CHARTERED ACCOUNTANTS ACADEMY

Commissioner Anesu Daka CA(SA)(Z)

- Chartered Accountant (South Africa);
- Professional Speaker (Toastmasters International);
- Founding & Principal Director of CAA
- Trained Facilitator of Learning
- Passionate Academic & Lecturer for Financial Accounting for ZCTA, ITC and APC and ACCA P2&F7;
- Former IFRS specialist and L&D manager for Ernst & Young Zimbabwe.
- Member of the ICAZ APC and Insurance APC sub-committee, ZAPB and FRMP.

CAA – Our Services

Chartered accountants (ICAZ)
CTA, ITC, APC
ACCA & CIS
Skills and professional

Consulting :
IFRS, TAX, Audit, Advisory,

Facilitated Technical Training
In-house Training on IFRS, TAX,
Audit and Financial Management

Publications

FAC4863

2016 Study Pack


GOAL
CTA
CA(Z) RA

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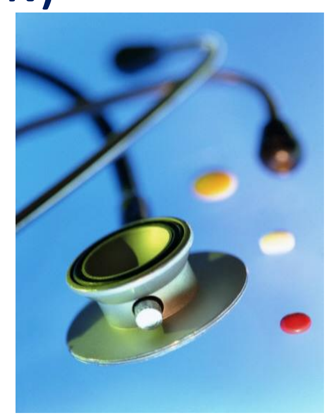
Meaning of “Applied”

Lets say YOU are a Doctor (IFRS *Consultant*)

You give medical remedy/medicine for the disease(s)- (*Apply IFRS principles to the ISSUE to get a CONCLUSION*)



You do DIAGNOSIS to a patient to identify the disease(s) -(*IFRS Issue(s)*)

APPLIED FINANCIAL ACC

- Key Areas to focus on:
  - Identifying the Issue in the question (**problem diagnosis**)
  - Application of accounting, auditing, FinAcc and taxation principles to reach a conclusion on the issue identified (**remedy application**).
  - UNDERSTANDING THE REQUIRED
  - Exam technique for both theory and calculation questions (**Answering the question**).
  - Workings & Referencing

APPLIED FINANCIAL ACCOUNTING

- Key Areas to focus on:
  - Time management
  - Layout and presentation
  - Hand-writing, verbosity, clear and concise
  - Recommendations/interpretations
- **NB**: 5 marks are allocated to: Arrangement and layout, clarity of explanation, logical argument and language usage.

Questions

The Accounting Treatment Framework

Purpose:

The understanding of The Accounting Treatment Framework will aid in the following better understanding of how IFRSs are structured and enhances comprehensive application of the IFRS requirements to a particular accounting issue by students, preparers or practitioners.

The Accounting Treatment Framework

- **Objective**
- **Scope**- is it covered under this standard?
- **Identification/definitions**
- **Initial recognition-is** it an asset, a liability, equity instrument, expense or income **and** what **type** (PPE, Inventory, intangible, financial, investment property etc)?
- **Initial measurement**-Cost/FV
- **Subsequent Recognition**:-depreciation/amortisation, impairment, revaluation/fair-valuation, gains or losses on disposals, amortisation of interest, e.g..
- **Subsequent measurement**:- should it be carried at FV, Rev amt, NRV, cost, PV, replacement cost, Cost less acc depr & impair (HCA) and realisable/settlement value.
- **Derecognition**- settlement
- **Presentation**:-is an SoFP item (NCA, CA, NCL, CL, EQUITY) or SCI item (P/L or OCI)?
- **Disclosure**;-what information should support the figures presented.


Identify transaction- What standard is applicable?
Measurement
Recognition
Disclosure
Presentation
Accounting Treatment

Recognition

Which element of AFS?- A, L, E or I & E as **per the Conceptual Framework**

Subsequent recognition: how should - fv adjustments, revaluation, depreciation, amortization, impairments, e.g.?

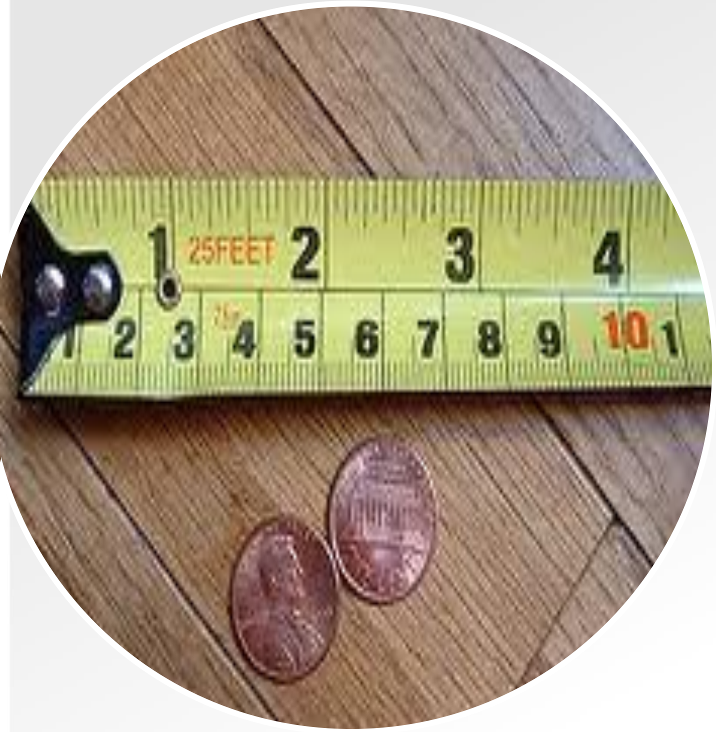
Derecognition – When should the element be removed from the books

Classification: **What is the type of element?**-

And what exactly ,e.g. for IAS 17 Finance or operating lease?

Timing:

When should the item be recognised in the AFS?



Measurement

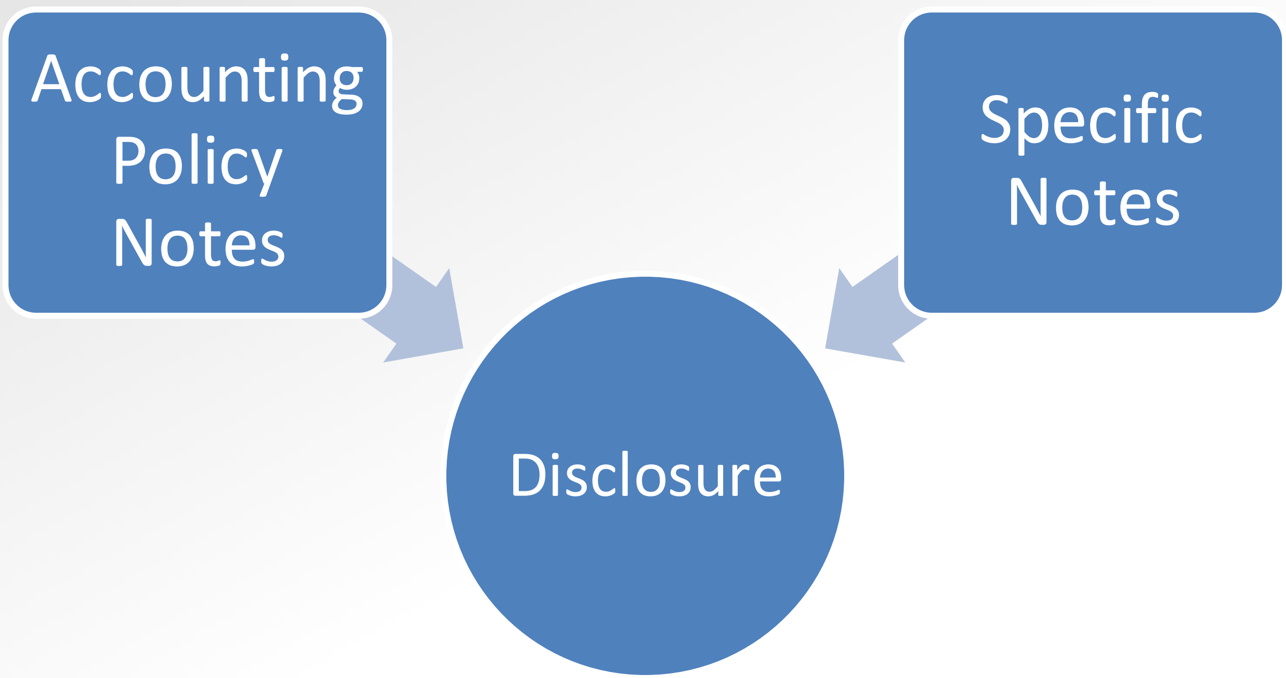
- **Initial measurement: How is the item measured at initial recognition date?**
- Subsequent measurement: At what value do you carry the element and how are is the closing balance measured- FV or Cost-Acc Dep and impairment ?

Presentation

SoP/L & OCI
- Is it P/L?
- Is it OCI?

SOFP
- Is it Non-Current? or
- Is it Current

SOCIE
- Is it Owners Equity?, or
- NCI?


Accounting Policy Notes
Specific Notes
Disclosure

Answer the question, please!!!!!

Structure: Theory Question

- **Identification of issue(s)**
  - Whether an asset should be recognised for the transportation of Tramline passengers?
  - Whether a provision should be recognised for the free transportation of the Transline Passengers/
- **Application/Discussion**
  - Apply the definition of asset on the scenario to prove an asset
  - Apply the definition of a provision to prove a provision
- **Conclusion**
  - Do not recognise an asset
- **Recommendation:**

  Dr Expense

  Cr Asset/~~Bank~~

  Correcting JE

  Prior period errors

Questions.

TUT 102

Test 1

Tutorial Letter 102

1. The Conceptual Framework
2. Presentation of financial statements
3. Income taxes
4. Accounting policies, changes in accounting estimates and errors
5. Inventories
6. Employee benefits

1. CONCEPTUAL FRAMEWORK

Examinability

- FQE
- UNISA CTA Exams

Examinability

2016 Possible areas of focus:

Theory questions mainly focusing on:

- wide application of definition of Asset and Liability

-Use of qualitative characteristics to assess whether AFS or accounting treatment is in compliance with IFRS

Overview

Purpose and Status

Underlying Assumption

Objective

Qualitative Characteristics

Elements

Financial Reporting

Definition:

The provision of financial information about an entity to external users, that is useful to them in making economic decision

For assessing the effectiveness of the entity's management

Financial statements:

Principle way of providing financial information to its users

Summary of the performance and financial position of the entity for the reporting period

The importance of the conceptual framework

Assists IASB in developing and reviewing standards

Promotes harmonisation of standards and reduces alternatives

Assists national standard setters to comply with international principles

Assists auditors on forming an opinion on whether statements conform with IFRS

Assist users in interpreting financial statements

Provides information on the work carried out by IASB

Financial statements users & their information needs

User	Information needs
Investors	• Information for risk and return/ability to pay dividend
Employees	• Provides information on an entity's stability and profitability • Job security
Lenders	• Ability to repay loans and related interest
Suppliers and other trade payables	• Ability to repay amounts due
Customers	• To assess if the company is a going concern that can be relied upon
Government	• Taxation correctly accounted for • Allocation of resources
Public	• Provide information on trends / developments • Gain public favour

Underlying Assumptions

- **PRIOR**
- Going Concern
- Accrual Basis

- **CURRENT**
- Going Concern
- ~~Accrual Basis~~

Note:

The accrual basis has been removed as an underlying assumption under the Conceptual Framework (IAS 1.27)

Going concern:
Entity will continue to trade for the foreseeable future

Qualitative characteristics of financial statements

Relevance	• Relevant if it has the ability to influence economic decision and is provided in time to do so • Predictive Value • Confirmatory value
Faithful Representation	• Complete, neutral and free from error
Comparability	• Information should be consistently prepared • Achieved by adopting the same accounting policies from one period to the next
Verifiability	• Helps assures users that information is faithfully represented
Timeliness	• Information must be available to users on time to be useful
Understandability	• Presentation of information needs to be understandable to users based on: • The user having reasonable knowledge • The users willingness to study the information provided

Elements of Financial statements: Asset

Elements	Definition	Recognition Criteria
Assets 4.4(a)	1. A resource 2. controlled by an entity 3. as a result of past events and from which 4. future economic benefits are expected to flow to the entity	1. Future economic benefits probable 2. Reliably measurable

Examples:

Cash, inventories, plant, property and equipment, intangible assets

How to use the definition of "asset"

- The definition of asset should be used in the following circumstances;
  - Proving whether an item/expenditure should be recognised as an asset.
  - To disapprove an expense, if an expenditure is an asset it is therefore not an expense, vice versa.

NB: Once an asset is proved, the next step is to CLASSIFY the asset into PPE, Intangible, Financial asset, e.t.c (see next slide)

Elements of Financial statements: Liability

Elements	Definition	Recognition Criteria
Liability	1. A present obligation 2. of the entity 3. arising from past events, 4. the settlement of which is expected to result in an outflow of an entity's resources.	1. Future economic outflow probable 2. Reliably measurable

Examples:

Trade payables, unpaid taxes and outstanding loans

When to use the definition of a "liability"

- Use the definition of a liability as follows:
  - To prove existence of a liability or disapprove equity
  - To prove a provision (a "**liabilit**y" of uncertain timing or amount).
- Key element on proving a liability is to prove existence of present obligation, as shown in the next slide.

Elements of Financial statements: Equity

Elements	Definition	Comment
Equity	The residual interest in an entity's assets after deducting all its liabilities	Equity = ownership interest – net assets Recognition: Reliably measurable

Examples:

Share capital, retained earnings and revaluation reserves

Elements of Financial statements: Income

Elements	Definition	Comment
Income	1. Increases in economic benefits 2. Not resulting from contributions made by equity holders	Revenue and gains Recognition: Reliably measurable, revenue must be earned

Examples:

Revenue revaluations, profit on the sale of a non- current asset and interest received on investments

NB: Never use this definition, rather use the definition of revenue as per IAS 18, if inflows are not revenue they are either other income (gains) or capital contribution by equity holders or debt from lenders.

Elements of Financial statements: Expense

Elements	Definition	Comment
Expenses	1. Decreases in economic benefits 2. Not resulting from distributions to equity holders	Expenses include losses Recognition: Reliably measured

Examples:

Materials and labour costs, depreciation and interest paid on loans

NB: Never use this definition, always use the definition of an asset, if it is not an asset it is therefore and expense.

Measurement Bases in financial statements

Historical Cost

- Assets- recorded at their original costs
- Liabilities- recorded at:
  - the original amount received
  - cash expected in settlement

Current Cost

- Assets-amount to be paid out at the end of the reporting period for an equivalent asset
- Liability - value they could be settled for at the end of the accounting period

Present Value

- Discounts future cash flows to account for time value of money

Realisable/ settlement value

- Assets- amount sold out for now
- Liabilities- amount settled for now

Apply Your Knowledge

- Attempt the question below from **Tut 102**:
  - Q2.1 – 2012 FQE Exam

QUESTION 2.2 (22 marks)

Dexter Limited ('Dexter') is a manufacturing group listed on the JSE Limited. The chief financial officer of the group recently contacted you, a specialist on IFRS, requesting you to accept the appointment as technical partner of Dexter and all its subsidiaries.

The Dexter group has always expressed explicit and unreserved compliance with International Financial Reporting Standards (IFRS) in its separate and consolidated annual financial statements.

The following unresolved accounting matter has been identified during a preliminary meeting with the accountant of the Dexter group:

Dexter's carbon footprint

The Kyoto Protocol is an international agreement linked to the United Nations Framework Convention on Climate Change. The major feature of the Kyoto Protocol is that it sets binding targets for 37 industrialised countries and the European community for reducing greenhouse gas (GHG) emissions. Companies in countries subject to the Kyoto Protocol aim to achieve their GHG emission reduction targets by acquiring certified emission reduction (CER) certificates from companies based in developing countries such as South Africa.

Dexter recently underwent a GHG assessment as part of its carbon offsetting strategy. Dexter has always been very conscious of its contributions to a 'greener' environment through the development of alternative projects such as solar and wind energy. Dexter wants to take advantage of the Kyoto Protocol's potential economic and environmental benefits relating to its environmentally-friendly projects, and especially the trade in CER certificates.

The Dexter Sandton factory converted from coal-based energy supplies to a fully solar based power plant in 20.8, which resulted in an average annual reduction of 18 000 tonnes of carbon dioxide emissions. The company as a result received CERs from the United Nations on 31 October 20.11.

The CERs awarded to Dexter are reliably estimated to have a total fair value of R10 million.

REQUIRED

	Marks
Prepare a memorandum to the chief financial officer in which you discuss and make recommendations on the initial recognition and measurement of the certified emissions reduction certificates in the financial statements of Dexter for the financial reporting period ended 31 December 20.11. **Please note:** • Include, but do not limit your answer to, references to the Conceptual Framework for Financial Reporting 2010. • Consideration must be provided for each class of asset for which the certified emissions reduction certificate may meet the definition. • No journal entries are required. • Ignore current and deferred taxation.	22

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Recognition

Which element of AFS?- A, L, E or I & E as **per the Conceptual Framework**

Derecognition – When should the element be removed from the books

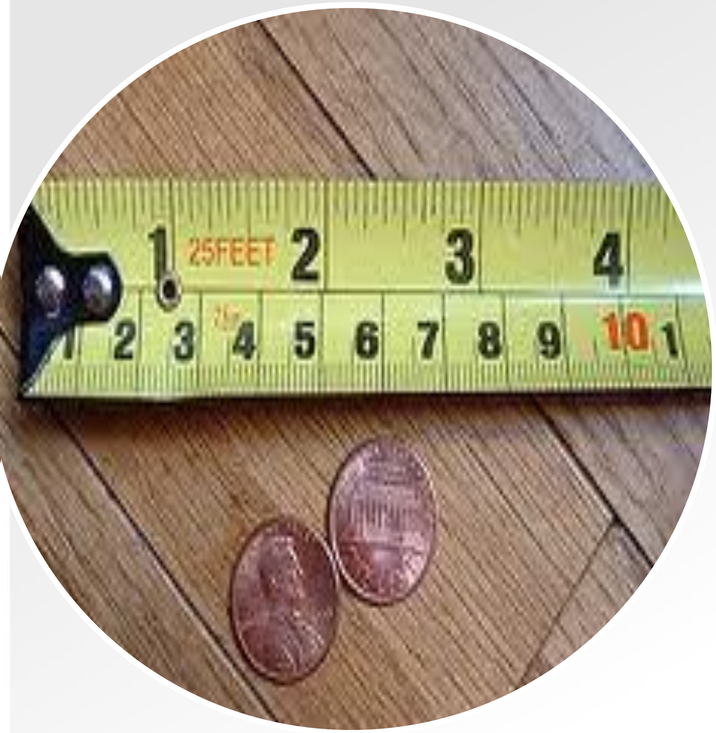
Subsequent recognition: treatment of - fv adjustments, revaluation, depreciation, amortization, impairments, e.g.?

