FAC3701

DISCUSSION CLASSES APRIL 2015





DISCUSSION CLASSES: APRIL 2015

PLEASE FEEL FREE TO CONTACT US:

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DISCUSSION CLASSES: APRIL 2015

Programme

9H00 – 9H15 Welcome and introduction.

9H15 – 10H45 Question 3 of TL 104.

10H45 – 11H00 Break.

11H00 – 12H00 Question 4 of TL 104.

12H00 – 12H15 Break.

12H15 – 13H00 Problems identified and exam technique.

Question 3 of Tutorial Letter 104/3/2015

Question 4 of Tutorial Letter 104/3/2015

Exam Scope

To pass the exam – what must I know?

- Almost all topics included in the module is examinable and will be included in the exam:
 - Learning Unit 1
 - Learning Unit 2 (only reading knowledge is required)
 - Learning Unit 3
 - Learning Unit 4
 - Learning Unit 5
 - Learning Unit 6
 - Learning Unit 7
 - Learning Unit 8
 - Learning Unit 9 (tutorial letter 102)
- Will there be multiple choice questions?

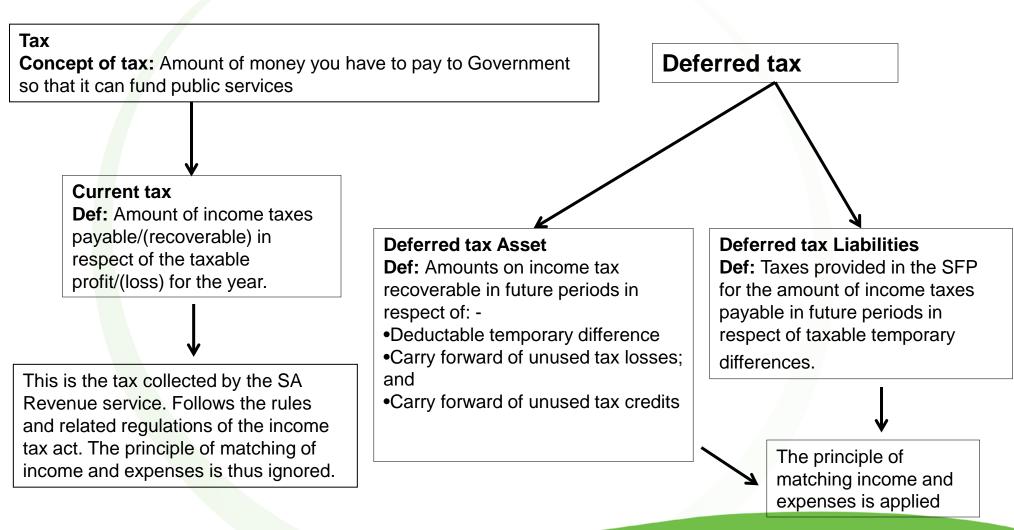
To pass the exam – what must I study?

- Tutorial Letter MO001
- Tutorial letter 101: Assignment 01 and 02 questions
- Tutorial letter 102: Learning unit 9
- Tutorial letter 103: Additional questions
- Tutorial letter 104: Integrated questions
- Tutorial letter 201: Solution to assignment 01
- Tutorial letter 202: Solution to assignment 02
- Textbook
- Journals
- Do PAST exam questions and additional questions under exam conditions

