liability settled, based on rates enacted or substantively enacted by the reporting date. When the rate falls from 25% to 22%, all existing deferred tax balances must be remeasured at 22%, because the temporary differences will now reverse at the lower rate. The remeasurement difference is recognised in profit or loss (or in OCI/equity if the underlying item was recognised there). Both assets and liabilities are remeasured — not just one side — and the adjustment applies to existing balances, not only to new temporary differences.

Section B, IAS 12 — effect of a change in tax rate on deferred tax · Ref B1d · f2116

Question 22: B 4,800,000 — treasury shares are excluded from the weighted average since they carry no rights to earnings or dividends

Treasury shares are shares that have been repurchased and are held by the company itself. They are deducted from equity (not treated as assets) and carry no right to vote, receive dividends, or share in earnings. IAS 33 therefore excludes them from the weighted average number of ordinary shares used in calculating basic EPS. The effective share count is 5,000,000 − 200,000 = 4,800,000. Using all 5,000,000 shares would understate EPS by including shares with no earnings entitlement. The other options misunderstand what treasury shares are.

Section B, IAS 33 — treasury shares and EPS · Ref B1s · f2118

Question 23: C Revaluation gains on property, plant and equipment under the revaluation model

IAS 1 requires OCI to present items that are excluded from profit or loss but recognised in the statement of comprehensive income. Revaluation gains under IAS 16 (upward revaluations of PP&E not reversing previous losses recognised in P&L) are a key OCI item, credited to the revaluation surplus in equity. Revenue, finance costs and depreciation are all recognised in profit or loss, not OCI. OCI captures items where immediate P&L recognition would cause excessive volatility or otherwise be misleading — such as asset revaluations, actuarial gains and losses on defined benefit plans, and certain foreign exchange differences.

Section B, Presentation of financial statements — IAS 1 · Ref B1t · f2119

Question 24: D When the entity expects to recover those costs through revenue earned under the contract or separately

IFRS 15 requires capitalisation of incremental costs of obtaining a contract — such as sales commissions payable only on securing the contract — when the entity expects to recover them through the contract (via the revenue it will recognise). These are recognised as an asset (a contract cost asset) and amortised on a basis consistent with the transfer of the goods or services. A practical expedient allows immediate expensing if the amortisation period would be one year or less. The 5-year and 10% thresholds are not in IFRS 15. Immediate expensing of all costs is not required; recoverability determines treatment.

Section B, IFRS 15 — contract costs · Ref B1u · f2136

Question 25: C £250,000

Under IFRS 3 (full goodwill / fair value method): Goodwill = consideration transferred + NCI at fair value − fair value of identifiable net assets = £800,000 + £200,000 − £750,000 = £250,000. This method recognises the NCI's share of goodwill as well as the parent's share. The £200,000 figure is the NCI at acquisition, not goodwill. £50,000 deducts the full net assets from the consideration but omits the NCI (£800,000 − £750,000). The proportionate method would give a lower figure: £800,000 − (£750,000 × 80%) = £200,000.

Section C, IFRS 3 — goodwill (fair value NCI method) · Ref C1a · f2031

Question 26: D £200,000

Proportionate NCI method: NCI is measured as the NCI percentage × fair value of net assets = 20% × £750,000 = £150,000. Goodwill = consideration transferred + NCI (proportionate) − fair value of identifiable net assets = £800,000 + £150,000 − £750,000 = £200,000. This method only recognises the parent's share of goodwill (not the full economic goodwill including the NCI's share). The full-goodwill (fair value NCI) method from the previous question gives £250,000 — the difference of £50,000 represents the NCI's unrecognised share of goodwill.

Section C, IFRS 3 — goodwill (proportionate NCI method) · Ref C1a · f2032

Question 27: B £268,000

Equity method: initial cost £250,000 + investor's share of post-acquisition profit (30% × £60,000 = £18,000) − dividends received (nil) = £268,000. The carrying amount is updated each period for the investor's share of the associate's profit or loss. Leaving the value at the original cost of £250,000 ignores the equity method adjustment. Adding the full £60,000 profit (£310,000) fails to apply the 30% ownership proportion. Deducting £18,000 instead of adding it (£232,000) would represent a share of a loss, but the associate was profitable.