Timing:

When should the item be recognised in the AFS?

Classification: **What is the type of element?**- PPE, Inv Prop, Inventory, e.g.

And what exactly ,e.g. for IAS 17 Finance or operating lease?



Measurement

- **Initial measurement: How is the item measured at initial recognition date?**
- Subsequent measurement: At what value do you carry the element and how are is the closing balance measured- FV or Cost-Acc Dep and impairment ?

QUESTION 2.2 – Suggested solution

An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity (Conceptual Framework chapter 4.4(a)). (1)

Resource: the Certified Emissions Reductions (CER) Certificates appear to be a resource, as these certificates provide Dexter with access to future economic benefits in the form of income from the sale of the CER Certificates to companies in developed countries that regulate carbon emissions very stringently. (1)

An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits (IAS 38.13). (1)

Control: Dexter controls the resource, as it is able to restrict other parties from accessing the future economic benefits that can be earned from the sale of the CER Certificates – these certificates have been awarded to Dexter by the United Nations and the CER Certificates therefore legally belongs to Dexter. (1)

Control: should any benefits arise from the sale of the CER Certificates, these future economic benefits legally belong to Dexter in terms of the sales agreement and the benefits are therefore legally protected. (1)

The past event leading to Dexter controlling the resource is the awarding of the CER Certificates to Dexter by the United Nations on 31 October 20.11. (1)

Economic benefits will arise through cash flows from the sale of the CER Certificates. (1)

The CER Certificates will be recognised as an asset in the financial statements of Dexter if they satisfy the recognition criteria of probable future economic benefits and reliable measurement at the date of the recognition (Conceptual Framework chapter 4.44). (1)

The future economic benefits are probable as companies in developed countries are in direct need of these CER Certificates to meet their carbon emission targets and the CER Certificates have been reliably estimated to have a fair value or R10 million. (2)

Conclusion: It therefore appears that the CER Certificates will be recognised as an asset in terms of the Conceptual Framework for Financial Reporting. (1)

Class: Intangible assets

An intangible asset is an identifiable, non-monetary asset without physical substance (IAS 38.8). (1)

The CER Certificates appear to be:

- Identifiable (they are separable as they can be divided from the entity and sold, transferred etc. and they arise in terms of legal rights as they were granted by the United Nations to Dexter), (1)
- Non-monetary (they are not rights to receive cash or cash equivalents) and (1)
- Without physical substance (they are not physical assets, but are a commodity without physical substance). (1)

The CER certificates appear to meet the definition of an intangible asset in terms of IAS 38. (1)

Class: Inventories

Inventories are assets held for sale in the ordinary course of business, in the process of production for such sale, or in the form of materials or supplies to be consumed in the production process or rendering of services (IAS 2.6). (1)

As Dexter wishes to trade in CER Certificates, regular sales thereof could result in sales in the ordinary course of business, meaning that the CER Certificates could be classified as inventory. (2)

Class: Property, plant and equipment and Investment property

Property, plant and equipment and Investment property are tangible assets. (1)

It is clear from the discussion on intangible assets that CER Certificates are of an intangible nature and therefore cannot be classified as property, plant and equipment of investment property. (1)

Class: Financial assets

A financial asset is defined in IAS 32.11 as either cash, an equity instrument of another entity or a contractual right to receive cash or another financial asset from another entity. (1)

IAS 32 AG 10 states that physical assets (inventory, PPE etc) and intangible assets are not financial assets. Control of such physical or intangible assets creates an opportunity to generate an inflow of cash or another financial asset, but it does not give rise to a present right to receive cash or another financial asset. (1)

It is clear from the above, that the CER Certificates will fall in the class of intangible assets or inventories, in which case IAS 32 AG 10 would rule out the possibility of this being a financial asset. (1)

Further, although the CER Certificate creates the opportunity to generate an inflow if Dexter elects to sell the CER's, the CER itself does not upon creation give rise to a present right to receive cash or another financial asset. (1)

Measurement

IAS 38.24 states that intangible assets are measured on initial recognition at cost. Cost is defined as the amount of cash or cash equivalents paid, or the fair value of the consideration given. (1)

IAS 2.9 states that inventories shall be measured at the lower of cost or net realisable value. (1)

Dexter has not paid for the CER. They were acquired as a consequence of applying for the CER from the UN. If any costs were incurred to obtain accreditation, these costs would be capitalised to the cost of the CER. This would constitute the cost of the intangible asset or inventory. (2)

It would be inappropriate to recognise the CER at fair value upon initial recognition, as the fair value does not constitute cost as defined in IAS 38 or IAS 2. (2)

Alternatively, the CER could be seen to be acquired by way of a government grant, in which case the entity could recognise both the intangible asset and the grant initially at fair value. (2)

Total (33)

Maximum (22)

Presentation of Statements: IAS 1

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Examinability

FQE

An element of IAS 1 has been examined in almost all FQE exams (Consolidation Format or Separate Accounts).

Most Examined:

- P/L + OCI
- SCE
- Extracts of CF Statement

UNISA CTA Exams

- Examined in:
  - 2015
  - 2014
  - 2013
  - 2012
  - 2009

Examinability

2016 Possible areas of focus:

- SFP
- Consolidated Profit and Loss account + Other Comprehensive Income
- Consolidated Statement of Changes in Equity + Link with OCI
- Notes to financial statements
- Current vs Non-current (theory)
- Off-setting principle (theory)

NB: Its most critical to know the formats and how each standard affect the above. A must Learn

Overview

- Presentation of Financial Statements
  - Overall considerations
  - Structure and content
    - Statement of Financial Position
    - Statement of Comprehensive Income
    - SOCIE
    - Notes
  - IAS 7 Statement of Cash Flows

Overall considerations

- Fair presentation
- Going concern
- Accrual basis
- Consistency
- Materiality and aggregation
- Offsetting
- Comparatives.

"Fair Presentation"

IAS 1.15 "Present fairly" means …

- "faithful representation of the effects of
  - transactions
  - other events and
  - conditions
- in accordance with the definitions and recognition criteria … set out in the Framework".

Compliance with IFRS

- An entity shall make **an explicit and unreserved statement of compliance with IFRSs in the notes.**
- An entity shall not describe financial statements as complying with IFRSs unless they **comply with all the requirements of IFRSs**.

IFRS Compliance Statement

NOTES FOR THE YEAR ENDED 31 DECEMBER 20.11

1. Accounting policy

1.1 Basis of preparation

The financial statements comply in all aspects with IFRS. It has been prepared on the historical cost basis, except for land that is revalued. (1)

Underlying Assumptions

- **PRIOR**
- Going Concern
- Accrual Basis

- **CURRENT**
- Going Concern
- ~~Accrual Basis~~

Note:
The accrual basis has been removed as an underlying assumption under the Conceptual Framework (IAS 1.27)

Going concern:
Entity will continue to trade for the foreseeable future- IAS1.25

Accrual basis of accounting

IAS1.27: An entity shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting.

Under Accrual Basis: Transactions & events are recorded when event occurs and not when cash is received or paid.

Consistency of Presentation

- The presentation and classification of items in the financial statements shall be retained from one period to the next unless a change is justified either by a change in circumstances or a requirement of a new IFRS. [IAS 1.45]

Materiality and aggregation

Material items

Immaterial items

- Present separately

- Aggregate with amounts of similar nature or function
- Need not present separately

Offsetting- IAS1.32

- <u>**Assets and liabilities should not be offset**</u> **except** when required or permitted by another IAS.

- <u>***Items of income and expense should be offset***</u> when required or permitted by an IAS
  - where gains, losses, etc. arising from the same or similar transactions/events are not material.

The most significant change to IAS 1 is that **Other Comprehensive Income** will be separated into two sections

Section 1 will include all items that will not be reclassified subsequently to profit or loss.

Section 2 will include items that will be subsequently reclassified to profit or loss when specific conditions are met.

Comparative information

Numerical information

Narrative information

- DISCLOSE *unless* an IAS permits/ requires otherwise
- INCLUDE where relevant to understanding *current* period's financial statements

The Complete Set of Financial Statements

Complete set of financial statements

- Statement of financial position
  - Assets, Liabilities and equity
- Statement of comprehensive income
  - Income (including gains) and expenses (including losses)
- Statement of changes in equity
  - All changes in equity
- Statement of cash flows
  - Major cash inflows and outflows
- Notes
  - Significant Accounting Policies / other Explanatory notes

IAS 1 requires the individual components of the financial statements to be presented with equal prominence in an entity's complete set of financial statements. [IAS 1.11]

Statement of Financial Position

Current/non-current distinction of assets and liabilities

Overall structure – 2 formats illustrated

Net assets (assets – liabilities) = Capital

Assets = Capital + Liabilities

Certain items ("line items") must be shown on the face of the statement of financial position.

Current / non-current Distinction

Current / Non-current	
IAS 1 requires that both assets and liabilities should be classified **separately** as current and non-current.	For most businesses it will be appropriate to identify this classification with reference to their **operating cycle.**

Current assets

- Expected to be realised in the normal course of the operating cycle (RM + WIP)
- Held primarily for trading purposes (FG)
- Expected to be realised within 12 months (IFRS 5)
- Cash or a cash equivalents
- All other assets classified as “non-current”.

Four criteria for identifying a current asset

- The entity expects to use or sell the asset in its normal operating cycle,
- it holds the asset primarily for trading rather than long-term usage within the business,
- it expects to realise the asset, sell it for cash, within twelve months after the reporting period,
- the asset is cash or a cash equivalent to which the entity has access within twelve months after the reporting period. [IAS 1.66]

Illustration of Current Asset classification

- An entity supplies seasoned timber to furniture manufacturers. The operating cycle is clearly defined and timber is matured over a three to five year period.
- The cost of the timber inventories would be classified as a current asset, as they are realised within the operating cycle. The entity should disclose the amount of inventories to be realised more than twelve months after the reporting period.

Current assets

Inventories	135,230	132,500
Trade receivables	91,600	110,800
Other current assets	25,650	12,540
Cash and cash equivalents	312,400	322,900
	564,880	578,740

Current liabilities

- Expected to be settled in the normal course of operating cycle
- Within 12 months of the end of the reporting period
- All other liabilities classified as "non-current".

Four criteria for identifying a current liability:

- The entity expects to settle the liability within its normal operating cycle,
- it holds the liability primarily for trading purposes,
- the liability is due to be settled within twelve months after the reporting period or
- the entity has no unconditional rights to defer payment for at least twelve months after the reporting period. [IAS 1.69]

Current liabilities

Trade and other payables	115,100	187,620
Short-term borrowings	150,000	200,000
Current portion of long-term borrowings	10,000	20,000
Current tax payable	35,000	42,000
Short-term provisions	5,000	4,800
Total current liabilities	315,100	454,420

Key to your future

Statement of P&L and OCI

Total Comprehensive income

- includes **profit or loss** for that period <u>plus</u> **other comprehensive income** recognised in that period.
- All items of income and expense recognised in a period must be included in profit or loss unless a Standard or an Interpretation requires otherwise. [IAS 1.88] Some IFRSs require or permit that some components to be excluded from profit or loss and instead to be included in other comprehensive income. [IAS 1.89]

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Statement of Comprehensive Income

An entity has a choice of presenting:

- a single statement of comprehensive income or
- two statements:
  - an income statement displaying components of profit or loss and
  - a statement of comprehensive income that begins with profit or loss (bottom line of the income statement) and displays components of other comprehensive income [IAS 1.81]

IAS 1R - Separate disclosure of owner changes and comprehensive income

Presentation of Statement of P&L and OCI

Single statement — either/or — **Two statements**

1) Statement displaying components of profit or loss and

2) Statement beginning with profit or loss and displaying components of other recognised income and expense

Statement of Comprehensive Income

- Certain items (“line items”) must be shown on the face
- Expenses analysed by function, or nature
- Functional classification requires additional disclosures of nature of expenses
- Overall structure - 2 formats illustrated.

Profit or Loss by function

XYZ Group – Statement of profit or loss and other comprehensive income for the year ended 31 December 20X7
(illustrating the presentation of profit or loss and other comprehensive income in one statement and the classification of expenses within profit or loss by function)
(in thousands of currency units)

	20X7	**20X6**
Revenue	390,000	355,000
Cost of sales	(245,000)	(230,000)
Gross profit	145,000	125,000
Other income	20,667	11,300
Distribution costs	(9,000)	(8,700)
Administrative expenses	(20,000)	(21,000)
Other expenses	(2,100)	(1,200)
Finance costs	(8,000)	(7,500)
Share of profit of associates[a]	35,100	30,100
Profit before tax	161,667	128,000
Income tax expense	(40,417)	(32,000)
Profit for the year from continuing operations	121,250	96,000
Loss for the year from discontinued operations	–	(30,500)
PROFIT FOR THE YEAR	121,250	65,500

Profit or loss by Nature

XYZ Group – Statement of profit or loss for the year ended 31 December 20X7 (illustrating the presentation of profit or loss and other comprehensive income in two statements and the classification of expenses within profit or loss by nature)
(in thousands of currency units)

	20X7	20X6
Revenue	390,000	355,000
Other income	20,667	11,300
Changes in inventories of finished goods and work in progress	(115,100)	(107,900)
Work performed by the entity and capitalised	16,000	15,000
Raw material and consumables used	(96,000)	(92,000)
Employee benefits expense	(45,000)	(43,000)
Depreciation and amortisation expense	(19,000)	(17,000)
Impairment of property, plant and equipment	(4,000)	–
Other expenses	(6,000)	(5,500)
Finance costs	(15,000)	(18,000)
Share of profit of associates[(a)]	35,100	30,100
Profit before tax	161,667	128,000
Income tax expense	(40,417)	(32,000)
Profit for the year from continuing operations	121,250	96,000
Loss for the year from discontinued operations	–	(30,500)
PROFIT FOR THE YEAR	121,250	65,500

Components of other comprehensive income (IAS 1.7) include:

	Component	IAS/ IFRS	Description	Para-graph
(a)	Changes in the revaluation surplus.	IAS 16	Property, plant and equipment	39
(b)	Remeasurements of defined benefit plans.	IAS 19	Employee benefits	57(d)
(c)	Gains and losses arising from translating the financial statements of a foreign operation.	IAS 21	The effects of changes in foreign exchange rates	32 37 38-49
(d)	Gains and losses from investments in equity instruments measured at fair value through other comprehensive income in accordance with paragraph 5.7.5.	IFRS 9	Financial instruments	5.7.5
(e)	Gains and losses on financial assets measured at fair value through other comprehensive income.	IFRS 9	Financial instruments	4.1.2A
(f)	The effective portion of gains and losses on hedging instruments in a cash flow hedge.	IFRS 9	Financial instruments	5.7.5
(g)	For particular liabilities designated as at fair value through profit or loss, the amount of the change in fair value that is attributable to changes in the liability's credit risk.	IFRS 9	Financial instruments	5.7.7

Presentation of the OCI(incl tax)

	20X7	20X6
Other comprehensive income:		
Items that will not be reclassified to profit or loss [Refer: paragraph 82A(a)(i)]:		
Gains on property revaluation	933	3,367
Remeasurements of defined benefit pension plans	(667)	1,333
Share of other comprehensive income of associates[(b)]	400	(700)
Income tax relating to items that will not be reclassified[(c)]	(166)	(1,000)
	500	3,000
Items that may be reclassified subsequently to profit or loss [Refer: paragraph 82A(a)(ii)]:		
Exchange differences on translating foreign operations[(d)]	5,334	10,667
Available-for-sale financial assets[(d)]	(24,000)	26,667
Cash flow hedges[(d)]	(667)	(4,000)
Income tax relating to items that may be reclassified[(c)]	4,833	(8,334)
	(14,500)	25,000
Other comprehensive income for the year, net of tax	(14,000)	28,000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	107,250	93,500

Presentation of OCI (net of tax)

	20X7	20X6

Alternatively, items of other comprehensive income could be presented in the statement of profit or loss and other comprehensive income net of tax.

Other comprehensive income for the year, after tax:	**20X7**	**20X6**
Items that will not be reclassified to profit or loss:		
Gains on property revaluation	600	2,700
Remeasurements of defined benefit pension plans	(500)	1,000
Share of other comprehensive income of associates	400	(700)
	500	3,000
Items that may be reclassified subsequently to profit or loss:		
Exchange differences on translating foreign operations	4,000	8,000
Investments in equity instruments	(18,000)	20,000
Cash flow hedges	(500)	(3,000)
	(14,500)	25,000
Other comprehensive income for the year, net of tax[c]	(14,000)	28,000

Attributable Section

TOTAL COMPREHENSIVE INCOME FOR THE YEAR	107,250	93,500
Profit attributable to:		
Owners of the parent	97,000	52,400
Non-controlling interests	24,250	13,100
	121,250	65,500
Total comprehensive income attributable to:		
Owners of the parent	85,800	74,800
Non-controlling interests	21,450	18,700
	107,250	93,500
Earnings per share (in currency units):		
Basic and diluted	0.46	0.30

Key to your future

Statement of Changes in Equity

- Separate statement showing results of dealing with equity owners only.
- Will include:
  - Profit or loss for period
  - Other comprehensive income adjustments
  - Cumulative effect of changes in accounting policy or correction of errors
  - New share issues
  - Dividends to equity holders.

