

**Part 4****Chapter 18**  
**Events after the reporting period**

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Question	Key issues
18.1	Alleged litigation before reporting date
18.2	Liquidation of a customer
18.3	Inventory write down, liquidation of a customer, date of authorisation
18.4	Understanding the effect of specific events: identification, discussion and journal entries
18.5	Reporting of a guarantee in the financial statements
18.6	Change in market value of investments
18.7	Insolvency of a customer, legal action against entity, obsolete inventory,
18.8	Litigation: provisions, contingencies and post reporting period events

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**Question 18.1**

Bigmouth Limited, a manufacturer of toothpaste, was taken to court over alleged defamation charges when Bigmouth Limited accused a rival toothpaste manufacturer of industrial espionage. Before the year end of 31 December 20X3, the lawyers of Bigmouth Limited advised that, although losing the case was unlikely, legal fees and settlement costs could amount to C800 000 in the event that the court case was lost.

On 4 February 20X4, the judge presiding over the case ruled that Bigmouth should pay C900 000 to the plaintiff as well as pay all of the plaintiff's legal fees, which amounted to C150 000.

The financial statements had not yet been authorised for issue at the time of the court ruling.

**Required:**

Discuss how this information should be treated in the financial statements of Bigmouth Limited for the year ended 31 December 20X3.

**Question 18.2**

Penguin Foods Limited received a letter from Total Liquidators on 15 January 20X1, stating that Salmon Fish Shop had been placed into liquidation owing to trading difficulties and that all creditors could expect to receive a liquidation dividend of no more than C0.15 in C1. Salmon Fish Shop owed Penguin Foods Limited C136 000 at 31 December 20X0.

The financial statements for the year ended 31 December 20X0 were approved on 15 March 20X1.

**Required:**

- Identify, giving reasons, what type of event this information would be classified as in terms of IAS 10.
- Disclose all the effects of the above information in the annual financial statements of Penguin Foods Limited as at 31 December 20X0 in accordance with IAS 10.

**Question 18.3**

Melrose Limited is a company that manufactures and distributes computerised electronic products. The head office is situated at The Melrose Arch with retail outlets and warehouses in different parts of the country. The financial year end of the company is 30 June.

The management of the company completed the draft financial statements for the *year ending 30 June 20X5* on 31 August 20X5. On 18 September 20X5, the board of directors reviewed the financial statements and authorised them for issue. A profit announcement appeared in the press on 19 September 20X5. The financial statements are made available to shareholders on 1 October 20X5 and are approved by shareholders at the annual meeting on 5 November 20X5.

The following events occurred after the end of the reporting period:

- A major competitor announced a reduction in the price of its MP3 players during July 20X5. The competitor was able to do this because of its ongoing investment in new

technology. Management of Melrose Limited had included the inventory of MP3 players on the draft statement of financial position at its cost of C6 500 000. It is estimated that the net realisable value of this inventory at 30 June 20X5 is C5 000 000 because of the competitor's price reduction.

- b) One of Melrose Limited's warehouses is situated on the Kwa-Zulu Natal north coast. A tropical storm struck the area during late August 20X5 and flooded the warehouse, destroying the entire inventory on the ground floor, comprising modems and lightning protector kits. This inventory was included on the draft statement of financial position at 30 June 20X5 at a cost of C3 000 000.
- c) A customer of Melrose Limited was placed into liquidation at the end of July 20X5. The amount of C400 000 owing by this customer was included in accounts receivable on the draft statement of financial position at 30 June 20X5.
- d) Another customer of Melrose Limited, whose retail outlet was situated on the Kwa-Zulu Natal north coast, announced early in September 20X5 that it was closing down after its premises and all the fixtures and fittings as well as its inventory were destroyed as a result of the August tropical storm. The company was under-insured and was forced to close down. Management of Melrose Limited estimates that it is unlikely that more than C0.30 in the C1 will be paid on liquidation. An amount of C150 000 owing from this customer was included in accounts receivable on the draft statement of financial position at 30 June 20X5.
- e) Melrose Limited proposed a bonus scheme for all employees amounting to C200 000. This scheme was approved by the board of directors and communicated to the employees on 19 September 20X5.

