Tutorial 2 Solutions

Comprehension questions

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1. **Why would an accounting estimate change and how is the change accounted for?**

2. **Provide examples of judgements made in preparing the financial statements that can lead to estimation uncertainty at the end of the reporting period. Describe the disclosures that would be required in the notes.**

Application and analysis exercises

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1. Revenue recognition – sale of goods

In each of the following situations, state at which date, if any, revenue will be recognised.

- A contract for the sale of goods is entered into on 1 May 2022. The goods are delivered on 15 May 2022. The buyer pays for the goods on 30 May 2022. The contract contains a clause that entitles the buyer to rescind the purchase at any time. This is in addition to normal warranty conditions.

- A contract for the sale of goods is entered into on 1 May 2022. The goods are delivered on 15 May 2022. The buyer pays for the goods on 30 May 2022. The contract contains a clause that entitles the buyer to return the goods up until 30 June 2022 if the goods do not perform according to their specification.
- A contract for the sale of goods is entered into on 1 May 2022. The goods are delivered on 15 May 2022. The contract contains a clause that states that the buyer shall pay only for those goods that it sells to a third party for the period ended 31 August 2022. Any goods not sold to a third party by that date will be returned to the seller.
- Retail goods are sold with normal provisions allowing the customer to return the goods if the goods do not perform satisfactorily. The goods are invoiced on 1 May 2022 and the customer pays cash for them on that date.

2. Revenue recognition – rendering of services

On 1 February 2024, FastNet Ltd entered into an agreement with Smith Ltd to develop a new database system (both hardware and software) for Smith Ltd. The agreement states that the total consideration to be paid for the system will be $430 000. FastNet Ltd expects that its total costs for the system will be $335 000. As the end of its reporting period, 30 June 2024, FastNet Ltd had incurred labour costs of $65 000 and materials costs of $180 000. Of the materials costs, $30 000 is in respect of materials that have not yet been used on the system. Of the labour costs, $12 500 is an advance payment to a subcontractor who had not performed their work on the project as at 30 June 2024. As at 30 June 2024, Smith Ltd had made progress payments to FastNet Ltd of $250 000.

FastNet Ltd calculates the measurement of progress using input methods in accordance with paragraph B18 of AASB 15/IFRS 15.

Required
Calculate the revenue to be recognised by FastNet Ltd for the year ended 30 June 2024 and prepare the journal entries to record the transactions described. Assume all of FastNet Ltd's costs are paid for in cash. (LO4)

3. Multiple-element arrangement

All Star Ltd provides a bundled service offering to Bruce Ltd. It charges Bruce Ltd $28 000 for initial connection to its network and two ongoing services — access to the network for 1 year and 'on-call troubleshooting' advice for that year. The end of All Star Ltd's reporting period is 30 June.

Bruce Ltd pays the $28 000 upfront, on 1 July 2023. All Star Ltd determines that, if it were to charge a separate fee for each service if sold separately, the fee would be:

Connection fee	$ 5 000
Access fee	9 000
Troubleshooting	18 000

Required
Prepare the journal entries to record this transaction in accordance with AASB 15/IFRS 15 for the year ended 30 June 2024, assuming All Star Ltd applies the relative fair value approach. Show all workings. (LO3 and LO4)

4. Accounting estimates and errors

Yung Ltd estimates its future liability for repairs to products sold with a 12-month warranty as a percentage of its net credit sales. Warranty expense and actual repair costs for the last 2 years ending 30 June were as follows.

	Warranty provisions	Actual costs
2021–22	$ 10 000	$ 16 000
2022–23	11 000	18 250

Required
Comment on Yung Ltd's accounting method for warranty liabilities. What action should be taken with respect to the accounting estimates? If an investigation during 2023–24 finds that the figure for warranty expense was incorrectly calculated for 2022–23 and

should have been $17 500, what action is required under AASB 108/IAS 8? (LO2 and LO3)

5. **Events after reporting period**

Events after the reporting period

Monty Ltd has provided the following information concerning events occurring between the end of the reporting period and the date the accounts were authorised. This information is to be considered in the preparation of the financial statements for the year ended 30 June 2022.

(a) On 29 August 2022 a lawsuit was lodged against the company by the families of crew members drowned in the 17 July storm, alleging negligence, and claiming $4 million in damages. No date has as yet been set for the court hearing.
(b) On 17 July 2022, a firebomb destroyed four of the company's transport vehicles resulting in damages of $600 000. Insurance will cover $450 000 of the damages but payment of the insurance claim has been delayed by a police investigation. As a result of the loss of these vehicles, the company's delivery schedules have been severely disrupted.
(c) On 18 July 2022, the release of a far superior and cheaper product by a competitor caused a major decline in demand for Monty Ltd's Product X. In an effort to sell remaining stock of the product, Monty Ltd has reduced its selling price to 50% of cost. Inventories on hand at 30 June 2022 were recorded at their cost of $306 000.

(d) On 15 August 2022, the Department of Occupational Health and Safety charged the company over unsafe storage practices that resulted in the leakage of toxic materials into a local creek. The leakage occurred on 3 July 2022. If found to be negligent by the court, the company will have to pay a fine of $250 000 plus legal and clean-up costs in excess of $175 000.

(e) On 21 August 2022, the purchasing manager discovered that a batch of invoices relating to June inventories purchases had not been processed. The invoices totalled $58 480.
(f) On 30 August 2022, the company issued a prospectus offering 6000 10% debentures of $150 each for public subscription. The debentures are redeemable on 1 October 2025. Interest is payable annually in arrears. The debentures are secured by a floating charge over the company's assets.

Assume all events and transactions are material.

Required

Classify the above events as either adjusting or non-adjusting events after the end of the reporting period. Justify your classification.

6. **Determining whether the following parties are related party of an entity**

Which of the below are related parties of an entity within the scope of AASB 124/IAS 124? Give reasons for your answer.

(a) A person who has the authority to plan, direct and control the activities of the entity
(b) The domestic partner and children of a director of the entity.
(c) The non-dependent parent of a director of the entity.

(d) A subsidiary company that is directly controlled by the entity.
(e) Dividend payment to employees who are holders of an entity's shares.
(f) A supplier with whom the entity transacts a significant volume of business, simply by virtue of the resulting economic dependence.