Section C, IAS 28 — equity method carrying amount · Ref C1c · f2034

Question 28: C Joint operation parties have rights to assets and obligations for liabilities; joint venture parties have rights only to net assets

IFRS 11 distinguishes joint arrangements by the rights and obligations of the parties. In a joint operation, parties have direct rights to assets and direct obligations for liabilities — they recognise their own share of each. In a joint venture, parties have rights only to the net assets (the whole arrangement) and use the equity method to account for it, recognising a single investment line. Proportionate consolidation (recognising a share of individual assets and liabilities) is prohibited for joint ventures under IFRS 11 — that treatment applies to joint operations only. The number of parties is not a distinguishing criterion.

Section C, IFRS 11 — joint arrangements classification · Ref C1d · f2035

Question 29: A £220,000

NCI at reporting date = NCI at acquisition + NCI's share of post-acquisition profit = £200,000 + (20% × £100,000) = £200,000 + £20,000 = £220,000. The NCI is updated each period for its share of the subsidiary's profit (and loss). Leaving it at £200,000 ignores the profit share. Taking 20% of £100,000 = £20,000 alone gives only the movement, not the total balance. The £180,000 figure would arise from deducting rather than adding the profit share.

Section C, NCI at reporting date · Ref C1a · f2037

Question 30: D 27.5p

Diluted EPS adjusts both earnings and shares. Adjusted earnings = £1,200,000 + £37,500 (interest saved, net of tax) = £1,237,500. Adjusted shares = 4,000,000 + 500,000 = 4,500,000. Diluted EPS = £1,237,500 ÷ 4,500,000 = £0.275 = 27.5p. Adding the shares without adjusting earnings gives 26.7p (£1,200,000 ÷ 4,500,000), which is not among the options. 26.1p and 29.2p do not follow from the figures. Using a pre-tax interest saving would also overstate the earnings adjustment. Basic EPS (30p) ignores the potential shares; diluted EPS is never higher than basic EPS, because instruments that would increase EPS are antidilutive and excluded.

Section C, IAS 33 — diluted EPS · Ref C1g · f2040

Question 31: C £100,000 — the investor's 25% share, provided it does not reduce the carrying amount below zero

Under IAS 28, the investor recognises its share of the associate's losses (25% × £400,000 = £100,000) through the equity method, reducing the investment's carrying amount. However, the investor should not recognise losses beyond the carrying amount of its investment (i.e. the investment cannot be reduced below zero) unless the investor has incurred legal or constructive obligations on behalf of the associate, or has made payments on its behalf. Once the investment is fully written down, further losses are suspended. Losses are definitely recognised under the equity method — the statement 'never recognised' is incorrect.

Section C, IAS 28 — equity method loss · Ref C1c · f2043

Question 32: D Using the equity method — recognising a single investment line and updating it for the venturer's share of profit or loss

IFRS 11 requires joint ventures to be accounted for using the equity method (the same method as associates under IAS 28). The venturer recognises a single investment line, initially at cost, and subsequently adjusted for its share of the joint venture's profit or loss and other comprehensive income. Proportionate consolidation — recognising a share of each individual asset and liability — is explicitly prohibited for joint ventures under IFRS 11 (it applies instead to joint operations). Cost-only and FVTPL are not permitted treatments for joint ventures in individual or group financial statements under IFRS.

Section C, IFRS 11 — joint venture equity method · Ref C1d · f2044

Question 33: A 24p

A bonus issue creates additional shares without economic substance (no consideration received). IAS 33 requires retrospective adjustment of the weighted average shares and all prior year EPS figures presented for comparison. Bonus issue = 2,000,000 × 1/4 = 500,000 new shares; total post-bonus shares = 2,500,000. Restatement factor = 2,000,000 ÷ 2,500,000 = 0.80. Restated prior year EPS = 30p × 0.80 = 24p. The original 30p is unadjusted. The 37.5p figure arises from dividing by the pre-bonus shares (inflating EPS). The 25p figure comes from applying an incorrect restatement factor.

Section C, IAS 33 — EPS adjustment for bonus issue · Ref C1g · f2049

Question 34: C Recognised at fair value at the acquisition date, as part of the total consideration transferred

IFRS 3 requires contingent consideration to be recognised at its fair value at the acquisition date, included in the total consideration transferred (and therefore in goodwill). Subsequent changes in fair value of contingent consideration classified as a financial liability are recognised in profit or loss after acquisition. Ignoring it until targets are met understates goodwill. A 50% probability threshold is not the applicable test — fair value at acquisition date is recognised regardless. Expensing in the payment year incorrectly treats it as a post-acquisition cost rather than part of the purchase price.

