# HKAS 2, 16, 36 and 37

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**Examples and Cases for Discussion**

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# HKAS 2

**Example**

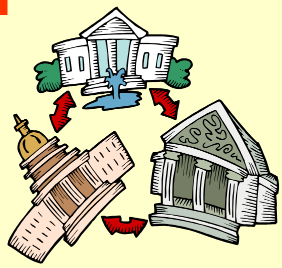
- A jewellery company
  - Is engaged in retailing and wholesale of gold and diamond
  - Has a significant level of inventories on golden and diamond products.
- In view of the significant price fluctuation of gold and diamond in these 2 years
  - the company considers whether it can carry such kinds of inventories at market price, instead of cost.
- Please advise.

# HKAS 16

**Example**

## Are the following assets PPE?

- Copier acquired under an operating lease
- Motor vehicle acquired under finance leases
- Owned property used for rental purpose
- Investment property under re-development
- Property held for a currently undetermined future use
- Leasehold land separated from the leasehold building





# HKAS 16

**Example**

- Several same air-condition plants have been installed by GV in several leasehold properties. When the properties are returned to the landlord in 4 years, the plants should be removed.
- The properties include factory (3 plants installed), show room (1 plant installed) and head office (2 plants installed).
- The purchase cost of each plant is $1,000. The installation cost is $1,000 for each plant. Present value of removal costs of the plant include $400 resulted from installation only and $400 from the usage during the 4 years.
- What is the cost of each plant to be recognised?

# HKAS 36

Example

Allocating Goodwill to CGU → Disposal

- An entity sells for $100 an operation that was part of a CGU to which goodwill has been allocated.
- The goodwill allocated to the unit cannot be identified or associated with an asset group at a level lower than that unit, except arbitrarily.
- The recoverable amount of the portion of the CGU retained is $300.



# HKAS 36

Case

Allocating Goodwill to CGU

Luenthai
Your Apparel Supply Chain Services Partner

- In its 2005 Interim Report, full set of HKFRS was adopted:
  - Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses.
  - Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.
  - Goodwill is allocated to cash-generating units for the purpose of impairment testing.

Any improvement?

## HKAS 36

**Example**

| On 1.1.2005 | Parent P | Sub S |
|---|---|---|
| Property | $ 0 | $ 6,000 |
| Investment | 0 | 0 |
| Cash at bank | 30,000 | 2,000 |
| | 30,000 | 8,000 |
| | | |
| Issued equity | $ (30,000) | $ (5,000) |
| Retained earnings | 0 | (3,000) |
| | (30,000) | (8,000) |

**On 1.1.2005**

- Parent P acquired 20% interest in Subsidiary S at $3,500 by cash.
- Fair value of the property of S was $8,000.

**During 2005**

- Parent P reported nil profit and profit of S was HK$6,000 (became cash).
- Fair value of S is HK$30,000 at year-end.
- P accounted for S as held for trading.

**On 1.1.2006**

- P acquired additional 60% interest in S at $22,000 by cash.
- Fair value of the property of S was $11,000.



## HKAS 36

**Example**

| *On 1.1.2006* | Parent P | Sub S | J#1 | J#2 | Consolidated |
|---|---|---|---|---|---|
| Property | $ 0 | $ 6,000 | | 5,000 | $ 11,000 |
| Goodwill | 0 | 0 | | 12,100 | 12,100 |
| Investment | 28,000 | 0 | (2,500) | (25,500) | 0 |
| Cash at bank | 4,500 | 8,000 | | | 12,500 |
| | 32,500 | 14,000 | | | 35,600 |
| | | | | | |
| Issued equity | $ (30,000) | $ (5,000) | | 5,000 | $ (30,000) |
| Retained earnings | (2,500) | (9,000) | 2,500 | 7,800 | (1,200) |
| Revaluation reserves | 0 | 0 | | (600) | (600) |
| Minority interest | 0 | 0 | | (3,800) | (3,800) |
| | (32,500) | (14,000) | | | (35,600) |

# HKAS 36

**Example**

- Assume S mainly involved in holding investment property to derive rental and had 2 properties managed independently.
- On 2.1.2006, S disposed of one property at $8,000 (cost $3,000) and the remaining property's recoverable amount was $14,000 (cost $3,000).
- Discuss the impact on the consolidation level.