XYZ Group – Statement of changes in equity for the year ended 31 December 20X7

(in thousands of currency units)

	Share capital	Retained earnings	Translation of foreign operations	Investments in equity instruments	Cash flow hedges	Revaluation surplus	Total	Non-controlling interests	Total equity
Balance at 1 January 20X6	600,000	118,100	(4,000)	1,600	2,000	–	717,700	29,800	747,500
Changes in accounting policy	–	400	–	–	–	–	400	100	500
Restated balance	600,000	118,500	(4,000)	1,600	2,000	–	718,100	29,900	748,000
Changes in equity for 20X6									
Dividends	–	(10,000)	–	–	–	–	(10,000)	–	(10,000)
Total comprehensive income for the year[(a)]	–	53,200	6,400	16,000	(2,400)	1,600	74,800	18,700	93,500
Balance at 31 December 20X6	600,000	161,700	2,400	17,600	(400)	1,600	782,900	48,600	831,500

XYZ Group – Statement of changes in equity for the year ended 31 December 20X7 (in thousands of currency units)

Changes in equity for 20X7									
Issue of share capital	50,000	–	–	–	–	–	50,000	–	50,000
Dividends	–	(15,000)	–	–	–	–	(15,000)	–	(15,000)
Total comprehensive income for the year[b]	–	96,600	3,200	(14,400)	(400)	800	85,800	21,450	107,250
Transfer to retained earnings	–	200	–	–	–	(200)	–	–	–
Balance at 31 December 20X7	650,000	243,500	5,600	3,200	(800)	2,200	903,700	70,050	973,750

(a) The amount included in retained earnings for 20X6 of 53,200 represents profit attributable to owners of the parent of 52,400 plus remeasurements of defined benefit pension plans of 800 (1,333, less tax 333, less non-controlling interests 200).
The amount included in the translation, investments in equity instruments and cash flow hedge reserves represent other comprehensive income for each component, net of tax and non-controlling interests, eg other comprehensive income related to investments in equity instruments for 20X6 of 16,000 is 26,667, less tax 6,667, less non-controlling interests 4,000.
The amount included in the revaluation surplus of 1,600 represents the share of other comprehensive income of associates of (700) plus gains on property revaluation of 2,300 (3,367, less tax 667, less non-controlling interests 400). Other comprehensive income of associates relates solely to gains or losses on property revaluation.

(b) The amount included in retained earnings for 20X7 of 96,600 represents profit attributable to owners of the parent of 97,000 plus remeasurements of defined benefit pension plans of 400 (667, less tax 167, less non-controlling interests 100).
The amount included in the translation, investments in equity instruments and cash flow hedge reserves represents other comprehensive income for each component, net of tax and non-controlling interests, eg other comprehensive income related to the translation of foreign operations for 20X7 of 3,200 is 5,334, less tax 1,334, less non-controlling interests 800.
The amount included in the revaluation surplus of 800 represents the share of other comprehensive income of associates of 400 plus gains on property revaluation of 400 (933, less tax 333, less non-controlling interests 200). Other comprehensive income of associates relates solely to gains or losses on property revaluation.

Statement of Changes in Equity

IAS 1 requires an entity to present a statement of changes in equity as a separate component of the financial statements. The statement must show: [IAS 1.106]

- total comprehensive income for the period, showing separately amounts attributable to owners of the parent and to non-controlling interests
- the effects of retrospective application, when applicable, for each component
- reconciliations between the carrying amounts at the beginning and the end of the period for each component of equity, separately disclosing:
  - profit or loss
  - each item of other comprehensive income
  - transactions with owners, showing separately contributions by and distributions to owners and changes in ownership interests in subsidiaries that do not result in a loss of control

Statement of Changes in Equity

- The following amounts may also be presented on the face of the statement of changes in equity, or they may be presented in the notes: [IAS 1.107]
- amount of dividends recognised as distributions, and
- the related amount per share

Statement of Cash Flows

Cash flow information provides users of the financial statements with information to:

- Assess an entity's ability to generate cash
- Indicate how it utilises the cash in its operations.

Requirements for the preparation of a statement of Cash Flows are set out in IAS 7 Statement of Cash Flows.

Note: Dealt with under Module 105

Notes to the Financial Statements

The notes must: [IAS 1.112]

- present information about the **basis of preparation** of the financial statements and the **specific accounting policies** used
- disclose any information required by IFRSs that is not presented elsewhere in the financial statements and
- provide additional information that is not presented elsewhere in the financial statements but is relevant to an understanding of any of them

- Notes should be cross-referenced from the face of the financial statements to the relevant note. [IAS 1.113]

Notes to the Financial Statements

- IAS 1.114 suggests that the notes should normally be **presented in the following order**:
- a statement of compliance with IFRSs
- a summary of significant accounting policies applied, including: [IAS 1.117]
  - the measurement basis (or bases) used in preparing the financial statements
  - the other accounting policies used that are relevant to an understanding of the financial statements
- supporting information for items presented on the face of the statement of financial position (balance sheet), statement of comprehensive income (and income statement, if presented), statement of changes in equity and statement of cash flows, in the order in which each statement and each line item is presented

Notes to the Financial Statements

- other disclosures, including:
  - contingent liabilities (see IAS 37) and unrecognised contractual commitments
  - non-financial disclosures, such as the entity's financial risk management objectives and policies (see IFRS 7)

Disclosure of judgements. New in the 2003 revision to IAS 1, an entity must disclose, in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements. [IAS 1.122]

Notes to the Financial Statements

- Disclosure of key sources of estimation uncertainty. Also new in the 2003 revision to IAS 1, an entity must disclose, in the notes, information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. [IAS 1.125] These disclosures do not involve disclosing budgets or forecasts. [IAS 1.130]

Questions ?

CHARTERED ACCOUNTANTS ACADEMY

Apply IAS 1- Knowledge

Try the following Questions

- Module 102 Question 3.1

INCOME TAXES: IAS 12

CHARTERED ACCOUNTANTS ACADEMY

Examinability

FQE

Jan 2016

2014 Jan

2013 Jan

2012

2010

2009

2008

2006

UNISA CTA Exams

- 2014
- 2013
- 2012
- 2011
- 2009

Examinability

2016 Possible areas of focus:

big question like the 2012 question. Plus deferred tax discussion or calc could still come though

IAS 12- Possible Exam Questions

- Presentation of Income Taxes on P/L, OCI, SoFP & SOCIE
- Disclosure notes for Income Taxes
- Calculation of Tax Expense
- Calculation of Temporary Differences using the SOFP method
- Calculation of Deferred Tax Asset/Liability
- Calculation of Taxable Income & Current Tax
- Dealing with Assessed Losses & tax credits
- Theory question on current + deferred tax implications

What is income Taxes?

- Tax levied on both **local** and **foreign** income earned by an entity, e.g.:
  - Normal corporate tax (25.75%) ito the Income Tax Act – (Chapter 23:06)
  - Capital gain tax ito of Capital Gains Act (Chapter 23:01)
  - Withholding tax on dividends

Presentation of Income Taxes

Presentation of Income Taxes

APRIL LTD
STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 28 FEBRUARY 20.12

	Notes	R	
Profit before tax		735 000	(½)
Income tax expense	3	(136 459)	(½)
PROFIT FOR THE YEAR		598 541	(½)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		598 541	

APRIL LTD
STATEMENT OF FINANCIAL POSITION AS AT 28 FEBRUARY 20.12

	Notes	R	
ASSETS			
Current assets			
Other receivables: SARS [C3]		4 271	(1½)
EQUITY AND LIABILITIES			
Non-current liabilities			
Deferred tax	10	315 840	(½)
Current liabilities			
Other payables: Tax payable in foreign country		46 200	(½)
			(4)

Disclosure of Income Taxes

APRIL LTD
NOTES FOR THE YEAR ENDED 28 FEBRUARY 20.12

3. Income tax expense

Major components of tax expense

	R	
SA normal tax		
Current tax	32 229	
-Current year [C1]	33 729	(5)
-Overprovision in prior year (31 000 - 29 500)	(1 500)	(1)
Deferred tax	58 030	
-Movement in temporary differences [C2] (239 000 x 28%)	66 920	(4)
-Change in tax rate [C2]	(8 890)	(1)
SA normal tax	90 259	
Foreign tax	46 200	(½)
	136 459	

Tax rate reconciliation

Accounting profit	735 000	(½)
Tax at 28%	205 800	(½)
Tax effect of non-taxable/non-deductible items:		
- Dividends received not taxable (175 000 x 28%)	(49 000)	(1)
- Capital gain on sale of land not taxable (210 000 x 33,4% x 28%)	(19 639)	(1)
- Fines and donations not deductible (700 x 28%)	196	(1)
- Legal fees not deductible (900 x 28%)	252	(1)
Change in tax rate [C2]	(8 890)	(1)
Effect of different tax rate on foreign income (132 000 x (35% - 28%))	9 240	(1½)
Overprovision of current tax in prior year (31 000 – 29 500)	(1 500)	(½)
Income tax expense	136 459	

The income tax rate has been decreased from 29% to 28% by the Minister on Finance in March 20.11 for financial years starting on or after 1 March 20.11. (IAS 12.81(d)) (½)

Deferred Tax Disclosure

Deferred tax

Analysis of temporary differences:		
Property, plant and equipment		
- Accelerated deductions for tax purposes [C2]	333 200	(1)
Revenue received in advance [C2]	(17 360)	(1)
Net deferred tax liability	315 840	
		(22)

Calculation of Income Taxes

Calculate the tax expense:

- Current Tax
- \+ Movement of Deferred Tax recognised in P/L

Calculation of the Tax Expense

Income tax expense

Major components of tax expense

	R	
SA normal tax		
Current tax	32 229	
-Current year [C1]	33 729	(5)
-Overprovision in prior year (31 000 - 29 500)	(1 500)	(1)
Deferred tax	58 030	
-Movement in temporary differences [C2] (239 000 x 28%)	66 920	(4)
-Change in tax rate [C2]	(8 890)	(1)
SA normal tax	90 259	
Foreign tax	46 200	(½)
	136 459	

Components of Tax Expense

Income Tax expense may include the following components:

- Current tax
  - Current Year (Taxable income X Current tax rate)
  - Prior Year: <u>Less</u> Over/<u>add</u> under provision
- Deferred Tax:
  - Current deferred tax (mvt btwn current closing & op DT bals)
  - +/-Effect of tax rate change (%change/prior rate X opening bal)
  - -Recognised deferred tax asset on assessed & capital losses
  - -/+ unrecognised deferred tax asset on prior period assessed loss
- Dividend tax
- Foreign tax expense (foreign income X foreign tax rate)

Current tax defined

- **Current tax:** amount of income tax payable/refundable based on taxable profit/loss for the current period or past periods

Deferred tax defined

- **Deferred tax:** tax payable/recoverable in the future period as a result of past transactions
- **Carrying amount:** measurement under IFRSs
- **Tax base:** measurement under tax law
- **Temporary difference:** difference in carrying amount of an item in the statement of financial position and its tax base

Current Tax Calculation Formula

	$
Profit Before Tax	**240,000**
Add/Less Permanent Differences (non-taxable income & expenses)	xxxxx
Less: Mvt in temporary differences as per the SOFP	**(100,000)**
Taxable Profit	**140,000**
Current Tax @ 25.75% of 140,000	35,000
Deferred Tax@25,75% of 100,000	**25,000**
Tax expense (Profit before Tax x 25.75%) 240,000 x 25.75%	**60,000**

Relationship between Taxable Income and PBT

Profit before tax (PBT)	
Revenue	XX
Less: Cost of Sales	(X)
Gross Profit	X
Plus: Other Income	X
Less: Operating expenses	(X)
Profit before tax	**X**

Taxable Income	
Profit before tax	**X**
+/- Permanent differences:	
- Non-taxable items	(X)
+Non-deductible items	X
Total accrued trade inc	X
+/- mvt in temporary diffs through profit and loss	X
Less: Tax Loss c/f	(X)
Taxable inc/(acc tax loss)	**X**

PBT

Revenue and Other Income:

- Revenue from contracts with customers
- Other Income:
  - Dividends received
  - Fair value adjustments on non-current assets
  - Impairment reversal
  - Interest Income
  - Gain on disposal
  - Deferred income recognised
  - Exchange gain/loss
  - Gain on bargain purchase
  - Gain/loss on loss of control

Operating and Other Expenses:

- Operating expenses (COS, salaries, rentals, e.tc)
- Other Expenses:
  - Donations
  - Fines
  - Impairment of goodwill
  - Impairment loss
  - Share based payment expense
  - Loss on disposal
  - Transaction costs
  - Fines
  - Finance costs

Taxable Inc = Gross Taxable Income

eductible expense in tr

Which income is not taxable/not in trade?

Which expense is not deductible/not for trade?

Revenue and Other Income:

- Revenue from contracts with customers
- Other Income:
  - Dividends received
  - Fair value adjustments on non-current assets
  - Impairment reversal
  - Interest Income
  - Gain on disposal
  - Deferred income recognised
  - Exchange gain/loss
  - Gain on bargain purchase
  - Gain/loss on loss of control

Operating and Othe

- Operating expenses (COS, salaries, rentals, e.tc)
- Other Expenses:
  - Donations
  - Fines
  - Impairment of goodwill
  - Impairment loss
  - Share based payment expense
  - Loss on disposal
  - Transaction costs
  - Finance costs

Permanent Differences:

Non-taxable items in PBT

- Dividends received
- Fair value adjustments on non-current assets
- Impairment reversal
- Interest Income
- Gain on disposal
- Deferred income recognised
- Exchange gain/loss
- Gain on bargain purchase
- Gain/loss on loss of control

Non-deductible expenses in PBT

- Donations
- Fines
- Impairment of goodwill
- Impairment loss
- Share based payment expense
- Loss on disposal
- Transaction costs
- Finance costs

Relationship between Taxable Income and PBT

Profit before tax (PBT)	
Revenue	XX
Less: Cost of Sales	(X)
Gross Profit	X
Plus: Other Income	X
Less: Operating expenses	(X)
Profit before tax	**X**

Taxable Income	
Profit before tax	X
+/- Permanent differences:	
- Non-taxable items	(X)
+Non-deductible items	X
Total accrued trade inc	X
+/- mvt in temporary diffs through profit and loss	X
Less: Tax Loss c/f	(X)
Taxable inc/(acc tax loss)	**X**

Relationship between PBT and Taxable Income

PBT

- Determine by the accountant
- Based on IFRS
- Include all income and expenses
- Based on substance only
- Includes net income taxable in current and future periods

Taxable Income

- Determined by the taxman
- Based on tax legislation (Zim Tax Act)
- Include only income and expenditure from trade
- Deducts tax loss b/f from previous period/s
- Based on legal form
- Only includes income taxed in current period (+/- mvtin temporary differences)

therefore

which of the following is true?

1. PBT = Taxable Income

2. PBT ≠ Taxable Income

2 is correct

Deferred Tax Key principle

- Temporary Differences = Carrying Amt less Tax Base
  - CA= determined in accordance with IFRS
  - TB= determined in accordance with tax law
- The tax base of an item on the statement of financial position is determined as follows:

Asset: is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an enterprise when it recovers the carrying amount of the asset.

Liability: is its CA less any amount that will be deductible for tax purpose in future periods.

Revenue received in advance: is its CA less any amount of the revenue that will NOT be taxable in future periods.

IAS 12 EXAMPLE (FLOW OF NOTES)

ILLUSTRATING STATEMENT OF FINANCIAL POSITION METHOD

- Included in the accounting profit of R1 000 000 are dividends received of R12 500 that are not taxable and a penalty of R5 000 that is not deductible for tax purposes. On 31 December 20.11 there were no temporary differences.
- Deasy Ltd acquired machinery on 1 January 20.12 for R300 000 which is depreciated over four years on the straight line basis. The depreciation is included in the accounting profit. The SARS allows a S12C deduction of 40% in the first year and 20% per year for the subsequent three years.
- Deasy Ltd acquired office buildings on 1 January 20.12 for R450 000 which is depreciated over 25 years on the straight line basis. The depreciation is included in the accounting profit. The SARS does not allow any tax allowance from the use of office buildings.
- The prepaid expenses for 20.12 R15 000 and income received in advance was R30 000.
- Normal tax rate is 28%

Approach to IAS 12 Question

- Step 1- Identify all requirements of the question
- Step 2- Prepare Skeletons of the required, e.g.:
  – P/L, OCI, SOFP, SOCIE
  – Notes: Tax Expense + Reconciliation, Deferred Tax, Current Tax Payable/Receivable
- Step 3: Prepare supporting calculations for each of the key figures on the items in Step 2.

Approach to IAS 12 Question

- Step 4: Enter all items not requiring complex calculations on the required in Step 2.
- Step 5. Make all the two most important calculations in the following order:
  - 1st-Deferred Tax calculation (usually more marks)
  - 2nd-Current Tax Calculation (considerable marks)

IAS 12 (FLOW OF NOTES)

C1. Current tax	20.12 R
Profit before tax	1 000 000
Non-taxable/non-deductible items:	-
Dividends received	(12 500)
Fine	5 000
Depreciation: office buildings	18 000
Movement in temporary differences (taxable) [C2]	(30 000)
tax loss	980 500
Unused tax loss of prior year	-
Taxable profit	980 500
Tax at 28%	274 540

C2. Deferred tax	CA R	TB R	TD R	DT at 28% (asset)/ liability R
31 Dec 20.12				
Machinery	225 000	180 000	A 45 000	12 600
Office buildings	450 000	-	IAS12.15 exemption	-
Prepaid expense	15 000	-	B 15 000	4 200
Revenue received in advance	30 000	-	C (30 000)	C (8 400)
Net deferred tax liability			30 000	8 400

BREAK DOWN OF EFFECT ON CURRENT TAX CALC

A	DEPRECIATION INCLUDED IN PROFIT BEFORE TAX	
	ADD: BACK DEPRECIATION	75 000
	LESS:TAX ALLOWANCE	(120 000)
B	PREPAID EXPENSE NOT RECOGNISED IN TEMRS OF IFRS	
	TAXABLE TEMPORARY	
	DECREASES TAXABLE PROFIT	
	IRO TAX ACT DEDUCTIBLE IN THE CURRENT YEAR	(15 000)
C	REVENUE NOT RECOGNISED IN TEMRS OF IFRS	
	DEDUCTIBLE TEMPORARY	
	INCREASES TAXABLE PROFIT	
	IRO TAX ACT TAXABLE IN THE CURRENT YEAR	30 000
		(30 000)

IAS 12 (FLOW OF NOTES)

C2.	Deferred tax	CA R	TB R	TD R	DT at 28% (asset)/ liability R
	31 Dec 20.12				
	Machinery	225 000	180 000	45 000	12 600
	Office buildings	450 000	-	IAS12.15 exemption	-
	Prepaid expense	15 000	-	15 000	4 200
	Revenue received in advance	30 000	-	(30 000)	(8 400)
	Net deferred tax liability			**30 000**	**8 400**

DEFFERRED TAX NOTE	**20.12 R**
ANALYSIS OF TEMPORARY DIFFERENCE	
- PROPERTY PLANT EQUIPMENT	
ACCELERATED DEDUCTION FOR TAX PURPOSES	12 600
PRE-PAID EXPENSE	4 200
REVENUE RECEIVED IN ADVANCE	(8 400)
NET DEFERRED TAX LIABILITY	**8 400**

BASED ON FUTURE TAX RATE IN CASE OF RATE CHANGE

Current Tax

a) Is the amount of income taxes payable or recoverable in respect of the taxable profit or loss for a period.

b) Refer above slide: current tax is part of tax expense (NB: current tax will be zero if there is a current assessed loss/no tax payable);

c) Interest and penalties arising from late payment of current tax expense shall be recognised separately as finance cost and other admin costs, respectively. Do NOT recognise these items as part of the tax expense;

d) Interest and penalties for late payments are not deductible tax expense, hence, treat them as non-deductible permanent differences when calculating taxable income and add these back to profit b4 tax.

e) Over/under provision- always compare final tax payment for prior year current tax payable(after deducting interest and penalties, referred above) to the opening tax provision outstanding. Recognise the over/under provision as part of the tax expense for the current year as shown in slide above. Do not restate prior tax balances.

