Preparation for exam. Part 2.

Example 1: Perform impairment test for goodwill and estimate the recognized amount of impairment loss

On 31 December 20X1, Entity T acquires 100% of voting rights in Entity M for CU10,000. Entity M has manufacturing plants in three countries. The data below relates to the end of 20X1.

	Allocation of purchase price	Fair value of identifiable assets	Goodwill
Activities in Country A	5,000	3,500	
Activities in Country B	2,000	1,500	
Activities in Country C	5,000	3,500	

Goodwill arising on the acquisition of Entity M has been allocated to three cash-generating units (Countries A, B and C).

During 20X2, a new government is elected in Country A. It passed legislation that significantly restricts exports of the main product produced by Entity T and its subsidiaries (ie Group T). As a result, and for the foreseeable future, Group T's production in Country A will be cut by 40 per cent. The significant export restriction and the resulting production decrease require Group T to estimate the recoverable amount of Country A's cash-generating unit at the end of 20X2. Management estimates cash flow forecasts for Country A operations and determines the cash-generating unit's recoverable amount to be CU 2,750.

	Goodwill	Identifiable assets	Total
Historical cost			
Accumulated amortization/depreciation (31 December 20X2)			
Carrying amount 31 December 20X2			
Impairment loss 31 December 20X2			
Carrying amount after impairment loss 31 December 20X2			

At the end of 20X2, accumulated amortization for goodwill and identifiable assets for cash-generating unit from country A was CU 350 and CU 400 respectively. Estimate impairment loss and new carrying amount of intangible assets for cash-generating unit from country A at 31 December 20X2.

Example 2: Estimate the value of a provision

A customer has initiated a lawsuit against an entity associated with personal injury when using one of the entity's products. The entity's lawyers estimate from experience that at the reporting date (31 December 20X1) the entity has:

a) a 40 per cent chance of being ordered to pay the customer compensation of CU1,500,000 and a 60 per cent chance of being ordered to pay compensation of CU750,000. The ruling is expected to take place in two years' time. The entity determines that a discount rate of 4 per cent is appropriate to adjust for the risks specific to the liability.

b) a 15 per cent chance of being ordered to pay the customer compensation of CU800,000, a 45 per cent chance of being ordered to pay compensation of CU1,000,000 and a 40 per cent chance of being ordered to pay compensation of CU1,200,000. For the purpose of this example, the risks specific to the liability and the time value of money have been ignored.

c) a 60 per cent chance of winning the lawsuit and thereby avoiding the payment of compensation. Furthermore, the entity's lawyers estimate that the entity has a 15 per cent chance of being ordered to pay the customer compensation of CU500,000 and 15 per cent chance of being ordered to pay the customer compensation of CU1,000,000. For the purpose of this example, the risks specific to the liability and the time value of money have been ignored.

What is the recognized amount of provision, if any, in every of these cases?

Example 3: Estimate the value of financial instruments

An entity bought 100 non-puttable ordinary shares during the year for cash of CU1000 and incurred broker transaction fees of CU25 in:

a) a listed company. At the year-end the shares are quoted at CU12 per share.
b) an unlisted company. The shares are not publicly traded and the fair value of the shares cannot otherwise be measured reliably.

What is the recognized and subsequently measured value of ordinary shares acquired in case of listed company and in case of unlisted company?

Example 4: Estimate the value of impairment loss

At the end of a financial reporting period an entity has an outstanding balance of CU2,000 due from a customer. This balance was not discounted as the transaction took place on normal business terms (short-term credit) with no hidden financing transaction.

a) Because of financial difficulties being experienced by the customer, the entity does not expect the customer to repay any of the CU2,000.
b) The entity has given the customer extra time to pay off the debt. The entity expects the customer will be able to pay about one year after the reporting date. Average market rate is 5%.

What is the recognized amount of the impairment loss in both cases?

Example 5: Account for issue of ordinary shares

On 1 January 20X1 SME B issues 100,000 ordinary shares in exchange for 800 ounces of gold. The par value of the shares is CU1 per share when gold was trading at CU500 per ounce.

What is the accounting for issue of ordinary shares?

Example 6: Account for issue of ordinary shares and sale of options

At 31 December 20X0 as a year-end SME A has ordinary share capital of CU150,000, which was contributed at par on incorporation of SME A. The par value of the shares of the entity is CU1 per share.

On 1 January 20X1 the entity issues a further 200,000 ordinary shares at CU7 per share. The shares are issued for cash.

