FINANCIAL ACCOUNTING 700 Seminar RS 7 – Suggested solution *PH Ferreira*	DEPARTMENT OF ACCOUNTING UP

SUGGESTED SOLUTION TO QUESTION 1

1.1 This event has no effect on conditions that existed at the reporting date. It is thus a non-adjusting event.

It may however influence the decisions of the users of financial statements. In terms of IAS 10.21, if non-adjusting events are material, then non-disclosure would affect the users' ability to make proper decisions and evaluations. Therefore, taking into account the materiality of this event, it should be disclosed.

If disclosed, show the:

- nature of the event; and
- an estimate of the financial effect (or statement that estimate cannot be made).

This disclosure will be made in a note (no adjustment made).

The board of directors would possibly also want to disclose it in the directors' report.

1.2 Refer to 1.1. Also consider the going concern concept.

1.3 Should the financial problems of the debtor have arisen wholly after the reporting date (e.g. as a result of its factory being devastated by a fire and not being insured), no additional evidence is provided of conditions which existed at the reporting date. It is thus a non-adjusting event. Disclose (don't adjust) the situation by way of a note, assuming the event is material (refer to 1.1). Also consider the going concern concept.

If the customer already experienced financial problems at the reporting date, but at that stage it was uncertain as to the severity thereof, and the uncertainty has now been resolved through a confirming event which indicates that the problems are real, then additional evidence is provided of conditions which existed at the reporting date, and an adjusting event exists. The amount of the adjustment should be recognised (adjusted) in the financial statements. The debtors' balance will thus be reduced to the amount which is expected to flow to the entity in future.

1.4 This event is not indicative of conditions that existed at the reporting date – it only arose after the reporting date and is thus a non-adjusting event. It may however severely influence the net realisable value of inventory in future. Therefore, if the materiality requirements of IAS 10.21 are met, the event will be disclosed (not adjusted) by way of a note (refer to 1.1). Also consider the going concern concept.

1.5 Should the decline in market price confirm an inherent problem i.r.o. the investment, that existed at the reporting date and that had not been factored into the market price at year-end, the investment should be adjusted (if carried at fair value) or tested for impairment (if carried at cost or amortised cost), as an adjusting event exists.

However, if the market price dropped as a result of conditions after the reporting date, it is a non-adjusting event that requires no adjustment in the financial statements. Disclosure of the event according to IAS 10.21 may be required if the event is material (refer to 1.1). The going concern concept should also be assessed (IAS 10.14).

1.6 The event provides further evidence of a condition that already existed at year end – the defect. The event thus requires adjustment to amounts in the financial statements. A present obligation exists at year end in respect of a past event (selling of the defective goods), that will result in an outflow of economic benefits in future. Provide for the cost of repairs in respect of goods already sold. Also consider possible write downs to net realisable value on inventory which are still on hand at reporting date as the cost of completion of the inventory will change. Consider whether claims for restitution should be made.

1.7 The event only occurred after reporting date and the conditions did not exist at reporting date. It is thus a non-adjusting event. Disclose in a note according to the requirements of IAS 10.21, if material. Also consider the going concern concept.

1.8 In terms of IAS 10.12 dividends that are proposed or declared after reporting date are not recognised as a liability at reporting date. These dividends should be disclosed in a note, detailing the total amount of the dividend, as well as the amount per share.

SUGGESTED SOLUTION TO QUESTION 2

Only 2.1 and 2.5 require adjustment as they are the only two events that provide further evidence of conditions that already existed at reporting date. Notes would however be required in those cases (2.2 to 2.4) where the non-adjusting event is regarded as material (refer to IAS 10.21).

SUGGESTED SOLUTION TO QUESTION 3

AIR HUMIDIFIERS

- The loss of inventory is an event after the reporting date, which is unfavourable (loss of R1 470 000) and which is indicative of conditions that arose after reporting date (long week-end in October 20X6) – non-adjusting event.
- Adjustments to assets and liabilities are not required, but it is necessary to consider whether the going concern assumption still applies to the company.
- IAS 10.21 should also be considered – if the non-adjusting event is material, then non-disclosure will lead to users not making proper evaluations and decisions. The following aspects should thus be disclosed in a note, if the event is regarded as material:
    - the nature of the event;
    - the financial effect thereof.

POSSIBLE TAKE-OVER

- The possible take-over commenced only after year-end. The negotiations after year end do not confirm conditions that already existed at reporting date. Consequently this is a non-adjusting event.
- For the sake of proper evaluation and decision-making by users, the event (if material) should be disclosed by way of a note, in terms of IAS 10.21.

SUGGESTED SOLUTION TO QUESTION 4

The issue is whether the dividend proposal after year-end can be recognised as a liability in the 20X0 financial statements.

According to The Conceptual Framework par.4.4(b) a liability is:

- a present obligation;
- arising from past events;
- the settlement of which is expected to result in an outflow of resources embodying economic benefits.

A present obligation:

The obligation to pay a dividend arises only after the proposal has been approved by the shareholders at an annual general meeting, which then gives rise to the formal declaration of a dividend.

The proposal by the directors therefore does not give rise to a present obligation.

Arising from past events:

The proposal by the directors is the past event, but this event does not give rise to a present obligation.

The settlement of which is expected to result in an outflow of resources embodying economic benefits:

The payment of the dividend is the expected outflow.

Conclusion and further discussion of accounting treatment

The proposed dividend should not be recognised as a liability.

This is therefore a non-adjusting event in terms of IAS 10 as it arose after year-end in totality.

IAS 10 requires disclosure in a note to the financial statements in respect of dividends proposed or declared after year-end. This disclosure is done in terms of IAS 1.137.