**Required:**

Discuss, with reasons, the nature of each event described above in terms of IAS 10 as well as the appropriate accounting treatment (include any necessary journal entries) and / or disclosure in the financial statements of Melrose Limited for the year ended 30 June 20X5.

**Question 18.4**

Toddy Limited's financial statements for the year ended 31 December 20X3 have not yet been authorised for issue. The directors are expecting to authorise the release of these financial statements on 5 May 20X4. The following issues, which have not yet been considered, require your attention:

- Vandalism during December 20X3 resulted in the complete destruction of a neighbouring company's warehouse, leading to that company filing for insolvency in January 20X4. This neighbouring company was, unfortunately, one of Toddy Limited's debtors, owing Toddy Limited C100 000 at 31 December 20X3. The liquidators announced in January 20X4 that C0.20 per C1 would be paid upon liquidation. The full balance owing by this debtor is included in the statement of financial position as at 31 December 20X3.
- Toddy Limited owns 100 000 shares in a listed company. At 31 December 20X3 the market price of each of these shares was C5. During March 20X4, war broke out and resulted in the share price dropping dramatically to C2 per share. The investment in shares as at 31 December 20X3 has not been adjusted for the drop in share price.
- Toddy Limited will be issuing 500 000 C1 par value shares on 10 May 20X4.

All amounts are material but none of the issues mentioned above have caused there to be a 'going concern' problem.

**Required:**

With reference to the treatment of *each* of the three issues in the financial statements of Toddy Limited for the year ended 31 December 20X3:

- i) Briefly explain the reasoning for your answer to part (i) above.
- ii) Provide the required adjusting journal entries, where appropriate, or state whether or not any related information would need to be disclosed in the abovementioned financial statements.

Set your answer out under the following headings:

- a) Insolvent debtor
- b) Drop in value of investment in shares
- c) Issue of shares

*Ignore taxation.*

**Question 18.5**

Simpson Limited is a family owned company that sells designer shorts and skateboards. The year end of the company is 30 June. Draft financial statements *for the year ended 30 June 20X3* were prepared *at 30 June 20X3* based on information available at that date. The directors are currently in the process of reviewing all available information prior to publishing the financial statements *on 30 September 20X3*.

At the beginning of August 20X2, Simpson Limited signed a guarantee amounting to C1 000 000 for the borrowings of a major supplier, Smithers Limited, whose financial condition at that time was sound. At 30 June 20X3, the directors of Simpson Limited still believed the financial condition of Smithers Limited to be sound. However, it has since come to light that the financial condition of Smithers Limited has been deteriorating since early 20X3 and at 30 August 20X3 it filed for protection from its creditors.

**Required:**

- a) Discuss, with reasons, how the guarantee would have been reported in the *draft* financial statements of Simpson Limited for the year ended 30 June 20X3.
- b) Discuss, with reasons, how the guarantee should be reported in the *published* financial statements of Simpson Limited for the year ended 30 June 20X3.

**Question 18.6**

Core Limited is a small company that designs customised software solutions for clients. The year end of the company is 30 June. Draft financial statements *for the year ended 30 June 20X3* were prepared *at 30 June 20X3* based on information available at that date. The directors are currently in the process of reviewing all available information prior to publishing the financial statements *on 30 September 20X3*.

Core Limited has a portfolio of investments where it invests excess cash on the stock exchange. At 30 June 20X3, the cost of the investments was C650 000 and the market value amounted to C725 000. During August 20X3, however, market conditions worsened and the market value dropped to C625 000 when the published financial statements were being finalised for publication.

**Required:**

Discuss, with reasons, how this matter should be reported in the published financial statements of Core Limited for the year ended 30 June 20X3.

**Question 18.7**

Blossom Limited is a large distributor of fresh flowers. The company has large contracts to supply florists and corporate event co-ordinators throughout the country. The financial director and his staff are in the process of preparing the financial statements for the year ended 31 December 20X8.

