

ACC2100 / ACF2100 Financial Accounting

Topic 6 Impairment of Assets & Business Combinations: Lecture Examples

Example 1: Impairment of Assets (PQ 13.7)

Saxon Ltd conducted an impairment test at 30 June 2015. As part of that exercise, it measured the recoverable amount of the entity, considered to be a single cash-generating unit, to be \$217 600. The carrying amounts of the assets of the entity at 30 June 2015 were:

Equipment	200 000
Accumulated depreciation	(40 000)
Patent	40 000
Goodwill	6 400
Inventory	32 000
Receivables	1 600

The receivables held by Saxon Ltd were all considered to be collectable. The inventory was measured in accordance with AASB 102 *Inventories*.

For the period ending 30 June 2016, the depreciation charge on equipment was \$14 720. If the equipment had not been impaired the charge would have been \$20 000.

At 30 June 2016, the recoverable amount of the entity was calculated to be \$10 400 greater than the carrying amount of the assets of the entity. As a result, Saxon Ltd recognised a reversal of the previous year's impairment loss.

Required

Prepare any necessary journal entries to account for the impairment loss at 30 June 2015 and the reversal of the impairment loss at 30 June 2016.

Example 1: Solution

CA = 200 000 – 40 000 + 40 000 + 6 400 + 32 000 + 1 600 =

RA =

Impairment loss =

The goodwill of is written off first.

The remaining impairment loss is allocated as follows:

	<i>Carrying Amount</i>	<i>Allocation</i>	<i>Net Amount</i>
Patent	40 000		
Equipment	<u>160 000</u>		
	<u>200 000</u>		

At **30 June 2015**, the journal entry to record the impairment is:

Impairment loss	Dr
Goodwill	Cr
Accum amort & imp losses – patent	Cr
Accum depn & imp losses –equipment	Cr

At **30 June 2016**, in relation to the assets previously adjusted for impairment:

	CA at 30/6/16	CA – if no impairment	Limits
Patent	36 800	40 000	
Equipment	200 000	200 000	
Accumulated depn & impairment losses	<u>(67 520*)</u>	<u>(60 000)</u>	
	132 480	140 000	

**Accum depn & impairment losses – Equip: 40 000 + 12 800 + 14 720*

As the recoverable amount at 30 June 2016 is only **\$10 400** greater than the carrying amount of the entity, this is the maximum reversal amount. The \$10 400 reversal is allocated as follows:

	<i>CA at 30/6/16</i>	<i>Allocation</i>
Patent	36 800	
Equipment	<u>132 480</u>	
	<u>169 280</u>	

However, the equipment can only be revalued upwards by

The balance of is allocated to the patent which increases its allocation to which is still less than \$3 200 (limit).

The reversal is then accounted for as follows:

Accum amortisation and imp losses – patent	Dr	
Accum depn & imp losses – equipment	Dr	
Income – reversal of impairment loss		Cr

Example 2: Business Combinations

Kite Ltd, a supplier of kites, agreed to acquire the business of Surfer Ltd, taking over all assets and liabilities as at 1 June 2016. The statement of financial position as at 1 June 2016 of Surfer Ltd was as follows:

	Carrying amount	Fair value
Plant and equipment	\$110,000	\$110,000
Accounts receivable	27,500	26,950
Inventory	82,500	88,000
Motor vehicle	33,000	38,500
Accounts payable	61,600	61,600
Bank overdraft	66,000	66,000
Share capital (50,000 ordinary shares)	100,000	

In exchange for the net assets of Surfer Ltd, Kite Ltd agreed to provide the following consideration:

- (1) Two fully paid ordinary shares in Kite Ltd plus \$2 cash for every ordinary share in Surfer Ltd. The share price on 1 June 2016 was \$1.20 per share. This price represented a six-month high. Costs of issuing the shares was \$500.
- (2) Kite Ltd agreed to supply cash to the value of any decrease in the share price below \$1.20 for the shares issued. This guarantee was valid for a period of 3 months (to 1 September 2016). Kite Ltd believed that there was a 60% chance that the share price would remain at \$1.20 and a 40% chance that it would fall to \$1.10.
- (3) Cash of \$25,000, half to be paid on the date of exchange and half in one year's time.
- (4) Supply of a patent to Surfer Ltd. The fair value of the patent is \$55,000. The patent was internally generated and therefore not recognised in the books of Kite Ltd.
- (5) Surfer Ltd was being sued by a former employee who was claiming \$40,000 compensation for unfair dismissal. Lawyers estimated that there was a 25% chance of winning the case.

Fees paid to legal advisers and valuers amounted to \$4,400. The incremental borrowing rate for Kite Ltd is 10% per annum. The shares (and cash consideration as noted in (1) above) were issued and paid on 1 June 2016, when the share price was \$1.20.

On 1 September 2016 the share price of Kite Ltd's shares was \$1.17.

Required:

- (a) Determine the consideration transferred.
- (b) Calculate the net fair value of the assets acquired and liabilities assumed.
- (c) Calculate goodwill/gain on bargain purchase.
- (d) Prepare the journal entries in the records of Kite Ltd in regard to the acquisition on 1 June 2016.
- (e) Prepare the journal entry required on 1 September 2016.

Example 2: Solution**(a) Purchase consideration**

Shares 100,000 shares @ \$1.20

Cash 50,000 shares x \$2

Guarantee 100,000 shares x $(1.20 - 1.10) \times 0.40$

Cash – now

Cash – deferred 12,500 x 0.909091

Fair value of patent

Total

(b) Net fair value of assets acquired and liabilities assumed

Plant and equipment	\$110,000
Accounts receivable	26,950
Inventory	88,000
Motor vehicle	<u>38,500</u>
	263,450
Accounts payable	61,600
Bank overdraft	66,000
Contingent liability (75% x 40,000)	<u>30,000</u>
	<u>157,600</u>

(c)

Goodwill =

(d) and (e)

General Journal

Date	Transaction	DR	CR
d) 1 June 2016	Plant and equipment	110,000	
	Accounts receivable	26,950	
	Inventory	88,000	
	Motor vehicle	38,500	
	Goodwill	197,014	
	Accounts Payable		61,600
	Bank overdraft		66,000
	Share capital		120,000
	Cash		112,500
	Provision for loss in value of shares		4,000
	Consideration payable		11,364
	Gain on sale of patent		55,000
	Contingent liability		30,000
	<i>(Acquisition of Surfer Ltd)</i>		
e) 1 Sept 2016	Acquisition related expenses		
	Cash		
	<i>(acquisition related costs)</i>		
	Share capital		
	Cash		
	<i>(costs of issuing shares)</i>		
	Provision for loss in value of shares		
	Cash		
	Gain		
	<i>(Contingency 100,000 x \$(1.20 – 1.17) paid)</i>		