Section C, IFRS 3 — contingent consideration · Ref C1a · f2083

Question 35: C In profit or loss — monetary item retranslation goes to P&L unless part of the net investment

Intragroup monetary balances denominated in a foreign currency are retranslated at the closing rate. The resulting exchange difference is recognised in profit or loss unless the balance forms part of the net investment in the foreign operation (settlement is neither planned nor likely to occur in the foreseeable future), in which case the difference is recognised in OCI in the consolidated statements (IAS 21.15 and 21.32). A simple trade-type intercompany balance would generate a P&L difference. On consolidation, the intragroup balance itself is eliminated, but the exchange difference recognised by the individual entities in their own individual financial statements remains in the consolidated P&L.

Section C, IAS 21 — intragroup monetary balances · Ref C1f · f2087

Question 36: D Apply a bonus fraction to pre-issue shares, then add new shares weighted from the issue date

A rights issue at below market price contains a bonus element (shares issued at a discount effectively include a free share component). IAS 33 requires: (1) the bonus fraction to be calculated as market price before issue ÷ TERP, and applied to shares in issue before the rights issue date; then (2) the new shares are added from the issue date, weighted for the remaining portion of the year. Prior year EPS is also restated by the bonus fraction. This treatment separates the bonus element (retrospective, like a bonus issue) from the cash-raised element (time-weighted from issue date). Adding all shares from 1 January or ignoring the bonus fraction would misstate EPS.

Section C, IAS 33 — rights issue EPS adjustment · Ref C1g · f2088

Question 37: D As part of the non-controlling interest in the consolidated balance sheet — they represent an external interest in the subsidiary

Preference shares of a subsidiary held by external investors represent an outside interest in the subsidiary that is not held by the parent group. In the consolidated financial statements, these are presented as part of non-controlling interest (NCI) within equity, separately from the equity attributable to the parent's shareholders. They are not a liability of the parent — the parent does not personally owe the preference share payments. They are not eliminated — only intragroup balances between parent and subsidiary are eliminated on consolidation. Preference shareholders in a subsidiary are simply a type of external investor, classified as NCI.

Section C, Consolidation — preference shares of subsidiary · Ref C1b · f2120

Question 38: B The group is presented as one entity — internal transactions should not inflate reported assets and liabilities

The consolidated financial statements present the group as a single economic entity. A loan between parent and subsidiary is an internal transaction — from the group's perspective, the 'asset' in one entity and the 'liability' in the other cancel out, and should not inflate reported group totals. Eliminating these balances gives a true picture of the group's external assets and obligations. The subsidiary's external assets and liabilities are not removed — only the intragroup amounts cancel. IAS 27 does not prohibit intragroup lending. Elimination reduces, not increases, the reported total assets of the group.

Section C, Elimination of intragroup balances · Ref C1e · f2122

Question 39: A Gain of £1.5m

On losing control, the group derecognises the subsidiary's identifiable net assets (£4m), goodwill (£0.6m) and the non-controlling interest (£0.9m), and compares the consideration received against the net amount derecognised. Net assets derecognised = net assets (£4m) + goodwill (£0.6m) − NCI (£0.9m) = £3.7m. Gain on disposal = consideration £5.2m − £3.7m = £1.5m. The NCI is subtracted (not added) because it represents a claim against the subsidiary's net assets that the group no longer has to satisfy once control — and the NCI itself — is derecognised; this is the step most commonly got wrong in this calculation. A £0.3m loss adds the NCI instead of deducting it (£5.2m − £5.5m), and a £2.1m gain leaves out the goodwill (£5.2m − £3.1m).

Section C, Disposal of a subsidiary — loss of control · Ref C1h · f2128

Question 40: B As a transaction between owners, recognised directly in equity — no gain or loss is recognised in profit or loss, since the group retains control throughout

Where control is retained after a partial disposal, IFRS 10 treats the transaction as one between owners (the group and the non-controlling interest), recognised directly in equity — the difference between the consideration received and the change in the carrying amount of the NCI is recorded within equity, not as a gain or loss in profit or loss. This is a deliberately different treatment from a full disposal (or a partial disposal that does result in loss of control), which does generate a P&L gain or loss. The subsidiary continues to be fully consolidated (not deconsolidated) since control is retained, and the transaction is recognised in the period it occurs, not deferred.