The following events took place between the reporting period date and the date of authorisation of issue of the financial statements:

- a) It was discovered that a customer, Violet Florists, who owed C100 000 at year-end was declared insolvent on 15 January 20X9 after its premises burnt down over the previous weekend. The premises were completely destroyed and were not insured.
- b) Legal action was brought against Blossom Limited for delivering old flowers to an event co-ordinator who needed them for a government function that hosted foreign heads of state on 23 December 20X8. The claim is for C10 000. Blossom Limited's lawyers believe it is highly likely that Blossom Ltd will have to pay C10 000.
- c) Flowers in stock often pass their sell-by date before they are sold and are left in the corner of the store room. At the year-end stock count on 31 December, some old flowers were inadvertently included in stock at their cost of C5 000. They will never be sold by Blossom Limited.
- d) There was a burglary at Blossom Limited's premises on 2 January 20X9 and pesticide and insecticide to the value of C10 000 was stolen. Such items are included in consumable stores.

The financial statements are authorised for issue on 20 January 20X9.

**Required:**

Prepare the journal entries that are necessary to correct the financial statements of Blossom Limited to ensure compliance with International Financial Reporting Standards. Provide reasons as to why a journal entry is / is not prepared.

**Question 18.8**

Lemon Limited is a company that produces jam and tinned fruit. It has a 31 December year end.

Lemon Limited purchased 200 tons of long-life limes on 2 December 20X2 for C500 000, half of which had been used in the production of marmalade by year-end. All the marmalade produced from this delivery of long-life limes had been sold to Pack-a-Sack Limited

(a popular nation-wide grocery chain) by year-end. On 10 December 20X2, a customer of Pack-a-Sack Limited suffered serious food poisoning and alleged that it was caused by a bottle of marmalade purchased from Pack-a-Sack Limited. This customer proceeded to take Lemon Limited to court over the poisoning. Lemon Limited is not insured against the potential losses that may result from the court case.

Due to public interest on a national level, the case went to court almost immediately. Indications during the court proceedings held in late December 20X2 were that Lemon Limited was probably responsible for the poisoning and would probably be found guilty: it was found that the marmalade was poisoned because the long-life limes used in its manufacture were transported by the supplier together with a load of insecticide, which had contaminated the limes. It was impossible, however, to reliably estimate the settlement costs at year-end. Due to the negative publicity arising from the court case, Lemon Limited has decided not to plead against the inevitable 'guilty' verdict and to willingly pay all costs, in the interests of salvaging a positive public image.

**The following additional information is relevant:**

- **Estimated costs:** During January 20X3, Lemon Limited's lawyers estimated that the court would award the plaintiff C2 500 000 whereas an out-of-court settlement would probably be C2 200 000.
- **Findings of the specialists:** Specialists hired by Lemon Limited in January 20X3 confirmed that 20% of the balance of the long-life limes in stock at year-end are also contaminated and must be destroyed.
- **Warnings by lawyers:** Lemon Limited has been unable to keep the case out of the media and their lawyers warned in December 20X2 that as soon as the verdict was published in the media, more, similar cases will probably be brought against Lemon Limited by other aggrieved customers, although it was impossible to estimate the number of cases or their financial impact.
- **Returns:** Pack-a-Sack Limited had sold all of the bottles of marmalade by 31 December 20X2. By the time the financial statements were authorized for issue on 15 February 20X3, no bottles of marmalade had been returned. It seems that there is only a remote chance that there would be any returns at this late stage.

All amounts are material but none of the issues mentioned above have caused there to be a 'going concern' problem.

**Required:**

Discuss, with reference to IAS 10, how – if at all – the events should be recognised and measured in the financial statements of Lemon Limited for the year ended 31 December 20X2 in order to comply with International Financial Reporting Standards.

You should use the following headings in your discussion:

- Estimated costs
- Findings by specialists
- The warning
- Possible returns