Current Tax JEs

Dr Creditor: SARS (outstanding prior provision)

Dr Finance costs (interest accrued on late payment of tax)

Dr Other expenses (penalties on late or incorrect provision)

Dr (under) /Cr (over) Income tax expense (overprovision prior year) B/F

Cr Bank

Final pmt of prior assessment

Dr Creditor: SARS

Cr Bank

1st & 2nd provisional pmt current year

What is the over/under provision?

11. The tax payable account in the general ledger on 29 February 2012 is as follows:

	R
Opening balance (1 March 2011) (tax payable in respect of 2011)	2 650 000
Payment made in final settlement of 2011 assessment	(2 610 000)
Provisional payments made in respect of 2012	(1 600 000)
	(1 560 000)

Current Tax JEs

Dr Creditor: SARS (outstanding prior provision) 2650 000
Dr Finance costs (interest accrued on late payment of tax)
Dr Other expenses (penalties on late or incorrect provision)
Dr (under) /Cr (over) Inc tax expense (overprovision) 40 000
Cr Bank 2610 000
Final pmt of prior assessment

Dr Creditor: SARS 1600 000
Cr Bank 1600 000
1st & 2nd provisional pmt current year

IAS 12 EXAMPLE 1

TREATEMENT OF TAX LOSS WHEN FUTURE PROFITS ARE PROBABLE

- Deasy Ltd acquired machinery on 1 January 20.12 for R300 000 which is depreciated over four years on the straight line basis. The depreciation charge is included in the accounting profit. The SARS allows a S12C deduction of 40% in the first year and 20% per year for the subsequent three years.
- The accounting loss for the year ended 31 December 20.12 is R500 000.
- **Future taxable profits are probable for the financial year ending 20.12**
- Normal tax rate is 28%

Required

Prepare the income tax note together with the tax rate reconciliation to the financial statements of Deasy Ltd for the year ended 31 December 20.12

IAS 12 EXAMPLE 1

C1.	Current tax	20.12
		R
	Loss before tax	(500 000)
	Non-taxable/non-deductible items:	-
	Movement in other temporary differences, except assessed losses (taxable) [C2]	(45 000)
	tax loss	(545 000)
	Unused tax loss of prior year	-
	Cumulative unused tax loss as at 31 December 20.12	(545 000)
	Tax at 28%	-

C2.	Deferred tax	CA R	TB R	TD R	DT at 28% (asset)/ liability R
	31 Dec 20.12				
	Machinery	225 000	180 000	45 000	12 600
				45 000	12 600
	Unused tax loss	-	545 000	(545 000)	(152 600)
	Net deferred tax asset			(500 000)	(140 000)

DEASY LTD

NOTES FOR THE YEAR ENDED 31 DECEMBER 20.12

3.	Income tax expense	20.12
		R
	Major components of tax expense	
	SA normal tax	
	Current tax	
	-Current year [C1]	-
	Deferred tax	
	-Movement in temporary differences [C2] (45 000 x 28%)	12 600
	-Unused tax loss recognized [C2] (545 000 x 28%)	(152 600)
		(140 000)
	Tax reconciliation	
	Accounting Loss	(500 000)
	Tax @ 28%	(140 000)
	Tax effect of non-taxable/non-deductible items:	-
	Income tax expense	(140 000)

IAS 12 EXAMPLE 2

TREATEMENT OF TAX LOSS WHEN FUTURE PROFITS ARE NOT PROBABLE

- Deasy Ltd acquired machinery on 1 January 20.12 for R300 000 which is depreciated over four years on the straight line basis. The depreciation is included in the accounting profit. The SARS allows a S12C deduction of 40% in the first year and 20% per year for the subsequent three years.
- The accounting loss for the year ended 31 December 20.12 is R500 000.
- **At the end of the financial year 20.12 there is uncertainty about the company's ability to generate taxable profit**
- Normal tax rate is 28%

Required

Prepare the income tax note together with the tax rate reconciliation to the financial statements of Deasy Ltd for the year ended 31 December 20.12

IAS 12: Dealing with Unused Tax Losses (IAS 12.34-37)

1. **Recognise** a deferred tax asset for the carry forward of unused tax losses and unused tax credits .
2. The deferred tax asset should be recognised to the **extent** that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised **(the benefit is a future reduced current tax**).
   - ❑ **1st** - recognise in full if and only if future taxable profits will be available to deduct the loss; or
   - ❑ **2nd** – if no future taxable income, recognise an asset equal to the credit balance of the deferred tax liability before recognising the deferred tax asset. (E.g., if deferred tax asset is $5000 and deferred tax liability is $4000 before recognising the deferred tax asset. You can recognise $4000 only as a deferred tax asset, and the deferred tax asset will be zero. Unrecognised deferred tax asset is $1000($5000-$4000), which is tax reconciling item (increase in unrecognised deferred tax asset results in a positive impact on the reconciliation, and vice versa for decreases – IAS 12.81(c)).
3. The unrecognised deferred tax asset should be disclosed separately in the notes as required by IAS 12.81(e)
4. If it is however uncertain whether there will be future taxable income, the deferred tax account may not reflect a debit balance, i.e. deferred tax balance is limited to zero (refer to example above)

- Ref to **Next Slide**

IAS 12 EXAMPLE 2

C1.	Current tax	20.12 R
	Loss before tax	(500 000)
	Non-taxable/non-deductible items:	-
	Movement in temporary differences (taxable) [C2]	(45 000)
	tax loss	(545 000)
	Unused tax loss of prior year	-
	Cumulative unused tax loss as at 31 December 20.12	(545 000)
	Tax at 28%	-

C2.	Deferred tax	CA R	TB R	TD R	DT at 28% (asset)/ liability R
	31 Dec 20.12				
	Machinery	225 000	180 000	45 000	12 600
				45 000	12 600
	Unused tax loss	-	45 000	(45 000)	(12 600)
	Net deferred tax asset			-	-
	Unused Tax loss c/f (545k-45000)			500000	140 000

DEASY LTD
NOTES FOR THE YEAR ENDED 31 DECEMBER 20.12

3.	Income tax expense	20.12 R
	Major components of tax expense	
	SA normal tax	
	Current tax	
	-Current year [C1]	-
	Deferred tax	
	-Movement in temporary differences [C2] (45 000 x 28%)	12 600
	-Unused tax loss recognized [C2] (45 000 x 28%)	(12 600)
		-
	Tax reconciliation	
	Accounting Loss	(500 000)
	Tax @ 28%	(140 000)
	Tax effect of non-taxable/non-deductible items:	-
	Unused tax loss not recognised (545 000 – 45 000) *28%	140 000
	Income tax expense	-

Limitation on creation of DT asset

IAS 12 EXAMPLE 3

TAX LOSS IS UTILISED

- Deasy Ltd acquired machinery on 1 January 20.12 for R300 000 which is depreciated over four years on the straight line basis. The depreciation is included in the accounting profit. The SARS allows a S12C deduction of 40% in the first year and 20% per year for the subsequent three years.
- The accounting loss for the year ended 31 December 20.12 is R500 000.
- **At the end of the financial year 20.12 there is uncertainty about the company's ability to generate taxable profit**
- **In 20.13 company generated an accounting profit of R1 000 000**
- Normal tax rate is 28%

Required

Prepare the income tax note together with the tax rate reconciliation to the financial statements of Deasy Ltd for the year ended 31 December 20.13

IAS 12 EXAMPLE 3

C1.	Current tax	20.13 R
	Accounting before tax	1 000 000
	Non-taxable/non-deductible items:	-
	Movement in temporary differences (taxable) [C2]	15 000
	tax loss	1 015 000
	Unused tax loss of prior year	(545 000)
	Taxable profit	470 000
	Tax at 28%	131 600

C2.	Deferred tax	CA R	TB R	TD R	DT at 28% (asset)/ liability R
	31 Dec 20.12				
	Machinery	225 000	180 000	45 000	12 600
				45 000	12 600
	Unused tax loss	-	45 000	(45 000)	(12 600)
	Net deferred tax asset			-	-
	31 Dec 20.13				
	Machinery	150 000	120 000	30 000	8 400
				30 000	8 400
	Unused tax loss	-	-	-	-
	Net deferred tax liability			**30 000**	**8 400**

DEASY LTD
NOTES FOR THE YEAR ENDED 31 DECEMBER 20.12

3.	Income tax expense	20.12 R
	Major components of tax expense	
	SA normal tax	
	Current tax	
	-Current year [C1]	131 600
	Deferred tax	
	-Movement in temporary differences [C2] (15 000 x 28%)	(4 200)
	-Unused tax loss recognized utilised [C2] (45 000 x 28%)	12 600
		140 000
	Tax reconciliation	
	Accounting Loss	1 000 000
	Tax @ 28%	280 000
	Tax effect of non-taxable/non-deductible items:	-
	Unused tax loss not recognised utilised (545 000 – 45 000) *28%	(140 000)
	Income tax expense	140 000

CLASS QUESTION 1

Example 1 – Deasy Ltd

- The accounting profit for the year ended 31 December 20.12 is R500 000.
- Included in the accounting profit are dividends received of R10 000 that are not taxable and a penalty of R15 000 that is not deductible for tax purposes.
- On 31 December 20.11 there were no temporary differences except for an unused tax loss of R550 000 for the year ended 31 December 20.11. The SARS assessment reflects an assessed tax loss of R550 000.
- Deasy Ltd acquired machinery on 1 January 20.12 for R300 000 which is depreciated over five years on the straight line basis. The SARS allows a S12C deduction of 40% in the first year and 20% per year for the subsequent three years.
- Future taxable profits are probable for both financial years ending 31 December 20.11 and 20.12.

Required

Disclose the income tax note and deferred tax note in the financial statements of Deasy Ltd for the year ended 31 December 20.12

CLASS QUESTION 1 - CALCULATIONS

C1 **Current tax**	**R**
Profit before tax	500 000
Non-taxable/ non-deductible items:	
Dividends received not taxable	(10 000)
Fine not deductible	15 000
Taxable profit before temporary differences	505 000
Movement in temporary differences (taxable in future) [C2]	(60 000)
Taxable profit before unused tax loss	445 000
Unused tax loss of prior year (given)	(550 000)
Cumulative unused tax loss as at 31 December 20.12	**(105 000)**
Tax at 28%	Nil

CLASS QUESTION 1 - CALCULATIONS

C2 **Deferred tax**

	Carrying amount R	Tax base R	Temporary difference R	Deferred tax at 28% (Dr)/Cr R
31 December 20.11				
Unused tax loss	-	550 000	(550 000)	(154 000)
31 December 20.12				
Machinery	240 000	180 000	60 000	16 800
Unused tax loss	-	105 000	(105 000)	(29 400)
			(45 000)	(12 600)
Movement in temporary differences (excluding tax loss) (taxable) (60 000 - 0)			60 000	16 800
Movement in unused tax loss ((105 000) - (550 000))			<u>445 000</u>	<u>124 600</u>
Total movement in temporary differences ((45 000) - (550 000))			**<u>505 000</u>**	**<u>141 400</u>**

CLASS QUESTION 1 - DISCLOSURE

Deasy Ltd

Notes to the financial statements for the year ended 31 December 20.12

3. Income tax expense			**20.12**
Major components of tax expense			**R**
SA normal tax			
Current tax			
- Current year	[C1]	-	
Deferred tax			
- Movement in temporary	[C2] (60 000 x 28%)	16 800	
- Unused tax loss utilised	[C2] (445 000 x 28%)	124 600	
			141 400
Tax reconciliation			
Accounting profit			**500 000**
Tax @ 28%			140 000
Tax effect of non-deductible/non-taxable items:			
- Dividends received	(10 000 x 28%)		(2 800)
- Penalty	(15 000 x 28%)		4 200
Income tax expense			**141 400**

CLASS QUESTION 1 - DISCLOSURE

Deasy Ltd

Notes to the financial statements for the year ended 31 December 20.12

10. Deferred tax	**20.12**
	R
Analysis of temporary differences:	
Property, plant and equipment	
- Accelerated deductions for tax purposes	16 800
Unused tax loss for normal tax	(29 400)
Net deferred tax asset	**(12 600)**

CLASS QUESTION 2

Example 2 – Deasy Ltd

- The accounting profit for the year ended 31 December 20.12 is R500 000.
- Included in the accounting profit are dividends received of R10 000 that are not taxable and a penalty of R15 000 that is not deductible for tax purposes.
- On 31 December 20.11 there were no temporary differences except for an unused tax loss of R550 000 for the year ended 31 December 20.11. The SARS assessment reflects an assessed tax loss of R550 000.
- Deasy Ltd acquired machinery on 1 January 20.12 for R300 000 which is depreciated over five years on the straight line basis. The SARS allows a S12C deduction of 40% in the first year and 20% per year for the subsequent three years.
- Assume that future taxable profits are probable as at 31 December 20.11 but when re-evaluated as at 31 December 20.12, that they are not.

Required

Disclose the income tax note and deferred tax note in the financial statements of Deasy Ltd for the year ended 31 December 20.12

CLASS QUESTION 2 - CALCULATIONS

C1 **Current tax**		**R**
Profit before tax		500 000
Non-taxable/ non-deductible items:		
Dividends received not taxable		(10 000)
Fine not deductible		15 000
Taxable profit before temporary differences	505 000	
Movement in temporary differences (taxable in future) [C2]		(60 000)
Taxable profit before unused tax loss		445 000
Unused tax loss of prior year (given)		(550 000)
Cumulative unused tax loss as at 31 December 20.12		**(105 000)**
Tax at 28%		Nil

CLASS QUESTION 2 - CALCULATIONS

C2 **Deferred tax**

	Carrying amount R	Tax base R	Temporary difference R	Deferred tax at 28% (Dr)/Cr R
31 December 20.11				
Unused tax loss	-	550 000	(550 000)	(154 000)
31 December 20.12				
Machinery	240 000	180 000	60 000	16 800
Unused tax loss	-	105 000	(60 000)	(16 800)
			-	-
Movement in temporary differences (excluding tax loss) (taxable)	(60 000 - 0)		60 000	16 800
Movement in unused tax loss	(550 000) - 60 000)		<u>490 000</u>	<u>137 200</u>
Total movement in temporary differences ((45 000) - (550 000))			**<u>550 000</u>**	**<u>154 000</u>**

CLASS QUESTION 2 - DISCLOSURE

Deasy Ltd
Notes to the financial statements for the year ended 31 December 20.12

3. Income tax expense		**20.12**
Major components of tax expense		**R**
SA normal tax		
Current tax		
- Current year	[C1]	-
Deferred tax		
- Movement in temporary	[C2] (60 000 x 28%)	16 800
- Unused tax loss utilised	[C2] (490 000 x 28%)	137 200
		154 000
Tax reconciliation		
Accounting profit		**500 000**
Tax @ 28%		140 000
Tax effect of non-deductible/non-taxable items:		
- Dividends received	(10 000 x 28%)	(2 800)
- Penalty	(15 000 x 28%)	4 200
- Unused tax loss not recognised	[C2] (105 000 - 60 000 = 45 000 x 28%)	12 600
Income tax expense		**154 000**

Apply IAS 12

Try the following questions in TUT 102:

- Question 5.1-2

Acc Policies, Changes in Estimates and Errors: IAS 8

CAA

CHARTERED ACCOUNTANTS ACADEMY

Examinability

FQE

None recently but can come in many forms

UNISA CTA Exams

- 2015
- 2014
- 2013
- 2012
- 2007

Examinability

2016 Possible areas of focus:

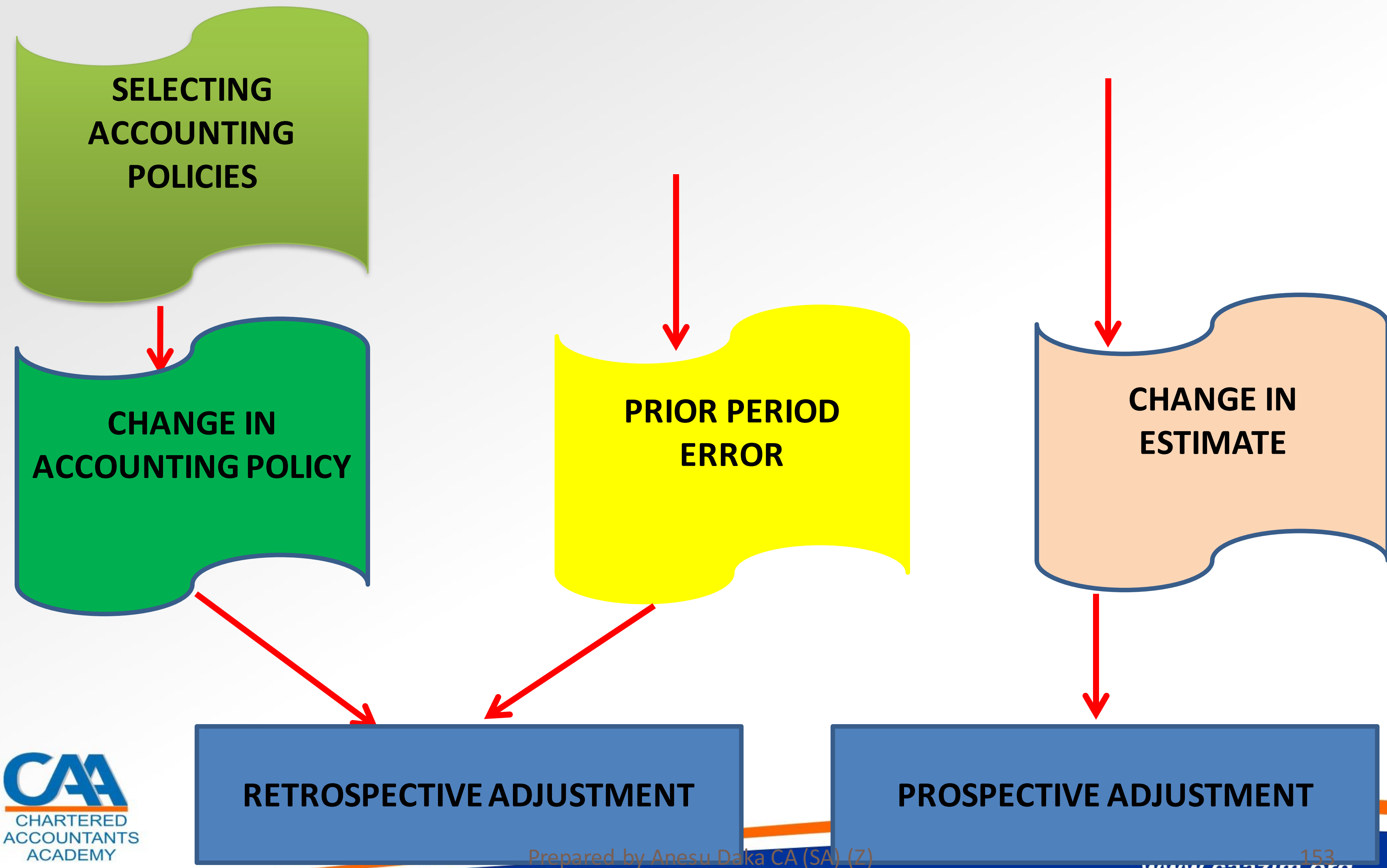
- Change in accounting policies
  - Disclosure Voluntary or due to change in IFRS (so many IFRS changes this year and last year)
- Prior Period Errors- more common

IAS 8 Possible Question

Theory Questions + disclosures:

1. Changes in accounting policy.
2. Changes in accounting estimates.
3. Prior Period Errors.

IAS 8 OVERVIEW



Key Definitions

- **Accounting policies** are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.
- **A change in accounting estimate** is an adjustment of the carrying amount of an asset or liability, or related expense, resulting from reassessing the expected future benefits and obligations associated with that asset or liability.

Key Definitions........

- **Materiality.** Omissions or misstatements of items are material if they could, by their size or nature, individually or collectively, influence the economic decisions of users taken on the basis of the financial statements.
- **Prior period errors** are omissions from, and misstatements in, an entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that was available and could reasonably be expected to have been obtained and taken into account in preparing those statements. Such errors result from mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

Selection and application of accounting policies

- How should the transaction or event be accounted for?

Selection and Application of Accounting Policies

Condition: Guidance available

- **When an IFRS specifically applies to a transaction, other event or condition, the accounting policy or policies applied to that item shall be determined by applying the IFRS.** or Interpretation and considering any relevant Implementation Guidance issued by the IASB for the Standard or Interpretation. [IAS 8.7]
- An entity shall apply its accounting policies consistently

Selection and Application of Accounting Policies

Condition: Guidance Unavailable

10. In the absence of an IFRS that specifically applies to a transaction, other event or condition, management shall use its judgment in developing and applying an accounting policy that results in information that is:

(a) relevant to the economic decision-making needs of users; and

(b) reliable, in that the financial statements:

(i) represent faithfully the financial position, financial performance and cash flows of the entity**;**

(ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form**;**

(iii) are neutral, ie free from bias;

(iv) are prudent; and

(v) are complete in all material respects.

Selection and Application of Accounting Policies

- **In making the judgment described in paragraph 10, management shall refer to, and consider the applicability of, the following sources in descending order:**
- **the requirements in IFRSs dealing with similar and related issues; and**
- **the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the *Framework.3***
- Also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources in paragraph 11. [IAS 8.12]

Selecting Accounting policies

- ☐Identify transactions or events with no specific accounting policies,
- ☐E.Gs
  - ☐Carbon certificates
  - ☐Indigenisation transactions

Change in accounting policies

- If an accounting policy changes that is non-compliance with consistency principle- so how do we achieve it?

Changes in Accounting Policies

- An entity is permitted to change an accounting policy only if the change:
  - is required by a standard or interpretation (**Compulsory**); or
  - results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance, or cash flows (**Voluntary**). [IAS 8.14]
- Note that changes in accounting policies do not include applying an accounting policy to a kind of transaction or event that did not occur previously or were immaterial. [IAS 8.16]

Changes in Accounting Policies

- The following are NOT changes in accounting policy:
  - the application of an accounting policy to transactions that differs in substance from previous transactions
  - the application of a new accounting policy to transactions that did not occur previously or was immaterial 8.16
- Initial application of a policy to revalue assets (IAS 16 or IAS 38) is a change in accounting policy to be dealt with as a revaluation in accordance with IAS 16 or IAS 38

Applying changes in accounting policies-22&23

COMPULSORY CHANGE

- Is required by an IFRS
- <u>Apply specific transitional arrangements of IFRS if applicable</u>
- <u>Otherwise apply retrospectively</u>

VOLUNTARY CHANGE

- Results in more relevant and reliable information
- Apply changes retrospectively to extent practicable

RETROSPECTIVE ADJUSTMENT

Amend current & comparative

Amend RE of year prior to comparative (if practicable)

	20.12 Current		20.11 Prior		20.10 Opening Prior
New figures	XXXXX		XXXXX		XXXXX
Old figures	XXXX		XXXX		XXXX
	XXX		XXX		XXX
Tax (28%)	(X)		(X)		(X)
	(XX)		(XX)		(XX)

CHARTERED ACCOUNTANTS ACADEMY

Key to your future

Changes in Accounting Policies

- Also, if it is impracticable to determine the cumulative effect, at the beginning of the current period, of applying a new accounting policy to all prior periods, the entity shall adjust the comparative information to apply the new accounting policy prospectively from the earliest date practicable. [IAS 8.25]

CHARTERED ACCOUNTANTS ACADEMY

Disclosures Relating to Changes in Accounting Policies

- Disclosures relating to changes in accounting policy caused **by a new standard or interpretation** include: [IAS 8.28]
  - the title of the standard or interpretation causing the change
  - the nature of the change in accounting policy
  - a description of the transitional provisions, including those that might have an effect on future periods

Disclosures Relating to Changes in Accounting Policies

- for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:
  - for each financial statement line item affected, and
  - for basic and diluted earnings per share (only if the entity is applying IAS 33)
- the amount of the adjustment relating to periods before those presented, to the extent practicable
- if retrospective application is impracticable, an explanation and description of how the change in accounting policy was applied.
- Financial statements of subsequent periods need not repeat these disclosures.

Disclosures Relating to Changes in Accounting Policies

- Disclosures relating to voluntary changes in accounting policy include: [IAS 8.29]
  - the nature of the change in accounting policy
  - the reasons why applying the new accounting policy provides reliable and more relevant information
  - for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:
    - for each financial statement line item affected, and
    - for basic and diluted earnings per share (only if the entity is applying IAS 33)
  - the amount of the adjustment relating to periods before those presented, to the extent practicable
  - if retrospective application is impracticable, an explanation and description of how the change in accounting policy was applied.

Disclosures Relating to Changes in Accounting Policies

- Financial statements of subsequent periods need not repeat these disclosures.
- If an entity has not applied a new standard or interpretation that has been issued but is not yet effective, the entity must disclose that fact and any and known or reasonably estimable information relevant to assessing the possible impact that the new pronouncement will have in the year it is applied. [IAS 8.30]

IAS 8 EXAMPLE 1

CHANGE IN ACCOUTING POLICY

The directors decided to change the accounting policy of the company in respect of the valuation of inventories. Previously the company valued inventories on the weighted average method and changed the policy to the first-in-first-out method as it will result in a more relevant and reliable presentation of the effect of inflation on the company's inventory balances. The inventory values at the end of February (year end), based on the two methods of valuation, were as follows:

Assume that the previous tax assessments will not be reopened for the change in valuation method.

	20.12	20.11	20.10
	R	R	R
Weighted average method (old)	706 500	685 000	656 000
First-in-first-out method (new)	745 300	720 000	684 500

REQUIRED 8 marks

Prepare the change in accounting policy note for the financial year ended 29 February 20.12

IAS 8: EXAMPLE 1

Calculating the impact of a change in accounting policy

	20.12 SOFP impact		2012 P/L impact		20.11 SOFP impact		2011 P/L impact		20.10 RE SOCIE impact	
FIFO (new) Weighted average (old)	745 300 706 500				720 000 685 000				684 500 656 000	
 Tax (28%)	38 800 (10 864)		3 800 (1 064)		35 000 (9 800)		6 500 (1 820)		28 500 (7 980)	
	27 936		2 736		25 200		4 680		20 520	

IAS 8: EXAMPLE 1

KAYMER LTD
NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 29 FEBRUARY 20.12

Change in accounting policy

The company changed its accounting policy in respect of the valuation of inventory from the weighted average method to the first-in-first-out method. This change was effected to ensure a more relevant and reliable presentation.
The change in policy was accounted for retrospectively and comparative amounts have been appropriately restated. The effect of this change is as follows:

Impact in P&L	20.12 R	20.11 R	20.10 R
Decrease in cost of sales [C1]	3 800	6 500	
Increase in current tax expense (due to increase in inventory) [C1]	(1 064)	(1 820)	
Increase in profit	**2 736**	**4 680**	
Impact in SFP			
Increase in inventory	38 800	35 000	28 500
Increase in tax payable	(10 864)	-	-
Increase in deferred tax liability	-	(9 800)	(7 980)
Increase in equity	**27 936**	**25 200**	**20 520**
Increase in earnings per share	R0,001	R0,002	R0,002

- Describe the nature and reason for the change in accounting policy
- Indicate how the changes has been accounted for
- Were impracticable to restate indicate reasons why
- Indicate effect on each financial statement item split into profit and equity
- Retrospective adjustment means adjust only 20.11 comparative period
- If error affected all the other years before 20.11 a disclosure of effect on opening retained earnings and equity will have to be made
- Effect of EPS including DEPS need to be indicated, in this example there is not enough information to show effect

Changes in Accounting Estimate

- The effect of a change in an accounting estimate shall be recognised prospectively by including it in profit or loss in: [IAS 8.36]
  - the period of the change, if the change affects that period only, or
  - the period of the change and future periods, if the change affects both.
- However, to the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, it is recognised by adjusting the carrying amount of the related asset, liability, or equity item in the period of the change. [IAS 8.37]

Disclosures Relating to Changes in Accounting Estimate

- Disclose:
  - the nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods
  - if the amount of the effect in future periods is not disclosed because estimating it is impracticable, an entity shall disclose that fact. [IAS 8.39-40]

IAS 8: EXAMPLE 3

Change in estimate

Tyrol Ltd was incorporated on a January 2009. On that day plant and machinery were purchased and available for use immediately. The company has always depreciated its plant and machinery at 20% on the reducing balance method. At the end of 20.12 the directors decided to write off the asset over the remaining useful life as from 1 January 20.12.

On 31 December 20.12 the remaining useful life was 2 year for plant and machinery.

	Cost	Accumulated depreciation	Carrying amount
Plant and machinery	1 750	854	896

REQUIRED:

Prepare the profit before tax note for the financial year ended 31 December 20.12

IAS 8: EXAMPLE 3

TYROL LTD
NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 FEBRUARY 20.12

PROFIT BEFORE TAX
Profit before tax is shown after taking the following into account:

	20.12	20.11
Depreciation	299 (1)	244 (2)

(1) 896/3 = 299
(2) 1750 * 80% *80% *20%= 244

Included in depreciation for 20.12 is a change in estimate, increase in depreciation by 120(C1) arising from the decision to depreciate plant and machinery on the straight line method in the instead of the reducing balance method. The decision will result in a decrease in depreciation in future of R120.

(C1)
- 896*20% = 179
- 299 – 179 = 120

Good Exam Technique

. **Write down proper headings and layout. To earn presentation marks**

- **Always include comparative unless specifically instructed to ignore!!!**
- **Show calculations and reference to calculations**

- **Describe the nature**
- **The amount of the change**
- **Indicate how the changes has been accounted for**
- **The effect on future period If impracticable, a statement to that effect**

Errors

- The general principle in IAS 8 is that an entity must correct all material prior period errors retrospectively in the first set of financial statements authorised for issue after their discovery by: [IAS 8.42]
  - restating the comparative amounts for the prior period(s) presented in which the error occurred; or
  - if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

Errors

- However, if it is impracticable to determine the period-specific effects of an error on comparative information for one or more prior periods presented, the entity must restate the opening balances of assets, liabilities, and equity for the earliest period for which retrospective restatement is practicable (which may be the current period). [IAS 8.44]
- Further, if it is impracticable to determine the cumulative effect, at the beginning of the current period, of an error on all prior periods, the entity must restate the comparative information to correct the error prospectively from the earliest date practicable. [IAS 8.45]

Errors

- **Disclosures Relating to Prior Period Errors**
- Disclosures relating to prior period errors include: [IAS 8.49]
  - the nature of the prior period error
  - for each prior period presented, to the extent practicable, the amount of the correction:
    - for each financial statement line item affected, and
    - for basic and diluted earnings per share (only if the entity is applying IAS 33)

Errors

– the amount of the correction at the beginning of the earliest prior period presented
– If retrospective restatement is impracticable, an explanation and description of how the error has been corrected.
– Financial statements of subsequent periods need not repeat these disclosures.

IAS 8: EXAMPLE 2

PRIOR PERIOD ERROR

On 31 January 20.11 Baobab Ltd received an amount of R342 000 (VAT included) from a customer for services that were only rendered during June 20.11. The accountant recognised the R342 000 as revenue in January 20.11 and did not allocate the VAT of 14% to the VAT output account. The result was that the R342 000 was included in revenue for the financial year ended 28 February 20.11. For tax purposes, the R342 000 was taxed in the financial year ended 28 February 20.11. The SARS indicated that they will re-open the 20.11 assessment to correct the amount of VAT that was incorrectly included in taxable profit. The figures in the trial balance have not yet been adjusted to account for the correction of the accounting error.

Ignore the implications of any penalties and/or interest on the late payment of VAT

REQUIRED

Prepare the prior period error note for the financial year ended 29 February 20.12 **8 marks**

Error Correcting Journal Entries:

What Happened

Dr Bank (sfp) 342 000

Cr Revenue (p/l) 342 000

Recognition of revenue.

Dr Tax Expense 95760

Cr Tax Payable 95760

(342k*28%)=95760

Recognition of current tax

What Should have Happened

Dr Bank (sfp) 342 000

Cr Def Revenue (SFP)

(342k*100/114) 300 000

Cr Vat Output (SFP) 42 000

Dr Deferred Tax(sfp) 84 000

Cr Tax Expense (P/l) 84000

(300k*28%)=84000

Error Correcting Journal Entries:

Dr Revenue (P/L) 342 000

Cr Def Revenue (SFP) (342k*100/114) 300 000

Cr Vat Output (SFP) 42 000

Reversal of revenue received in advance and accrual of VAT on revenue.

Dr Deferred Tax (Sfp) (300k*28%) 84 000

Dr Tax Payable (SFP)(42000*28%) 11 760

Cr Tax Expense (P/L) 95760

Recognition of deferred tax on revenue received in advance and adjustment to overstated current tax

IAS 8: EXAMPLE 2

Prior period error

Revenue received in advance during the 20.11 financial year was incorrectly recognised as revenue in the financial year ended 28 February 20.11 instead of the financial year ended 29 February 20.12. The amount recognised erroneously included the VAT that was charged on the amount received. The comparative amounts for the financial year ended 29 February 20.12 was restated. The effect of the restatement on the financial statements is summarised below: (2)

	20.11	
Decrease in revenue	(342 000)	(½)
Decrease in income tax expense (342 000 x 28%)	95 760	(1)
Decrease in profit	(246 240)	(½)
Increase in revenue received in advance (342 000 x 100/114)	(300 000)	(1)
Increase in VAT payable (342 000 x 14/114) or (342 000 – 300 000)	(42 000)	(1)
Increase in deferred tax asset (300 000 x 28%)	84 000	(1)
Decrease in current tax payable (42 000 x 28%)	11 760	(1)
Decrease in equity	(246 240)	

- Describe the nature of an error.
- Indicate how the changes has been accounted for
- Were impracticable to restate indicate reasons why

- Indicate effect on each financial statement item split into profit and equity
- Error only affects 20.11
- Retrospective adjustment means adjust only 20.11 comparative period
- If error affected all the other years before 20.11 a disclosure of effect on opening retained earnings and equity will have to be made
- Effect of EPS including DEPS need to be indicated, in this example the is not enough information to show effect

Apply IAS 8

Level 2

Try the following:

- Tut 102 Question 6.1

Inventory: IAS 2

CAA

CHARTERED ACCOUNTANTS ACADEMY

IAS 2: INVENTORIES

Examinability

Past ITC/FQE Exams

Past FQE Exams

- Not examined in the last 10 yrs

Past CTA Exams

- 2011 only

Examinability

2016 Possible areas of focus:

- UNISA had it the 2011 CTA exam- it could be coming- see UNISA Question at end of the Inventory section (Woodi Ltd – Part C)

Key Areas of Focus

- Accounting for manufactured inventories:
  - Cost of purchase, including rebates, settlement discounts and deferred settlement terms
  - Calculate Raw-material, WIP and FG balance, taking into account NRV
  - Calculate cost of sales
  - Calculate the inventory write down

Inventories is:

- assets held for sale in the ordinary course of business (finished goods),
  - assets in the production process for sale in the ordinary course of business (work in process),
  - and materials and supplies that are consumed in production (raw materials).
  - Consumables (include insignificant PPE items, stationery, etc.)