# HKAS 36

**Example**

Entity A performed an impairment review on the CGU X, which has the following assets on hand:

| | Carrying amount |
|---|---|
| Goodwill | $ 1,500 |
| Property, plant and equipment (carried at revalued amounts) | 4,000 |
| Property, plant and equipment (carried at cost) | 5,700 |
| Inventory, at net realisable value | 2,400 |
| AFS financial assets, at fair value | 1,300 |
| Total | 14,900 |

- After an impairment review, Entity A found that the recoverable amount of CGU X is $12,000.
- Calculate the impairment loss and allocate to the individual asset.

# HKAS 37

**Example**

- Nette has recently constructed a natural gas extraction facility and commenced production one year ago (1 June 2003). There is an operating licence given to the company by the government which requires the removal of the facility at the end of its life which is estimated at 20 years. Depreciation is charged on the straight-line basis.
- The cost of the construction of the facility was $200 million and the net present value at 1 June 2003 of the future costs to be incurred in order to return the extraction site to its original condition are estimated at $50 million (using a discount rate of 5% per annum). 80% of these costs relate to the removal of the facility and 20% relate to the rectification of the damage caused through the extraction of the natural gas. The auditors have told the company that a provision for decommissioning has to be set up.
- Explain with reasons and suitable extracts/computations the accounting situations in the financial statements for the year ended 31 May 2004; and
- Discuss whether the treatment of the items appears consistent with the 'Framework'.



# HKAS 37

**Example**

- Entity A is involved in a court case about the plagiarism of software.
- Legal opinion seems to indicate that Entity A will lose the case.
- Entity A estimates that
  - the most likely outcome (60% chance) will be a settlement payment of costs and penalties of $1 million in 2 years' time
  - the best case scenario (30% chance) is deemed to be a settlement payment of $500,000 in one year's time and
  - the worst case scenario (10% chance) will be a settlement payment of $2 million in 3 years' time (discount rate is 5%)
- Discuss the implication on the financial position.

# HKAS 37

**Example**

- Entity A operates profitably from a factory that it has leased under an operating lease.
- During the year, Entity A relocates its operations to a new factory.
- The lease on the old factory continues for the next 4 years.
- Entity A cannot cancel that lease and the factory cannot be re-let to another user.
- Discuss.



# HKAS 37

**Example**

- The directors of Desolve, planned and approved the closure of its glass making activity, a 100% owned subsidiary company, Glass. This decision was announced on 30 June 2001 and the subsidiary was closed down on 30 November 2001. The year end of the group is 31 July 2001 and the financial statements were approved on 10 December 2001.
- Desolve wished to make a provision of $15 million at 31 July 2001 for the costs of closing the glassmaking business. This amount has taken into account approximately $3 million for the potential profit on the disposal of the land and buildings of the subsidiary. Desolve has included this amount ($15 million) in non-current assets and not the income statement as the costs will be recoverable from the estimated disposal proceeds. The contracts for the sale of the land and buildings were signed on 1 November 2001 and were completed on 20 December 2001 for a price of $25 million at a profit of $4 million.
- It was anticipated that between 31 July 2001 and 30 November 2001 the subsidiary would make operating losses of $20 million before it is closed. Also there would be a cost of $5 million incurred in retraining and relocating the employees who accept employment in the refocused Group.

# HKAS 37

**Example**

- The HK Building Management Ordinance S20(2) suggests the (Owners) Corporation to consider establishing a contingency fund to provide for any expenditure of an unexpected or urgent nature.
- In line with the above, a Maintenance and Repair Fund is normally established by a property management company in order to provide funds for the estimated cost of anticipated maintenance, redecoration and repair works which will be undertaken in the foreseeable future on the premises.
- Should the property management company recognise a provision for such repairs and maintenance in the financial statements?