Section C, Partial disposal without loss of control · Ref C1h · f2131

Question 41: D Financial, manufactured, intellectual, human, social and relationship, and natural capital

The IIRC Integrated Reporting Framework identifies six capitals that organisations use and affect: financial capital (funds available to produce goods and services); manufactured capital (physical objects used in production); intellectual capital (knowledge-based intangibles); human capital (people's competencies and wellbeing); social and relationship capital (institutions and relationships); and natural capital (environmental stocks and flows). The other options substitute incorrect labels or invented categories — none correctly names all six as defined in the framework.

Section D, Integrated Reporting — six capitals · Ref D1a · f2052

Question 42: C To require disclosure of sustainability-related risks and opportunities that could affect cash flows, financing, or cost of capital

IFRS S1 establishes general requirements for how entities communicate sustainability-related risks and opportunities that are reasonably expected to affect their cash flows, access to finance, or cost of capital over the short, medium or long term. The focus is on sustainability-related financial information relevant to investors — not on replacing existing IFRS financial reporting standards. IFRS S1 applies financial materiality, not a requirement to disclose everything regardless of financial significance. Setting emissions targets is outside the scope of IFRS S1 — it is a disclosure standard, not a target-setting framework.

Section D, IFRS S1 — general sustainability disclosure · Ref D1b · f2055

Question 43: B Task Force on Climate-related Financial Disclosures — IFRS S2 uses the same four-pillar structure and was built to be consistent with TCFD recommendations

TCFD stands for Task Force on Climate-related Financial Disclosures, established by the Financial Stability Board. Its recommendations (governance, strategy, risk management, metrics and targets) were widely adopted by preparers and regulators globally. The ISSB (International Sustainability Standards Board) built IFRS S2 to be consistent with and effectively incorporate TCFD recommendations, providing the same four-pillar structure in a formal accounting standard. This means companies already reporting under TCFD have a head start in implementing IFRS S2. TCFD has no connection to the other descriptions given.

Section D, IFRS S1 and S2 — relationship to TCFD · Ref D1b · f2106

Question 44: C Governance, strategy, risk management, and metrics and targets

IFRS S1 (General Requirements for Sustainability-related Financial Information) mirrors the four content areas also used in IFRS S2: governance (how the entity's governing body oversees sustainability-related risks and opportunities); strategy (how sustainability-related risks and opportunities affect strategy and financial planning); risk management (how sustainability risks are identified, assessed and managed); and metrics and targets (measurements and goals used to assess performance). These four areas provide a consistent structure across all ISSB standards. The other options describe either financial statement elements or general ESG topics, not the ISSB disclosure framework.

Section D, IFRS S1 — four content areas · Ref D1b · f2139

Question 45: D An assessment of the challenges and uncertainties the organisation is likely to encounter and the potential implications for its business model and future performance

The outlook content element in the Integrated Reporting Framework requires the organisation to discuss the challenges and uncertainties it is likely to face and their potential implications for strategy, business model and future performance. It is forward-looking but does not require precise numerical forecasts — qualitative disclosure of key uncertainties and their expected impacts is what is sought. An outlook section is not a going concern guarantee and does not mandate competitive benchmarking against peers. The emphasis is on helping stakeholders understand what management foresees and how the organisation plans to navigate it.

Section D, Integrated Reporting — outlook content element · Ref D1a · f2140

Question 46: D Scope 1 = direct emissions from sources the entity owns or controls; Scope 2 = indirect emissions from purchased energy (e.g. electricity); Scope 3 = all other indirect emissions occurring in the entity's value chain (e.g. purchased goods, business travel, use of sold products)

The Scope 1/2/3 framework, which IFRS S2 requires entities to use, categorises emissions by their source and the entity's degree of direct control: Scope 1 covers direct emissions from sources the entity owns or controls (e.g. its own vehicles, on-site fuel combustion); Scope 2 covers indirect emissions from the generation of purchased energy the entity consumes (e.g. purchased electricity); and Scope 3 covers all other indirect emissions arising throughout the entity's value chain, both upstream and downstream (e.g. emissions embedded in purchased goods and services, employee business travel, and emissions from the use of the entity's sold products). This is not an optional choice between alternative measures, has nothing to do with different time periods, and applies across all industries, not just energy.