Fundamental Principle

- Inventories are valued at the lower of:
  - **cost** and
  - **net realisable value** (NRV). [IAS 2.9] (NRV is excluded from IFRS 13)

- Exam approach:
  - First determine the cost,
  - Then NRV (estimated SP- estimated cost to completion & cost to sell)
- Determine which one of the two is lower.

Measurement of Inventory

- Cost should include all: [IAS 2.10]
  - **costs of purchase** (including taxes, transport, and handling) net of trade discounts, rebates and settlement discount received or receivable.
  - **costs of conversion** (including fixed and variable manufacturing overheads) and
  - **other costs incurred** in bringing the inventories to their present location and condition

- IAS 23 *Borrowing Costs* identifies some limited circumstances where borrowing costs (interest) can be included in cost of inventories that meet the definition of a qualifying asset. [IAS 2.17 and IAS 23.4]- wine production, ship building, e.g.

Measurement of Inventory

- Inventory cost should NOT include: [IAS 2.16 and 2.18]
  - abnormal waste
  - storage costs
  - administrative overheads unrelated to production
  - selling costs
  - foreign exchange differences arising directly on the recent acquisition of inventories invoiced in a foreign currency
  - interest cost when inventories are purchased with deferred settlement terms.

Example: Deferred settlement terms

Q: X Ltd buys inventory, with a cost of R250 000, from B Ltd. Due to cash flow problems experienced by X Ltd, it is agreed that the amount due will be settled after nine months, even though the normal credit period granted by B Ltd is only three months. A fair discount rate is 12% per annum, compounded monthly.

S: As payment is deferred for nine months, the cost of the inventory should be the present value of R250 000, discounted over a period of nine months, at a rate of 1% per month. This will amount to R228 585 (FV = 250 000; i = 12/12; n =9).

Measurement of Inventory

- For inventory items that are **not interchangeable, specific costs are attributed to the specific individual items** of inventory. [IAS 2.23]
- For items that are **interchangeable, IAS 2 allows the FIFO or weighted average cost formulas.** [IAS 2.25] The LIFO formula, which had been allowed prior to the 2003 revision of IAS 2, is no longer allowed.
- The same cost formula should be used for all inventories with similar characteristics as to their nature and use to the entity. For groups of inventories that have different characteristics, different cost formulas may be justified. [IAS 2.25]
- The standard cost and retail methods may be used for the measurement of cost, provided that the results approximate actual cost. [IAS 2.21-22]

Cost of inventories

- Cost of inventories depends on whether the inventory is being bought or manufactured from within as follows:

Type of inventory	Bought	Manufactured/converted
Raw-material (RM)	Use Cost formulas-FIFO/WACO	
Merchandise/Finished goods	Use Cost formulas-FIFO/WACO	Direct material used + labour used + direct overheads + allocated fixed costs
Work-in-progress	N/A	Direct material used + conversion cost

Accounting Discounts & Rebates

- Apply Circular 09/2006 (refer to your SAICA handbook on circulars- Vol 3)

Discounts and rebates on Inventory Purchases (Learn to identify these in Q)

a) **Trade discount-** discount given to all traders and bulk buyers

b) **Cash discounts received**- discount given on all cash purchases

c) **Settlement discount receivable-** discount receivable after paying within a certain stipulated time

d) **Volume rebates receivable-** Customer has to achieve a certain level of purchases before being awarded a rebate.

NB:*c and d are complex

-

Discounts and rebates on Inventory Purchases

- a)**Trade and cash discounts received**
  -Deduct from inventory
  -Easy to account for – deducted at point of sale

- b)**Settlement discount receivable**
  -Deduct from inventory **ONLY** when receivable (check probability of receivability from the Q)

- c)**Volume rebates receivable**
  -Deduct from inventory **ONLY** when receivable (check probability of receivability from the Q)

-

Raw material (RM) Cost

- Determine the cost of RM:
  - Identify the cost formula used to measure RM:
    - FIFO – RM cost is based on the cost of the last purchase
    - Weighted Average Cost- determine total cost of all purchases/weighted average number of units of RM purchased.

Cost of goods Manufactured

Direct material used (do T account)

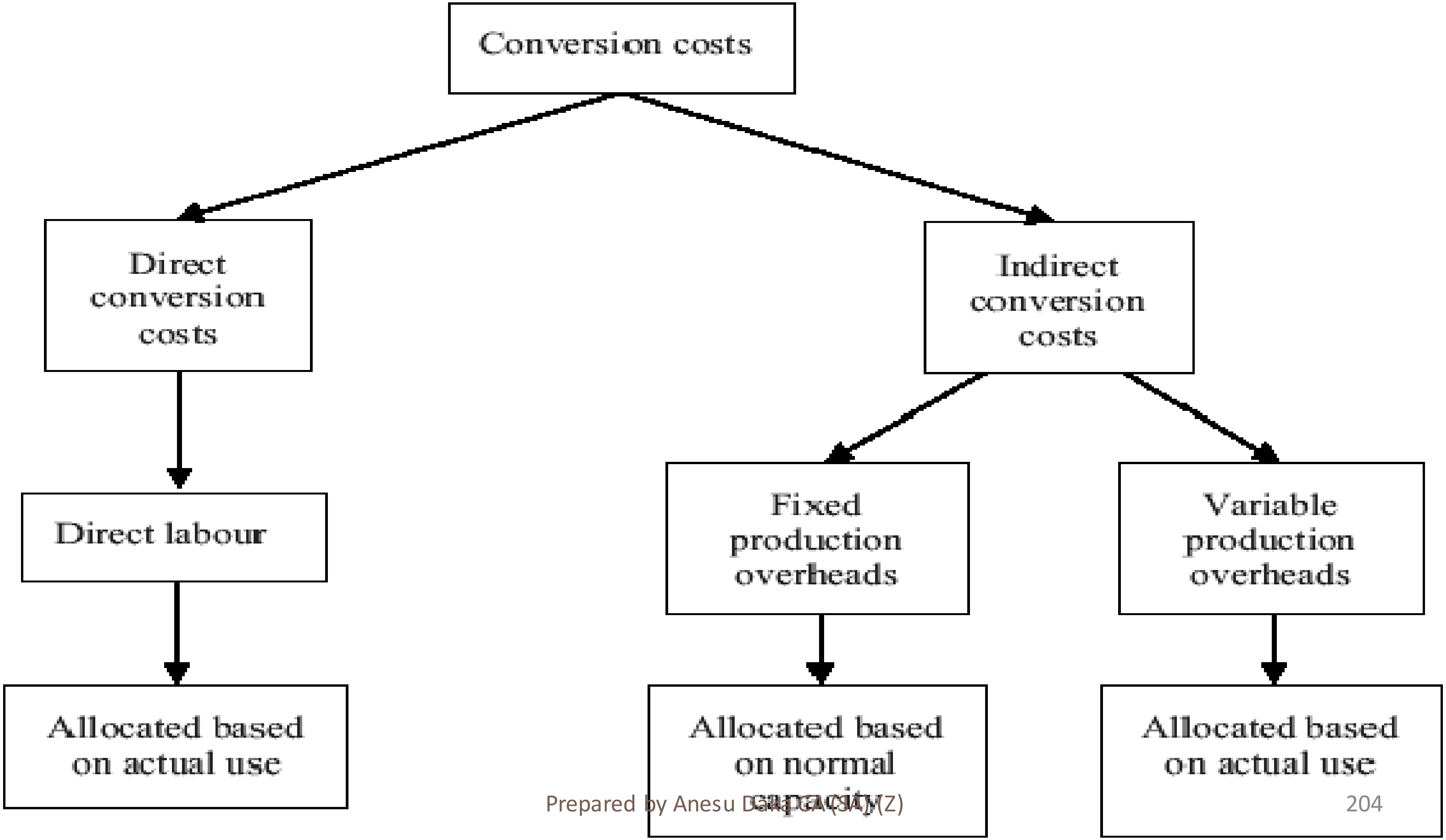
+ labour used (actual + normal loss hrs X rate)

+ direct overheads (allocated based on actual units)

+ allocated fixed costs (allocated based on normal capacity)

(see diagram below)

Allocation of Conversion Costs



Write-Down to Net Realisable Value

- NRV is the estimated selling price in the ordinary course of business, less the estimated cost of completion and the estimated costs necessary to make the sale. [IAS 2.6] Any write-down to NRV should be recognised as an expense in the period in which the write-down occurs. Any reversal should be recognised in the income statement in the period in which the reversal occurs. [IAS 2.34]

Expense Recognition

- Cost of inventory is recognised as **COST OF SALES (COS)** comprising of:
  - cost-of-goods-sold (number of units sold X manufacturing cost p/unit)
    - + Normal wastage (included in cost of inventory)
  - Any write-down to NRV, and
  - any inventory losses are also recognised as an expense when they occur:
    - Abnormal wastage (not included in inventory but included directly in COS
    - -Over/+under-recovery of fixed overheads ([IAS 2.34]

Disclosure

- Required disclosures: [IAS 2.36]
- accounting policy for inventories
- carrying amount, generally classified as merchandise, supplies, materials, work in progress, and finished goods. The classifications depend on what is appropriate for the entity
- carrying amount of any inventories carried at fair value less costs to sell
- amount of any write-down of inventories recognised as an expense in the period
- amount of any reversal of a write-down to NRV and the circumstances that led to such reversal
- carrying amount of inventories pledged as security for liabilities
- cost of inventories recognised as expense (cost of goods sold). IAS 2 acknowledges that some enterprises classify income statement expenses by nature (materials, labour, and so on) rather than by function (cost of goods sold, selling expense, and so on). Accordingly, as an alternative to disclosing cost of goods sold expense, IAS 2 allows an entity to disclose operating costs recognised during the period by nature of the cost (raw materials and consumables, labour costs, other operating costs) and the amount of the net change in inventories for the period). [IAS 2.39] This is consistent with IAS 1 *Presentation of Financial Statements*, which allows presentation of expenses by function or nature.

Apply IAS 2

Level 2

Try the following:

- Tut 102 Question 4.1-2

Case Study

CTA 2-Case Study 7 Question 2

Inventories

Topwood values raw material and work in progress (WIP) on a first-in-first-out (FIFO) basis.

The following are information regarding their manufacturing process:

Raw material

Raw material on hand on 30 June 20.10 (at cost)	R532 800
Raw material on hand on 30 June 20.11	?
Raw material purchased during the year	105 000 kg

The following costs relating to the purchasing of raw material were incurred during the current financial year:

	R
Purchase price	5 728 500
Transport costs	56 000
Handling costs	32 000
Storage (not part of production process)	48 000
Administrative expenses	29 600
	5 894 100

The inventory count at year end indicated that only 28% of the total raw material purchased was on hand at 30 June 20.11.

The normal raw material wastage is 15%, which takes place at the beginning of the production process.

The net realisable value of raw material amounts to R50 per kilogram on 30 June 20.11.

Work in progress

	R
Work in progress on hand on 30 June 20.10, at cost	428 400

The cost of work in progress at 30 June 20.11 has not yet been calculated. Detailed production records indicate that 15% of this year's allocated production expenditure and material used relate to furniture that were still under production at year end. The demand for the product is so high that all manufactured furniture is sold as soon as the production process is completed.

Overhead costs

Topwood uses normal capacity for the allocation of the fixed production overhead during the year.

The following overheads occurred during the year ended 30 June 20.11:

	R
Variable production overheads (fully productive)	752 800
Fixed production overheads	1 250 300

Normal capacity equals 15 000 units per year. Due to various problems, Topwood only produced 13 800 units for the year.

Labour

The following information is available for the year ended 30 June 20.11:

Direct labour	R12,60 per hour
Productive hours	125 000 hours
Normal idle hours	3 400 hours

Finished products

	R
Finished products on hand on 30 June 2010, at cost	1 569 000

Of the finished products, 25% of the units transferred from WIP in the current year was still on hand on 30 June 20.11.

The selling price of the finished products was R750 on 30 June 20.11. Delivery cost per product amounts to R50, while sales commission amounts to 2.5%.

QUESTION 2

		Marks
(a)	Prepare the journal entries to account for the share-based payment scheme for the year ended 30 June 20.11. Ignore taxation. Journal narrations are not required.	10
(b)	Prepare the journal entry to record the leave pay accrual for the year ended 30 June 20.11.	5
(c)	Calculate the amount (Rand) of work in progress Topwood Ltd transferred to finished products during the 30 June 20.11 financial year.	7
(d)	Calculate the cost of sales that should be included in the financial statements of Topwood Ltd for the year ended 30 June 20.11.	3
(e)	Discuss whether the raw materials need to be written down to its net realisable value at 30 June 20.11.	4
	Communication skills: Logical flow and conclusion	1

Please note:

- Comparative amounts are not required
- Round off all calculated amounts to the nearest Rand
- Your answer must comply with International Financial Reporting Standards (IFRS).

Planning the answer

- Calculation **WIP transferred to FGs account** :
  - Approach:
    - calculate the cost of goods produced:
      - RM used (op RM + Purchases+ normal wastage – clo RM)
      - + direct labour (productive + normal loss hrs) X rate per hr
      - + variable overheads (units produced * variable cost/unit or given amt)
      - + allocated fixed overheads (units produced/normal capacity * total fixed overheads

Using T Accounts or Pro-forma (Manufacturing Account Format) may work

(c) Work in Progress transferred to finished products

	R	
Raw material		
- Opening balance at 1 July 20.10	532 800	(½)
- Purchases (5 728 500 + 56 000 + 32 000)	5 816 500	(1)
- Closing balance (5 816 500 x 28%)	(1 628 620)	(1)
Transferred to WIP	4 720 680	
		(2½)
Work in progress		
- Opening balance at 1 July 20.10	428 400	(½)
- Raw material	4 720 680	(½)
- Direct labour (125 000 + 3 400) x 12,60	1 617 840	(1½)
- Fixed production overheads [C3]	1 150 276	(1)
- Variable production overheads	752 800	(½)
- Closing balance (8 241 596 x 15%)	(1 236 239)	(1)
Transferred to finished products	7 433 757	
		(2½)
	Total	(7½)
	Maximum	(7)

C3. Fixed production overheads

Fixed overheads / Normal capacity units (R1 250 300/15 000)	83,35 per unit	[½]
Per unit x actual units produced (R83,35 x 13 800)	R1 150 276	[½]
Under-recovery of fixed production overheads (1 250 300 – 1 150 276)	R 100 024	[1]

(d) Cost of sales

	R	
Cost of products sold [C4]	7 144 318	(2)
Unallocated fixed production overhead costs [C3]	100 024	(1)
Cost of sales	7 244 342	
		(3)

(e) Discussion if raw materials need to be written-down to its NRV

The general rule of IAS 2 is that inventories should be reflected at the lower of cost or net realisable value. (½)

There is however one exception to this general rule and this is that raw materials or supplies that will be incorporated in the finished product are not written-down below cost if the finished product is expected to be sold at or above cost (IAS 2.32). (1)

	R	
Selling price of finished products (750 – 50 – (750 x 2.5%))	681,25	(1)
Cost price of finished products (1 858 439 / (13 800 x 25%))	538,68	(1)
Cost per kilogram of raw material purchased during the year (5 816 500 / 105 000)	55,39	(1)
Net realisable value per kilogram (given)	50,00	(½)

Because the NRV of the finished products are above the cost price, the raw material should not be written down to NRV (1)

Total (6)

Maximum (4)

Communication skills: Logical flow and conclusion (1)

C4. Finished products

	R	
Opening balance	1 569 000	[½]
Work in progress	7 433 757	[½]
Closing balance (25% x 7 433 757)	(1 858 439)	[1]
Products sold, i.e. cost of sales	7 144 318	[2]

Employee Benefits: IAS 19

CAA

CHARTERED ACCOUNTANTS ACADEMY

Examinability

Past ITC/FQE Exams

Past FQE Exams

- 2004 (JE on BDP and discussion of bonus provision)-27 marks

Past CTA Exams

- 2013
- 2012
- 2011
- 2010
- 2009

Examinability

2016 Possible areas of focus:

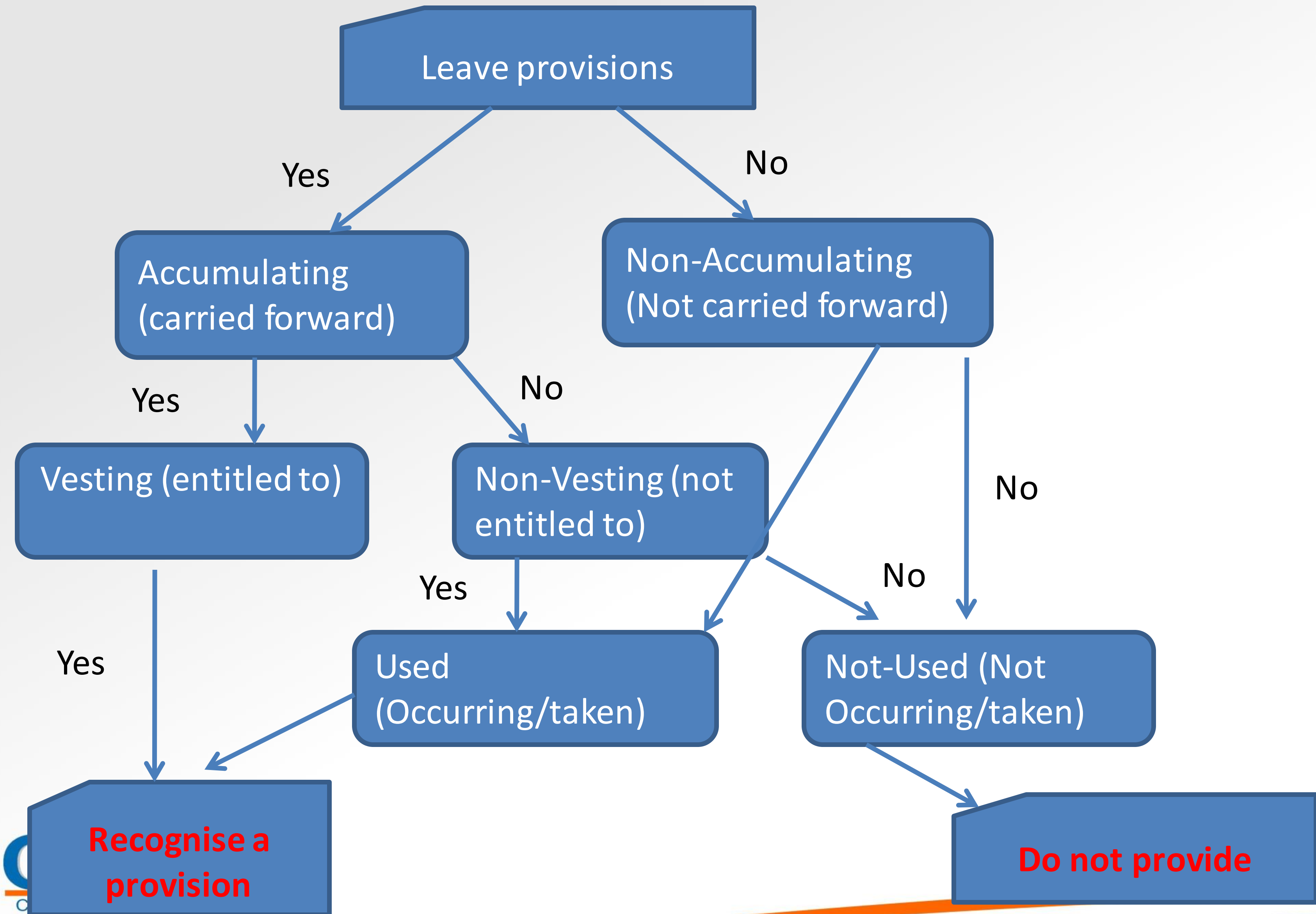
- Test of changes in IAS 19 (Defined Benefit Plan) still possible even though tested in 2013
- Restructuring and other long-term benefits
- IFRS 2 has been tested very often including 2012, hence, both IAS 19 and IFRS 2 are still going to be tested again.

