

**Answer to example 4 – Onerous contract**

(a) Yes, a legal obligation under the purchase contract

| Give notice, and buy the cloth for 2 more months and produce |               | Give notice, buy the cloth, and sell immediately |         | Cancel the contract without notice |         |
|--------------------------------------------------------------|---------------|--------------------------------------------------|---------|------------------------------------|---------|
| Cost $2 \times 900 \times \$7$                               | 12,600        | $2 \times 900 \times \$7$                        | 12,600  | $2 \times \$700$                   | 1,400   |
| Labour cost $2 \times 900/3 \times \$4$                      | 2,400         |                                                  |         |                                    |         |
|                                                              | <u>15,000</u> |                                                  |         |                                    |         |
| Sell $2 \times 300$ dresses $\times \$22$                    | 13,200        | Sell $2 \times 900 \times \$6.25$                | 11,250  |                                    |         |
| Loss                                                         | (1,800)       | Loss                                             | (1,350) | Loss                               | (1,400) |

There is therefore an unavoidable loss of \$1,350. This should be provided for in the Statement of Financial Position and expensed through the Statement of Profit or Loss and Other Comprehensive Income. In the Notes to the Financial Statements, there should be an explanation of the circumstances and the uncertainties concerning timings, amounts and assumptions

**Answer to example 5 – Restructuring**

- (a) There is neither a legal nor constructive obligation, because no obligating event has yet occurred. The directors could change their minds, and decide to keep the Kaunas factory open. Therefore, no provision is appropriate.
- (b) There is a detailed plan, the impact of which has been communicated to suppliers and the workforce. Paulius has therefore raised the valid expectation in the minds of those affected. Although not a legal obligation, there is a constructive obligation arising from some past event, involving the probable outflow of economic resource. A provision is therefore appropriate in the amount which represents the best estimate of the costs of closing the Kaunas factory.

**Chapter 14****Answer to example 1 – Events after the reporting period**

B

- The impairment indicator existed at the reporting date and the valuation gives additional evidence towards the impairment review, therefore an adjusting event
- The sale of inventory below cost provides additional evidence on the value of the inventory at the reporting date, therefore an adjusting event
- The fraud/error is an adjusting event as it will have been in evidence at the reporting date but not yet discovered, therefore an adjusting event.
- The insolvency of the customer gives evidence that they were in financial difficulty at the reporting date, therefore an adjusting event.

**Answer 2– Events after the reporting period**

Non-adjusting events as the issue of shares does not give evidence of a condition that existed at the year-end. The company would use the issue of shares in its calculation of basic EPS.

An adjusting event as the legal action and its outcome give evidence of a condition that existed at the reporting date. A provision of \$80,000 would be made.

An adjusting event that reduces the value of year-end inventory by \$10,000 as it gives evidence of the fall in value of the inventory held at the reporting date. Inventory included in the accounts at the year-end would now be included at \$15,000.