Section D, IFRS S2 — Scope 1, 2 and 3 greenhouse gas emissions · Ref D1b · f2150

Question 47: B Net profit margin 15%; asset turnover 0.6 times

Net profit margin = profit after tax ÷ revenue = £180,000 ÷ £1,200,000 = 0.15 = 15%. Asset turnover = revenue ÷ total assets = £1,200,000 ÷ £2,000,000 = 0.6 times. Together these link to ROCE via the DuPont identity: ROCE = net profit margin × asset turnover (though this typically uses EBIT in the numerator). The 9% arises from dividing profit by assets. The 1.7 times asset turnover arises from dividing assets by revenue (£2,000,000 ÷ £1,200,000), which inverts the formula.

Section E, Net profit margin and asset turnover · Ref E1a · f2066

Question 48: A Asset turnover has declined — the company is generating less revenue per pound of capital employed

ROCE = EBIT margin × asset turnover. If EBIT margin is unchanged, a decline in ROCE must be entirely attributable to a fall in asset turnover — the company is generating less revenue per pound of capital employed (perhaps due to asset expansion not matched by revenue growth, or slower revenue growth). Tax rate does not affect ROCE (which uses EBIT, a pre-tax measure). Cost of equity affects the hurdle rate but not the measured ROCE itself. Dividend payout affects equity reserves but not EBIT or capital employed in a way that directly changes asset turnover.

Section E, DuPont analysis — ROCE decomposition · Ref E1a · f2073

Question 49: C It artificially increases the current ratio at year-end by reducing current liabilities, raising concerns about window dressing

Repaying the loan before year-end reduces both cash and current liabilities by the same amount; where the current ratio (current assets ÷ current liabilities) was above 1, this increases it at the reporting date. Since the loan is immediately redrawn after year-end, the reported ratio does not reflect the ongoing liquidity position — this is classic window dressing. It is not a required treatment under any accounting standard; it is a deliberate timing of a financial transaction to present a more favourable ratio. This limitation of ratio analysis — that period-end balances can be managed — is a key reason why trend analysis and understanding of the business are important supplements to ratio calculation.

Section E, Window dressing and ratio limitations · Ref E1d · f2075

Question 50: C 75 days

Cash conversion cycle = inventory days + receivables days − payables days = 60 + 55 − 40 = 75 days. This measures the time between paying for goods (when payables are settled) and receiving cash from customers. A shorter CCC is generally better as it means cash is tied up for less time. 115 days omits payables days (60 + 55). The 40 days figure uses payables days alone. The 155 days sums all three without any subtraction.

Section E, Cash conversion cycle · Ref E1b · f2107

Question 51: D 40%

Debt-to-total capital = debt ÷ (debt + equity) = £600,000 ÷ (£600,000 + £900,000) = £600,000 ÷ £1,500,000 = 40%. This is an alternative gearing definition from debt-to-equity. Debt-to-equity would give £600,000 ÷ £900,000 = 66.7%. The 60% figure arises from inverting numerator and denominator or using equity in the numerator. The 150% would result from reversing equity and debt in the debt-to-equity formula.

Section E, Gearing — debt to total capital · Ref E1a · f2108

Question 52: D 10.8%

Sustainable growth rate = ROE × retention ratio = ROE × (1 − payout ratio) = 18% × (1 − 40%) = 18% × 60% = 10.8%. This is the rate at which a company can grow using only retained earnings — without changing its capital structure or issuing new equity. Using just the ROE (18%) ignores the payout constraint. The 7.2% figure might arise from ROE × payout ratio (18% × 40%), using the wrong retention factor. The 4.5% could result from a calculation error. Retention ratio = 1 − dividend payout ratio.

Section E, Sustainable growth rate · Ref E1d · f2112

Question 53: C Excess current assets may earn low returns when capital could be deployed more productively

While a current ratio above 1.0 is generally considered healthy from a liquidity perspective, an excessively high ratio may mean the company is holding too much cash (earning little return), carrying excess inventory (with associated holding costs) or allowing receivables to build up rather than collecting promptly. These tie up capital that could be deployed more productively. The optimal level balances liquidity risk against the opportunity cost of holding liquid but low-return assets. A ratio above 2.0 is not automatically excellent; it depends on the business and industry norms. The ratio becomes critical (but not only then problematic) when below 1.0.