Key Focus Areas

- Recognition & measurement of:
  - Leave and bonus provisions
  - Restructuring provisions + Business Combinations + IAS 37
- Identification/classification of employee benefits
- Key changes to IAS 19- especially changes to Defined benefit plans
- Presentation and Disclosure + Journal Entries

Recognition: Provision for leave

- Leave Pay provisions- including annual and other leaves (sick, maternity, e.g.) and can be classified as:
  - Accumulating compensated leave, or
    - Can be carried forward if not utilised in the current year
    - May either be given as leave or paid as cash (vests)
    - Not paid as cash (non-vesting) but can be taken as leave only
  - Non-accumulating compensated leave, or
    - Can no be c/f if not utilised in current year
    - Usually NO provision is provided, e.g. for sick leave, maternity leave, paternity leave, e.t.c


Leave provisions
Yes
No
Accumulating (carried forward)
Non-Accumulating (Not carried forward)
Yes
No
No
Vesting (entitled to)
Non-Vesting (not entitled to)
Yes
No
Yes
Used (Occurring/taken)
Not-Used (Not Occurring/taken)
Recognise a provision
Do not provide

Accounting for Leave Pay Provisions

Dr Short-term employee benefits (p/L)

Cr Leave Provisions (SoFP)

Formula for amount of leave pay provision:

Amount = expected # of days leave to be taken/paid out X salary per day

- Expected # of days = total leave days available adjusted for the probability of being taken as leave or paid as cash.
- Salary per day =
  - monthly salary divided by 21.67 days, or
  - Annual salary divided by 260 days (use days given)

Deferred Tax Implications

SoFP Method

	CA	TB	TD		DT
Leave prov	XXX	0	XXX	25%	X

Profit-sharing and Bonus Payments

- The entity should recognise the **expected cost** of profit-sharing and bonus payments when, and only when,
  - it has a **legal or constructive obligation** to make such payments as a result of past events and
  - a **reliable estimate of the expected cost** can be made. [IAS 19.17]
- IAS 37 – provisions (Provision for bonus)
- Provision is a **liability** of <u>uncertain</u> **amount** or **timing**

Deferred Tax Implications

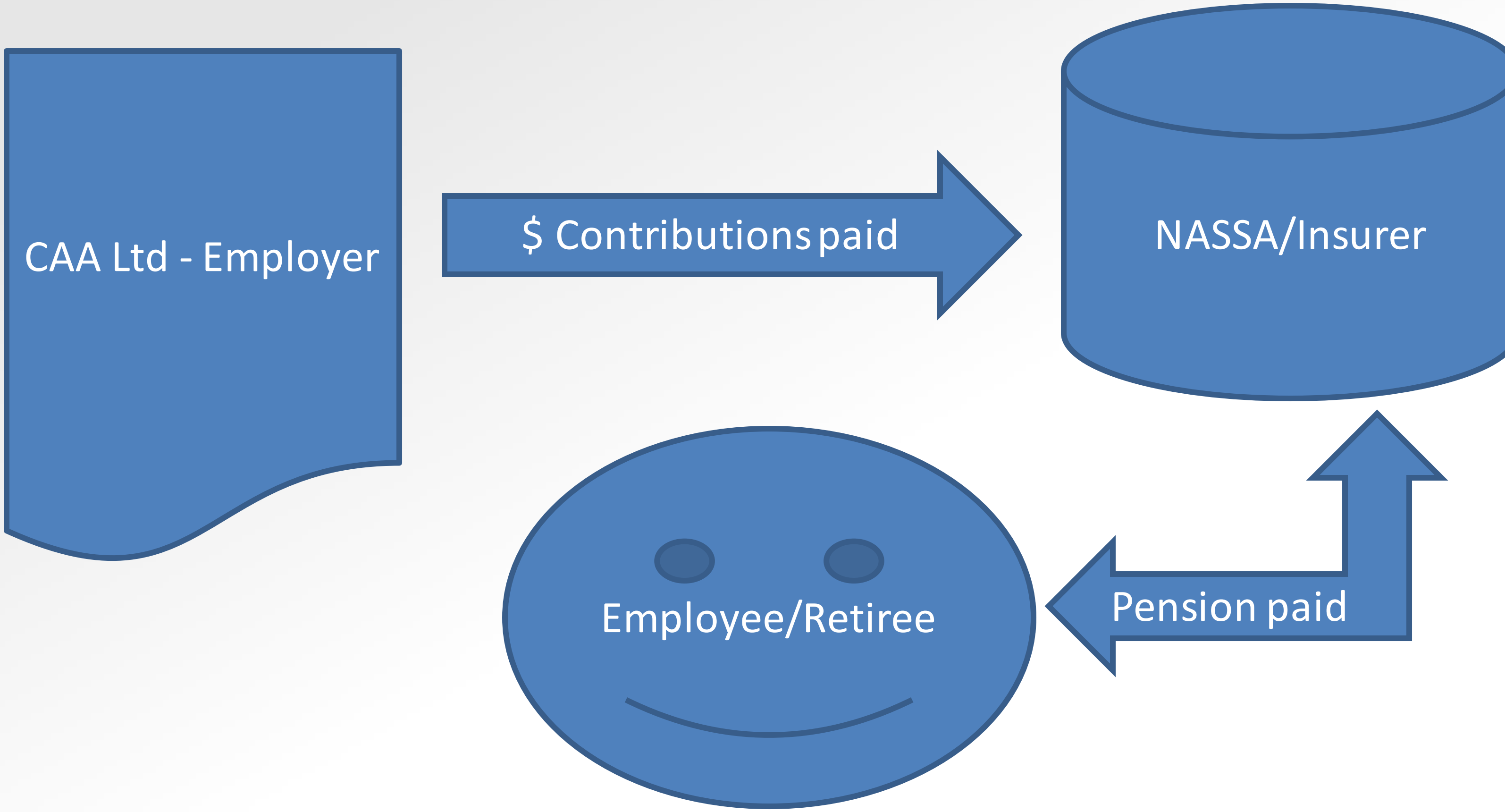
B/S Method

	CA	TB	TD		DT
Bonus prov	XXX	0	XXX	25%	X

Types of Post-employment Benefit Plans

- The accounting treatment for a post-employment benefit plan will be determined according to whether the plan is a:
  - **defined contribution** or
  - **defined benefit plan**:
- Under a **defined contribution plan**,
  - the entity pays **fixed** contributions into a fund
  - but has no legal or constructive obligation to make further payments if the fund does not have sufficient assets to pay all of the employees' entitlements to post-employment benefits. (see diagram)
- A **defined benefit plan** is a post-employment benefit plan:
  - the entity pays contributions into a fund
  - but has legal or constructive obligation to make further payments if the fund does not have sufficient assets to pay all of the employees' entitlements to post-employment benefits.
  - These would include both formal plans and those informal practices that create a constructive obligation to the entity's employees. (see diagram)

Defined Contribution Diagram



Employer defines/guarantees the employee contribution only

Nature of DCPs:

- E.g.:
  - provident funds and
  - premiums to fund life insurance policies

Defined Contribution Plans

- For defined contribution plans, the cost to be recognised in the period is the contribution payable in exchange for service rendered by employees during the period.

Dr Defined Contribution expense (6% of Gross salary)

Cr Bank (contribution)/Contribution payable

- If contributions to a defined contribution plan do not fall due within 12 months after the end of the period in which the employee renders the service, they should be **discounted to their present value**. [IAS 19.83]

Defined Contribution Plans

Example

- All the employees of Toi-Toi Ltd belong to the XYZ provident fund (a defined contribution plan). During the year current contributions amounting to $210 000 were paid over to the fund. Apart from that, the company also decided to pay over additional contributions of $500 000 during the current year, in order to improve the future benefits of current and retired employees. Forty percent of this additional contribution relates to retired employees. The remaining average working life of the current employees is ten years. What will the defined contribution plan expense for the year amount to?

CHARTERED ACCOUNTANTS ACADEMY

Defined Contribution Plans

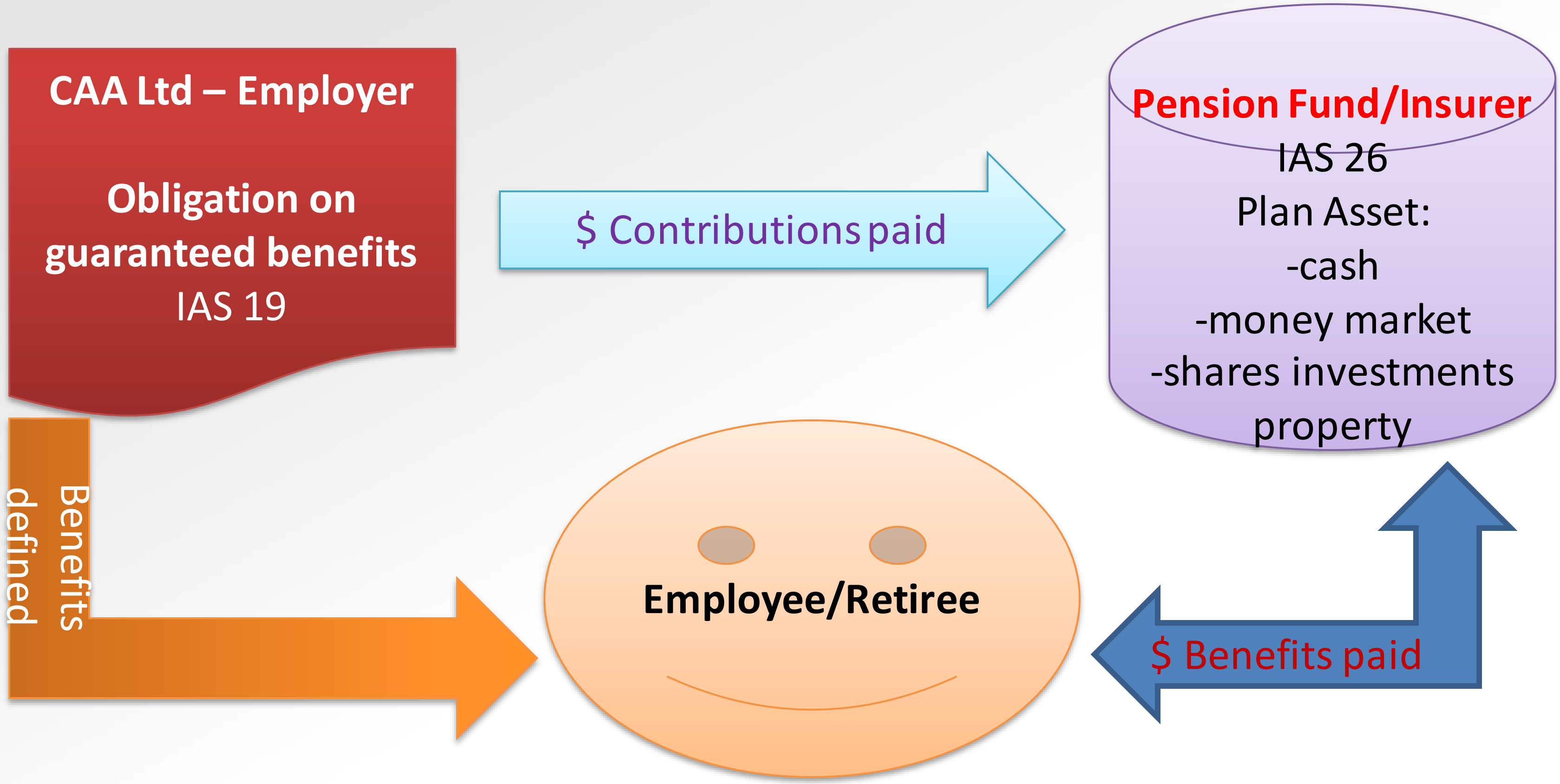
Example

- $710 000, According to IAS 19.44, the total contribution payable to a defined contribution plan in exchange for services, should be recognised as an expense. No distinction is made between current and additional contributions, or between current and retired employees.

Dr Employee benefits 710k

Cr Bank/Provident fund contribution payable 710k

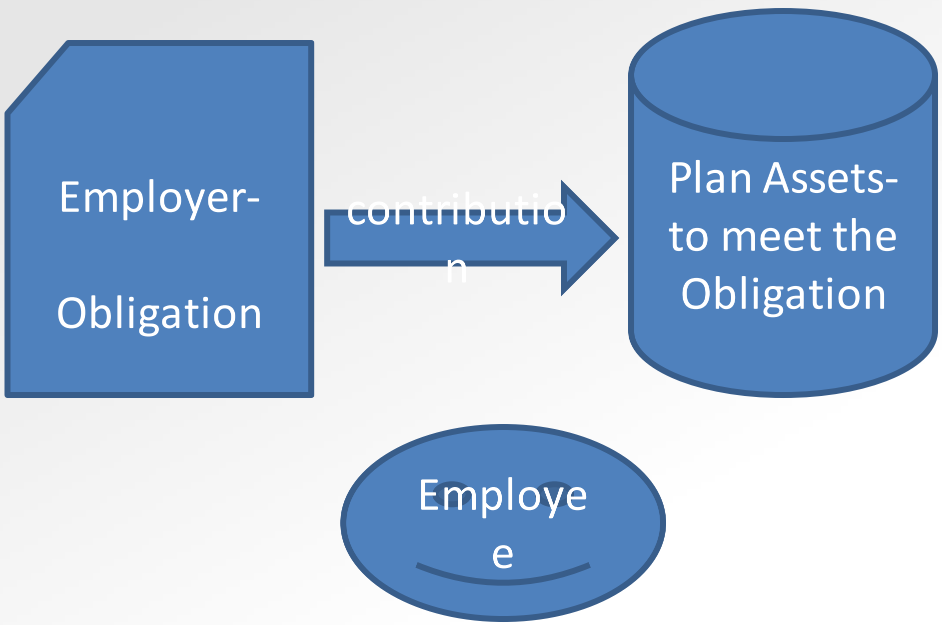
Defined Benefit Plan Diagram



Employer defines/guarantees the employee benefit ($2000) after retirement and is obliged to provide this. Employer is liable for any short-falls

Plan Assets-Funded Vs Unfunded

- FUNDED Obligation



Employer creates and contribute into a fund to meet obligation

- UNFUNDED Obligation

Employer DOES NOT contribute into a fund to meet obligation

Examples:

- Pension funds
- Promise to pay medical aid contributions of an employee after retirement

Key Examination Areas

- Disclosure in P/L (PBT note- employee benefits)
- JE for the OCI- re-measurement gain/losses
- SOFP notes:
  – Net liability
  – Reconciliations of the obligation and the plan assets

SOFP Presentation

STATEMENT OF FINANCIAL POSITION AS AT 30 SEPTEMBER 20.12

	Note	20.12 R'000	20.11 R'000	
ASSETS				
Non-current assets				
Deferred taxation		170	185	(2)
EQUITY AND LIABILITIES				
Non-current liabilities				
Post-employment benefit liability	5	530	400	(2)
Current liabilities				
Provision for bonus and leave		310	295	(2)
			Total	(6)

P/L Disclosure

Profit before taxation

	20.12 R'000	20.11 R'000	
The following items are included in profit before tax:			
Employee benefit expenses			
Short-term employee benefits [C6]	2 735	2 609	(4)
Defined benefit plan expense	384	691	(1)
- Current service cost	341	316	(1)
- Net interest [C1]	43	15	(2)
- Past service cost	-	360	(1)
		Total	(9)

SOFP Disclosure

Net defined benefit liability

	20.12 R'000	20.11 R'000	
Present value of the obligation [5.2]	5 540	4 990	(1)
Fair value of plan assets [5.3]	(5 010)	(4 590)	(1)
Liability recognised in the statement of financial position	530	400	

SOFP Disclosure

Reconciliation of the present value of defined benefit obligation

Present value of obligation at beginning of the year	4 990	4 110	(1)
Interest cost (10,7% x 4 990; 11% x 4 110)	534	452	(2)
Current service cost	341	316	(1)
Past service cost - increased benefits	-	360	(1)
Benefits paid	(320)	(301)	(1)
Remeasurement (balancing figure)	(5)	53	(1)
Present value of obligation at end or year	5 540	4 990	

SOFP Disclosure

Reconciliation of the fair value of the defined benefit plan assets

Fair value of plan assets at beginning of the year	4 590	3 970	(1)
Interest income			
(10,7% x 4 590; 11% x 3 970)	491	437	(2)
Contributions received	387	372	(1)
Benefits paid	(320)	(301)	(1)
Remeasurement (balancing figure)	(138)	112	(1)
Fair value of plan assets at end of year	5 010	4 590	

Plan assets include property leased by Yster Ltd with a fair value of R1 120 000 (20.11 - R950 000). (1)

SOFP Disclosure

Pension fund

The Ouhout Pension Fund is a defined benefit plan for employees. All the employees of Yster Ltd are members of the pension fund. Actuarial valuations are made annually. The most recent valuations was made on 31 September 20.12. The actuary is of the opinion that the plan is in a sound financial position. There are no unusual risks or any significant concentration of risk to which the plan is exposed. (2)

Discount rate	10,7	11,0	(1)
Future salary increases	7,0	7,0	(1)
Future pension increases	5,0	5,0	(1)

SOFP Disclosure

Net defined benefit liability

	20.12 R'000	20.11 R'000	
Present value of the obligation [5.2]	5 540	4 990	(1)
Fair value of plan assets [5.3]	(5 010)	(4 590)	(1)
Liability recognised in the statement of financial position	530	400	

SOFP Disclosure

Net defined benefit liability

	20.12 R'000	20.11 R'000	
Present value of the obligation [5.2]	5 540	4 990	(1)
Fair value of plan assets [5.3]	(5 010)	(4 590)	(1)
Liability recognised in the statement of financial position	530	400	

SOFP Disclosure

Net defined benefit liability

	20.12 R'000	20.11 R'000	
Present value of the obligation [5.2]	5 540	4 990	(1)
Fair value of plan assets [5.3]	(5 010)	(4 590)	(1)
Liability recognised in the statement of financial position	530	400	

Defined Benefit Obligation

Reconciliation of mvt in the defined benefit obligation:

Opening Balance –PV	XXXX
+Past service cost (if any)- (see next slide)	XX
+Finance cost (Op Bal x Discount rate)	X
+Current Service Cost	XX
- Benefits paid	(XX)
-/+ re-measurement gains/losses (b/f)	X
Closing Balance – PV (given by actuary)	XXXX

Defined Benefit Obligation

- **<u>Past service cost</u>** is the **change** in the obligation for employee service in prior periods, arising as a result of changes to plan arrangements in the current period.
- Past service cost may be either:
  - positive (where benefits are introduced or improved) or
  - negative (where existing benefits are reduced).
- Past service cost should be recognised **immediately** to:
  - the extent that it relates to former employees or to active employees .

