

5. Critical accounting judgments and key sources of estimation uncertainty

In the application of the Entity's accounting policies, which are described in Note 4, the Entity's management are required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Critical accounting judgments and key sources of uncertainty in applying the estimations that may have a significant impact on the amounts recognized in the accompanying consolidated financial statements are as follows:

- a. **Inventory and accounts receivable allowances** - The Entity use estimates to determine inventory and accounts receivable reserves. When calculating inventory reserves, the Entity considers production and sales volumes, as well as the demand for certain products. When determining the allowance for doubtful accounts, the Entity primarily considers the financial risk represented by each customer, unguaranteed accounts and significant collection delays based on established credit conditions (See Notes 8 and 9 for further detail).
- b. **Property, plant and equipment** - The Entity reviews the estimated useful lives of property, plant and equipment at the end of each reporting period, to determine the depreciation of these assets. Asset useful lives are defined according to the technical studies prepared by specialized internal personnel and with the participation of external specialists. During the years 2014 and 2013, based on detailed analysis of the Entity management modify the useful life of certain components of property, plant and equipment components. The level of uncertainty related to useful life estimates is also linked to market changes and asset utilization based on production volumes and technological development.
- c. **Investment property** - The Entity prepares an annual valuation of investment property with the assistance of independent appraisers. The valuation techniques are based on different methods including; cost, market and income approaches; the Entity has utilized the physical inspection. The valuation methodology includes observable assumptions for properties which, while dissimilar, nonetheless involve the same geographic zones and commercial use. The Entity considers the highest and best use of its assets.

The valuation techniques used by the Entity were not modified in 2014 and 2013. Entity management considers that the valuation methodologies and assumptions utilized are appropriate for determining the fair value of the Entity's investment properties.

- d. **Impairment of long-lived assets** - The carrying value of noncurrent assets is reviewed to detect indications of impairment; i.e., if certain situations or changing circumstances indicate that carrying values may not be recoverable. If indications of impairment are detected, the Entity performs a review to determine whether the carrying value exceeds its recovery value and is impaired. When applying asset impairment tests, the Entity must estimate the value in use assigned to property, plant and equipment and cash generating units, in the case of certain assets. Value in use calculations require that the Entity determine the future cash flows produced by cash generating units, together with an appropriate discount rate for calculating present value. The Entity utilizes cash flow projections by estimating market conditions, prices, production and sales volumes.
- e. **Valuation of financial instruments** - The Entity uses valuation techniques for its financial instruments which include information that is not always based on an observable market to estimate the fair value of certain financial instruments. Notes 12 and 13 contains detailed information on the key assumptions used to determine the fair value of the Entity's financial instruments, as well as an in-depth sensitivity analysis of these assumptions. Entity management considers that the valuation techniques and assumptions it has utilized are suitable for determining the fair value of its financial instruments.
- f. **Contingencies** - As the Entity is involved in certain legal proceedings, it evaluates the probability of a payment obligation arising, accordingly, it considers the legal situation in effect at the estimate date and the opinion of its legal advisers; these evaluations are periodically reconsidered.
- g. **Employee benefits at retirement** - The Entity uses assumptions to determine the best annual estimate of these benefits. Like the above assumptions, these benefits are jointly and annually determined in conjunction with independent actuaries. These assumptions include demographic hypotheses, discount rates, expected remuneration increases and future employee tenure, among other items.

While the Entity considers that these assumptions are appropriate, any modification in this regard could affect the value of employee benefit assets (liabilities) and the statement of income and other comprehensive income of the period in which any such modification takes place.

- h. **Revenue recognition for construction contracts** - When the results of a construction contract can be estimated reliably, revenue is recognized using the percentage-of-completion method based on costs incurred, taking into account the expected costs and revenues at the end of the project, as the activity takes place. Changes in the performance of work, and estimated yields, including those that may arise for incentives for early conclusion of the projects, contractual penalties and final agreements in contracts, are recognized as income in the periods in which revisions are made or approved by customers.

In accordance with the terms of various contracts, revenue is recognized and not necessarily related to the actual amounts billable to customers. Management periodically evaluates the reasonableness of its receivables. In cases where there is evidence collection difficulty, additional allowances for doubtful accounts affecting income in the year they are determined are recognized. The estimate of the reserve is based on the best judgment of the Entity under the circumstances prevailing at the time of its determination.