Section E, Working capital management — optimal current ratio · Ref E1b · f2115

Question 54: C Revaluation increases capital employed, mechanically reducing ROCE — the difference may reflect accounting policy rather than operational performance

Under the revaluation model, asset values (and hence capital employed) are higher than under cost model, mechanically reducing ROCE even if underlying trading performance is identical. When comparing companies using different PP&E measurement models, the analyst must be aware that reported ROCE differences may reflect accounting policy choices rather than genuine operational differences. IFRS permits either the cost or revaluation model, so it is not the case that both companies must use the same policy. The direction of the effect (higher revaluation → higher capital → lower ROCE) is consistently as described.

Section E, Benchmarking ratios across accounting policies · Ref E1d · f2123

Question 55: A It shows the EPS that would result if all potentially dilutive instruments (convertibles, options) were exercised, increasing the share count and reducing EPS

Diluted EPS assumes the exercise of all potentially dilutive instruments — such as share options (typically at zero or below-market cost to holder) and convertible bonds (adding shares to the denominator and interest saved to the numerator). The net effect is a larger share count (diluted denominator), which generally reduces EPS. This makes diluted EPS a more cautious measure — it shows the EPS available to shareholders if all dilutive potential shares were issued. Diluted EPS is by definition not higher than basic EPS (anti-dilutive instruments are excluded). Preference dividends affect both similarly.

Section E, Earnings per share — dilution concept · Ref E1c · f2125

Question 56: C 11% — combining the dividend yield with the capital gain

Total shareholder return (TSR) = dividend yield + capital gain = 3% + 8% = 11%. TSR captures the full return received by shareholders: cash income from dividends plus the change in the value of their investment. It is a comprehensive return measure widely used in executive remuneration benchmarks. Counting only capital gains ignores the dividend component. Counting only dividends ignores capital appreciation. Subtracting one from the other (5%) has no financial meaning in this context.

Section E, Dividend yield and total shareholder return · Ref E1c · f2127

Question 57: A Rising working capital — growing receivables and inventory absorb cash even as revenue and profit rise

When a company is growing, receivables and inventory typically increase — representing cash that has been committed to operating the business but not yet collected. This is the most common cause of operating cash flow lagging behind profit in a growing business. Depreciation actually reduces profit relative to cash (it is a non-cash charge added back in the cash flow statement). Tax reduces both cash and profit. Interest received increases both cash and profit in most cases. The working capital build-up scenario — profit growing but cash lagging — is a classic financial analysis red flag that can precede liquidity problems if unchecked.

Section E, Operating cash flow versus profit · Ref E1b · f2129

Question 58: C Comparing financial data across multiple periods to identify trends in revenue, costs, and key ratios over time

Horizontal analysis (trend analysis) compares financial data across multiple periods — typically two to five years — to identify trends in absolute amounts and percentage changes for items such as revenue, costs, profit, and key ratios. This helps identify whether performance is improving, deteriorating, or cyclical over time. Comparing against industry peers is cross-sectional (peer) analysis. Calculating line item proportions within a single period is vertical (common-size) analysis. Comparing subsidiaries to parents is a different type of internal analysis, not horizontal analysis.

Section E, Horizontal and trend analysis · Ref E1d · f2143

Question 59: B Market price reflects expected future earnings and unrecognised intangibles — accounting does not fully capture these

Listed company share prices reflect investor expectations about future earnings, dividends and growth. They also incorporate value from intangible assets — such as brand strength, proprietary technology, customer loyalty and management capability — which cannot be recognised on the balance sheet when internally generated. Book value records historical costs (less depreciation) and is thus typically lower than market value for successful, growing companies. Efficient market theory does not imply market equals book value — it implies prices reflect available information, which includes growth prospects beyond book assets. Book value can exceed market value, for example in distressed or low-return businesses.

Section E, Book value vs market value — why they diverge · Ref E1c · f2146

Question 60: C Overtrading — the company is growing revenue faster than its working capital can support, risking a cash flow crisis despite profitable trading

Overtrading occurs when a business grows so rapidly that its working capital becomes insufficient to support the increased activity. Indicators include: deteriorating current ratio (working capital stretched); rising receivables days (customers paying more slowly as sales expand); rising payables days (stretching suppliers to fund the growth); and cash shortages. The company may be profitable on paper but face a cash flow crisis because the growth is consuming cash faster than it is generated. This is distinct from over-capitalisation (too much equity) or conservative working capital management (which would show opposite trends). It is not a liquidity strength signal.

Section E, Working capital — overtrading symptoms · Ref E1b · f2147