Also on 1 January 20X1, as an incentive to encourage investment, each shareholder is permitted to buy one share option for every share purchased on 1 January 20X1 at CU0.65 per option. Each option allows the holder to buy one share on 31 January 20X2 at CU6 per share. 70,000 share options are purchased.

On 31 January 20X2 70,000 share options are converted into ordinary shares. The commercial law to which the entity is subject requires to account for depletion of share option reserve as share premium.

What is the accounting for conversion of options into ordinary shares?

Example 7: Account for change in a parent's interest

Since SME Z was formed it has been owned 85 per cent by SME A and 15 per cent by SME B. On 31 December 20X5, when the carrying amount of SME Z's net assets was CU200,000, SME A reduced its holding in SME Z to 70 per cent by selling 15 per cent of SME Z's shares to SME B for CU35,000.

What is the accounting for change in SME A's interest in SME Z?

Example 8: Estimate the value of revenue

A vehicle dealer enters into contracts to maintain its customer's new vehicle for a three-year period.

On 1 January 20X1 a customer paid the dealer CU15,000. Experience has shown that the costs to the dealer of maintaining new vehicles of the model owned by the customer are on average CU2,000 in the first year of ownership, CU2,000 in the second year and CU4,000 in the third year.

What is the amount of revenue recognized at the end of each reporting period during the lifetime of the contract?

Example 9: Estimate the value of revenue

Under a construction contract, a contractor agrees to a fixed contract price of CU3,000 to refurbish the kitchen of a residential flat. The contractor's initial estimate of contract costs at 1 February 20X1, the date the contract is agreed, is CU2,100. The contract price will be paid to the contractor on completion of the refurbishment.

The contractor has a 30 June year-end. As at 30 June 20X1 contract costs incurred for work performed to date are CU1,800 and the contractor estimates that costs to complete the contract will be CU300 (i.e. total contract costs will be CU2,100). The contractor determines the stage of completion of the contract by calculating the proportion that contract costs incurred for work performed to date bear to the latest estimated total contract costs.

What is the amount of revenue recognized at the end of each reporting period during the lifetime of the contract?

Example 10: Estimate the value of carryback for current tax loss

In accordance with the relevant tax rules in its jurisdiction, an entity estimates its taxable loss for the tax period 20X7/20X8 at CU10,000. The tax legislation in the jurisdiction permits entities to carry back losses three tax years into the past. Taxable income in 20X6/20X7 was CU3,500, in 20X5/20X6 it was CU4,000 and in 20X4/20X5 it was CU3,000. The entity has a 30 September financial year-end (end of the reporting period) and this coincides with the entity's tax year. The relevant income tax rates are as follows:

- 18 per cent in 20X6/20X7 and 20X7/20X8
- 19 per cent in 20X5/20X6
- 20 per cent in 20X4/20X5.

What is the recognized amount of carryback for current tax loss if:

a) The tax legislation in the jurisdiction permits entities to carry back losses three tax years into the past and there is no requirement on which of the three years the loss is set off against first.
b) The tax legislation in the jurisdiction permits entities to carry back losses three tax years into the past and there is a requirement that the entity should set the losses against the most recent period possible, i.e. 20X6/20X7 first, 20X5/20X6 second and 20X4/20X5 last.

Example 11: Estimate the value of deferred tax liability

An entity has an item of equipment that is depreciated faster for tax purposes than for financial reporting purposes. On 31 December 20X1 a temporary difference of CU2,000 arises related to this equipment that is expected to increase taxable profit in the future. The temporary difference is expected to reverse in five years' time. In the entity's jurisdiction, tax is payable at 18 per cent on the first CU50,000 of taxable profit earned, 20 per cent on the next CU100,000 of taxable profit earned, 24 per cent on the next CU100,000 of taxable profit earned, 26 per cent on the next CU100,000 of taxable profit earned, and 30 per cent on any remainder (i.e. excess above CU350,000). In 20X6 the entity expects to earn taxable profit of CU500,000.

What is the recognized amount of differed tax liability?

Example 12: Account for a foreign currency transaction

On 24 December 20X1 an entity with a functional currency of CU buys raw materials from a supplier on credit for FCU12,000. The entity pays the supplier on 17 January 20X2. The entity has a financial year-end of 31 December 20X1.

The spot exchange rates are as follows:

- 24 December 20X1: CU1.5 = FCU1
- 31 December 20X1: CU1.7 = FCU1
- 17 January 20X2: CU1.6 = FCU1

What is the recognized amount of purchase of inventories? How it should be accounted for?