Defined Benefit Obligation

<u>Past service cost</u>

- **Recognition-** include the **VESTED+NON-VESTING** past service cost in the P&L , as follows.

Dr Past service costs (P/L) XXX

Cr Defined benefit Obligation (F/P) XXX

Recognition of <u>past service</u> costs-**increase** in benefits

OR

Dr Defined benefit obligation (F/P) XXX

Cr Past service (P/L) XXX

Recognition of <u>past service costs</u>- **decrease** in benefits

Example: Past service costs

- CAA Ltd has a year-end of 31 December 20X9. On 1 January 20X9 improvements were made to the defined benefit plan, in terms of which additional benefits will be provided to employees when they retire, based on services from 1 January 20X7. The benefits become vested after four years of service. At 1 January 20X9 the present value of the additional benefits for service from 1 January 20X7 to 1 January 20X9 is as follows:

Employees with > four years' service at 1/1/20X9	90 000

Required – Prepare the JEs for the recognition of past service costs in 20X9

Defined Benefit Obligation

Past service cost

- **Initial recognition-** include the whole determined past service cost in the obligation, as follows.

Dr Past service cost (P&L) 90000

Cr Defined benefit obligation (F/P) 90000

Defined Benefit Obligation

Current Service Cost:

- **Recognition:** the increase in the present value of the defined benefit obligation resulting from employee service in the current period.
- Measurement: PV of the current year's benefit is known as current service cost.

JE

Dr Current service cost (staff cost) (P/L) XXX

Cr Defined benefit obligation (F/P) XXX

Defined Benefit Obligation

Interest Cost:

- **Recognition:** Interest cost is the increase during a period in the present value of a defined benefit obligation which arises because the benefits are one period closer to settlement.
- **Measurement**:
  - Opening PV of defined benefit obligation + past service cost determined at the BEGINNING of the year) X % discount rate
- NB: use this formula if the benefits paid are paid at the end of the year and not during the year at specific dates.

Defined Benefit Obligation

Interest Cost:

- **Measurement**: If benefits are paid at specific dates e.g. 30 June and 31 December for a December year end use the compound interest approach:
  - Interest for Jan- June = (Op PV of Obligation + past service cost at the beginning of the yr, if any) * discount rate
  - Interest for July – Dec =
    - (Op PPV of Obligation +
    - past service cost at the beginning of the yr, if any +
    - interest for Jan - June less benefits paid) X
    - discount rate
  - Interest cost recognised in P/L= Jan – June + July – December

Dr Net Interest cost/income (staff cost) (P/L) XXX

Cr Defined benefit obligation (F/P) XXX

Defined Benefit Obligation

Benefits paid :

- **Recognition:** When employees receive their benefits, the **defined benefit obligation reduces**. Benefits are paid either from the assets of the employer, if the plan is UNFUNDED, or from specific/plan assets set aside to meet the obligation, if the plan is FUNDED.

- **Measurement**: amount always given

Dr Defined benefit obligation (F/P)	XXX
Cr Plan Assets (if Funded) or Bank (if UNFUNDED (F/P)	XXX

Defined Benefit Obligation

Reconciliation of mvt in the defined benefit obligation:

Opening Balance –PV	XXXX
+Past service cost (if any)- (see next slide)	XX
+Finance cost (Op Bal x Discount rate)	X
+Current Service Cost	XX
- Benefits paid	(XX)
-/+ re-measurement gains/losses (b/f)	X
Closing Balance – PV (given by actuary)	XXXX

Defined Benefit Obligation

Remeasurement gains & Losses:

- **Recognition:** arises from the difference btwn the recognised obligation and the actuarially valued obligation (see recon in slide above)

- **Measurement**: determine from the reconciliation of the in the obligation (see above slide)

Actuarial gain or loss = Actuary's valuation less recognised book value of the obligation

Defined Benefit Obligation

Remeasurement gains & Losses:

- **Recognition Journal Entries:**

Re-measurement loss(**OCI**) XXX

Cr Defined benefit obligation (F/P) XXX

Recognition of re-measurement loss on obligation

Dr Defined benefit obligation (F/P) XXX

Cr Re-measurement gain (**OCI**) XXX

Recognition of re-measurement gain on obligation

Plan Assets- Funded

Reconciliation of mvt in the defined benefit obligation:

Opening Balance –FV	XXXX
+Interest Income(Op Bal x disc rate)-P/L	X
+Contribution paid	XX
- Benefits paid	(XX)
+/- re-measurement gains/losses (b/f)	X
Closing Balance – FV (given by actuary)	XXXX

Plan Assets

Interest income:

- **Recognition:** Expected is the increase during a period in the fair value of a plan assets due to growth in plan assets.
- **Measurement**:
  - Opening FV of plan assets + contributions made at the **BEGINNING** of the year) X yield rate (or discount rate)
- NB: use this formula if the contributions are paid at the BEGGINNING of the year and not during the year at specific dates.

Plan Assets

Interest Income:

- **Measurement**: If contributions are paid at specific dates e.g. 30 June and 31 December for a December year end use the compound interest approach:
  - Expected return for Jan- June = Op FV of plan assets * discount rate
  - Expected return for July – Dec =
    - (Op PPV of Obligation +
    - past service cost at the beginning of the yr, if any +
    - interest for Jan - June less benefits paid) X
    - discount rate
  - Interest cost recognised in P/L = expected return in (Jan – June) + (July – December)

Plan assets (F/P)	XXX	
Net interest cost/income (staff costs) (P/L)		XXX

Plan Assets

Contributions to the plan assets:

- **Recognition:** Contributions (employer+ employee) made to the plan increase the assets available to meet the obligations. Contributions paid are thus not expensed, but are accounted for as an increase in plan assets.
- **Measurement**: - always given by actuary

Dr Plan assets (F/P)	XXX	
Cr Bank (F/P)		XXX

Plan Assets

Benefits paid :

- **Recognition:** When employees receive their benefits, the **defined benefit obligation reduces**. Benefits are paid either from the assets of the employer, if the plan is UNFUNDED, or from specific/plan assets set aside to meet the obligation, if the plan is FUNDED. Benefits reduce plan assets (See JE below)

- **Measurement**: amount always given

Dr Defined benefit obligation (F/P)	XXX
Cr Plan Assets (if Funded) or Bank (if UNFUNDED (F/P)	XXX

Plan Assets- re-measurement gains/losses

Reconciliation of mvt in the defined benefit obligation:

Opening Balance –FV	XXXX
+Interest income (Op Bal x yield rate)-P/L	X
+Contribution paid	XX
-Benefits paid	(XX)
Recognised book value	XXX
+/- re-measuremnt gains/losses (b/f)	X
Closing Balance – FV (valued by actuary)	XXXX

Plan Assets

Re-measurement gains & Losses:

- **Recognition:** arises from the difference btwn the recognised plan assets and the actuarially valued plan assets (see recon in slide above)

- **Measurement**: determine from the reconciliation of the in the plan assets (see above slide)

Actuarial gain or loss = Actuary's valuation less recognised book value of the plan assets

Plan Assets

Re-measurement gains & Losses:

- **Recognition JEs:**

Dr Re-measurement loss (**OCI**)	XXX	
Cr Plan assets (F/P)		XXX

Recognition of actuarial loss

Dr Plan assets (F/P)	XXX	
Cr Re-measurement loss (**OCI**)		XXX

Recognition of actuarial gain

Defined Benefit Plans

- Plan curtailments or settlements: **Gains or losses** resulting from curtailments or settlements of a plan **are recognised when the curtailment or settlement occurs**.
- Curtailments are:
  - reductions in scope of employees covered or
  - in benefits.

Curtailment/Settlement

- Closure Ltd decides to close down a plant on 31 December 20.1 and that each employee will receive a lump-sum payment of R25000, as a final settlement of all obligations to the employees. Using the current actuarial assumptions immediately before the settlement, the following was established:
  - Present value of the obligation immediately:
    - Before closure of the plant 920000
    - After closure of the plant 828000
  - Fair value of plan assets immediately before closure was 800000 and decrease in assets due to settlement is 50000

Q- What is the gain/loss on settlement?

Curtailment JE

Change in obligation (920000-828000)	92000
Change in plan assets (800000-750000)	(50000)
Gain on net decrease in net liability	42000

Dr Defined benefit obligation (F/P)	92000	
Cr Plan assets (F/P)		50000
Cr Gain on curtailment (staff costs) (P/L)		42000

Defined Benefit Liability

Measurement -[IAS 19.57(b)]

- For defined benefit Liability, the amount recognised in the balance sheet should be:

PV of the defined benefit obligation at Y/E	XXXX
less FV of Plan Assets at Y/E	(XXXX)
Net Obligation	**XX**

Defined Benefit Plans

Asset Ceiling (IAS 19.64):

- If the calculation of the balance sheet amount as set out above results in an **asset**, the amount recognised should be **limited to lower of** :
  - the surplus in the defined benefit plan, and
  - the asset ceiling determined using the discount rate specified in paragraph 83

Other Issues

- IAS 19 also provides guidance on allocating the cost in:
- a multi-employer plan to the individual entities-employers
- a group defined benefit plan to the entities in the group
- a state plan to participating entities

Deferred Tax Implications

- Sec 11(1) of the RSA Income tax Act allows the employer to deduct his **contribution** when it is actually paid to the fund.
- For a defined benefit plan the **employee benefits expense** is an accounting expense.
- Deferred tax arise as there is always a difference between the contribution and the employee benefit expense.

Deferred Tax Implications

B/S Method

	CA	TB	TD		DT
Net DBO	XXX	0	XXX	30%	X

Deferred taxation

	Carrying amount	Tax base	Temporary difference at 100% or 66,6%	Deferred tax at 28% (assets)/ liabilities
20.10	(596)	-	(596)	(167)
Post-employment benefit liability	(140)	-	(140)	(39)
Remeasurement (given)	(456)	-	(456)	(128)
Provision for bonus	(180)	-	(180)	(50)
Provision for leave [C5]	(86)	(86)	-	-
	(862)	(86)	(776)	(217)
Movement in P/L (-140 - 180)			(320)	
Movement in OCI			(456)	
20.11	(459)	-	(459)	(129)
Post-employment benefit liability	(400)	-	(400)	(112)
Remeasurement [C2]	(59)	-	(59)	(17)
Provision for bonus	(200)	-	(200)	(56)
Provision for leave [C5]	(95)	(95)	-	-
	(754)	(95)	(659)	(187)
Movement in P/L (-140 -200) - (-320)			(280)	
Movement in OCI			(397)	
20.12	(397)	-	(397)	(111)
Post-employment benefit liability	(530)	-	(530)	(148)
Remeasurement [C2]	133	-	133	37
Provision for bonus	(210)	-	(210)	(59)
Provision for leave [C5]	(100)	(100)	-	-
	(707)	(100)	(607)	(170)
Movement in P/L (-530 -210) - (-280)			(140)	
Movement in OCI			192	

Other Long-term Benefits – para 153-158

Examples

- Long-term compensated absences such as long-service or sabbatical leave.
- Jubilee or other long-service benefits.
- Long-term disability benefits.
- Profit-sharing and bonuses payable twelve months or more after the end of the period in which the employees render the related service.
- Deferred compensation paid twelve months or more after the end of the period in which it is earned.

Other Long-term Benefits

Recognition and measurement in the **SoFP**:

- The amount recognised as a liability for other long-term employee benefits is thus the net total of the following amounts:
- The PV of the defined benefit obligation at the reporting date,
- **minus** the FV at the reporting date of plan assets (if any) out of which the obligations are to be settled directly.

PV of Defined Obligation	XXXXX
Less FV of Plan Asset	(XXXX)
Other Long-term benefit liability	XX

Other Long-term Benefits

156 For other long-term employee benefits, an entity shall recognise the net total of the following amounts in profit or loss, except to the extent that another IFRS requires or permits their inclusion in the cost of an asset:

(a) service cost (see paragraphs 66–112);

(b) net interest on the net defined benefit liability (asset) (see paragraphs 123–126); and

(c) remeasurements of the net defined benefit liability (asset) (see paragraphs 127–130).

CHARTERED ACCOUNTANTS ACADEMY

Termination Benefits

For termination benefits, IAS 19 specifies that amounts payable should be **recognised when**, **and only when**, the entity is demonstrably committed to either:

- terminate the employment of an employee or group of employees before the normal retirement date; or
- provide termination benefits as a result of an offer made in order to encourage voluntary redundancy.

Recognise termination benefits when an entity can demonstrate commitment to a termination, e.g. :

❑ entity has a detailed formal plan for the termination;

- the location, function, and approximate number of employees who will be compensated for terminating their services;
- the termination benefits for each job classification or function;
- when the plan will be implemented; **and**

- is without realistic possibility of withdrawal.
- Where **termination benefits fall due after more than 12 months after the balance sheet date, they should be <u>discounted</u>**. [IAS 19.139 & IAS 37.72- Restructuring Provision]

Termination Benefits

Recognition

[Refer: Basis for Conclusions paragraphs BC258–BC260 and BC262–BC268]

165 **An entity shall recognise a liability and expense for termination benefits at the earlier of the following dates:**

(a) **when the entity can no longer withdraw the offer of those benefits; and**

(b) **when the entity recognises costs for a restructuring that is within the scope of IAS 37** [Refer: IAS 37 paragraphs 70–83] **and involves the payment of termination benefits.**

Termination Benefits

Measurement

[Refer: Basis for Conclusions paragraph BC261]

169 **An entity shall measure termination benefits on initial recognition, and shall measure and recognise subsequent changes, in accordance with the nature of the employee benefit, provided that if the termination benefits are an enhancement to post-employment benefits, the entity shall apply the requirements for post-employment benefits. Otherwise:**

(a) if the termination benefits are expected to be settled wholly before twelve months after the end of the annual reporting period in which the termination benefit is recognised, the entity shall apply the requirements for short-term employee benefits.

(b) if the termination benefits are not expected to be settled wholly before twelve months after the end of the annual reporting period, the entity shall apply the requirements for other long-term employee benefits.

Example 12.30: Termination benefits

X Ltd restructured its operations and wanted to reduce its workforce with approximately 25%. As a result, management approved a detailed formal plan on 25 October 20X2 in terms of which a voluntary redundancy offer would be made to 30 employees who are all between the ages of 55 and 65. On 15 December 20X2 each of these employees were offered a lump-sum payment of R1 500 000, on the condition that they leave the employment of X Ltd on 28 February 20X3. At year-end (31 December 20X2) all indications were that 25 employees would accept the offer. However, on 28 February 20X3 only 20 employees accepted the offer. The amount due to these employees was settled on 15 March 20X3.

The termination benefits should be recognised as a liability when X Ltd is demonstrably committed to provide the termination benefits. This will be when the entity has a detailed formal plan for the termination (25 October 20X2) and is without realistic possibility of withdrawal (15 December 20X2 when the offer was made to the employees.). A liability of R37 500 000 (25 x 1,5 mil) should thus be raised in the 20X2 financial statements:

	Dr	Cr
	R	R

Termination benefits (staff costs) (P/L)	37 500 000	
Accrual for termination benefits (F/P)		37 500 000

As the actual number of employees who accepted the offer differed from the expected number of employees, an adjustment should be made in the 20X3 financial statements:

	Dr R	Cr R
Accrual for termination benefits (F/P)	37 500 000	
Bank (F/P) (1,5 mil x 20)		30 000 000
Termination benefits (staff costs) (P/L) (1,5 mil x 5)		7 500 000

12.9

Apply IAS 19

Level 2

Try the following:

- Tut 102 Question 7.1-7.2

Do 2015 Test 1 and compare answer to your attempt

CTA Support

Do not take risk with CTA 2.

All the best

CAA is the Key to Your Future!