IAS 12 INCOME TAXES

FAC3701 GROUP DISCUSSION LEARNING UNIT 4

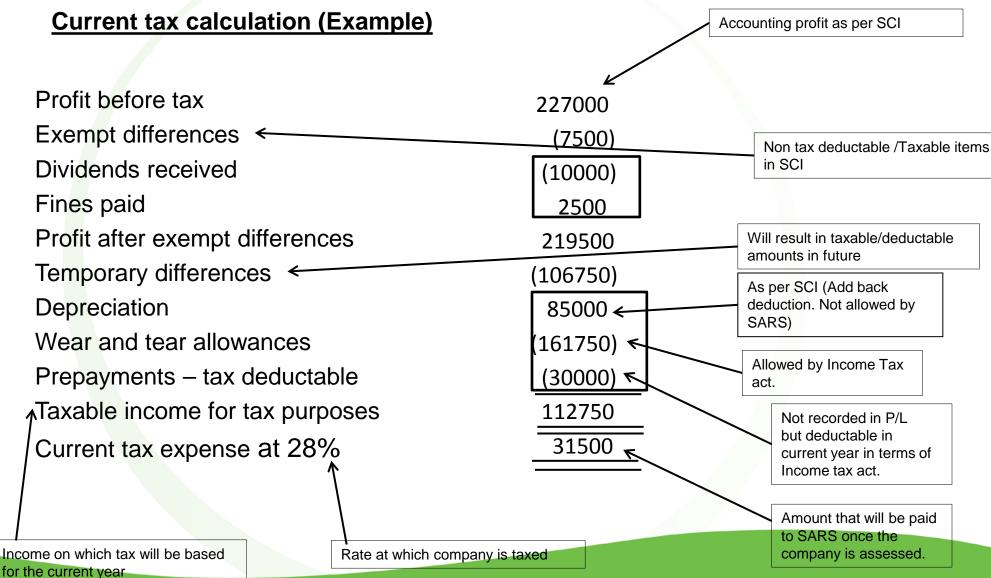
IAS 12 : Income tax



IAS 12 Income tax

Current Tax

Current tax



Current Tax

- Examples of other items that should be included in calculation under temporary differences if tax base ≠ carrying amount:
 - Accounting profit/loss on sale of asset: SP CA*
 - •Taxable recoupment/loss on sale of asset: SP TB
 - Income received in advance
 - Expenses prepaid
 - Allowances for credit losses for tax purposes (Tax)
 - Provision for credit losses (Acc)

^{*}Assuming no capital gains is applicable

If capital Gains tax is applicable then

Accounting profit on sale of asset: CP –CA

Taxable recoupment on sale of asset: CP-TB

Current tax

Under/over provision of prior year tax.

- In practice the assessed tax for i.e. the current R31 500 tax on page 26, as calculated by SARS may differ from the amount calculated and disclosed by the entity.
- This assessment is usually done after the tax amount has been disclosed in the tax return to the tax authority.
- Thus difference should not be disclosed as a prior year error.
- Difference between the assessed tax and the tax calculated by the company will be disclosed as a under/over provision in the income tax note.
- Example: Entity claims a deduction that is disallowed when the return is assessed after year end.

Current tax

Important

- Learn the structure as shown in example 11 on page 100 of learning unit 4 in Tutorial letter MO001/3/2015 (Please use structure, else no marks will be allocated)
- Slot figures into the structure.
- Calculations should be on the main structure of the answer.
- If results of calculations are not transferred to the correct position in the notes no marks can be allocated.

Definitions

Deferred tax liabilities: Taxes provided in the SFP for the amount of income taxes payable in future periods in respect of taxable temporary differences.

Deferred tax assets: Taxes recoverable in future periods in respect of:

- deductable temporary differences
- carry forward of unused tax losses
- carry forward of unused tax credits

TAXABLE TEMPORARY DIFFERENCES

Temporary differences that will result in taxable amounts in determining taxable profit/(tax loss) or future periods when the carrying amount of the asset or liability is recovered or settled.

DEDUCTABLE TEMPORARY DIFFERENCES

Temporary differences that will result in amounts that are deductible in determining taxable profit/(tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.

4 rules of deferred tax

- Rule 1: Carrying amount of the asset > tax base of the asset = a deferred tax liability
- Example

Cost of Asset - R120000

Accumulated depreciation up to financial year end date - R24000

Accumulated Tax allowance up to financial year end date – R40000

	CA	ТВ	Temp Dif	
	R	R	R	
Cost	120000	120000	0	
Acc Dep / Tax allowance	(24000)	<u>(40000)</u>	<u>16000</u>	
CA/TB	96000	80000	<u>16000</u>	

 Applying rule 1: Since the carrying amount of the asset is greater than the tax base of the asset it is a deferred tax liability

Journal entry:	DR	CR
	R	R
Deferred tax expense (SCI) (16000*.28)	4480	
Deferred tax liability (SFP) (16000*.28)		4480

Rule 1 (Continued)

- Prepayments
- Assume a year end of 31/12/2010 and the entity pays its insurance for Jan 2011 – March 2011 in advance

	CA	ТВ	Temp Dif
	R	R	R
Insurance paid in advance	1000	0	1000

 Since the carrying amount of the asset is greater than its tax base it is a deferred tax liability

Journal entry:	DR	CR
	R	R
Deferred tax expense (SCI) (1000*.28)	280	
Deferred tax liability (SFP) (1000*.28)		280

- Rule 3: Carrying amount of the asset < tax base of the asset a deferred tax asset will be recognised
- Example

Cost of Asset - R120 000

Acc Depr up to financial yearend date – R40 000

Accumulated Tax allowance up to financial year-end date – R24 000

	CA	ТВ	Temp Dif
	R	R	R
Cost	120 000	120 000	0
Dep / Tax allowance	(40 000)	(24 000)	16 000
CA / TB	80 000	96 000	16 000

 Applying rule 3: Since the carrying amount is less than the tax base of the asset it is a deferred tax asset

Journal entry:	DR	CR
	R	R
Deferred tax asset (SFP) (16000*.28)	4480	
Deferred tax expense (SCI) (16000*.28)		4480

- Applying rule 2 and 4
- Rule 2: Carrying amount of the liability < tax base of the liability a deferred tax liability will be recognised.

Rule 4: Carrying amount of the liability > tax base of the liability a deferred tax asset will be recognised.

Example

Provision for warranty cost—R150 000

Warranty cost are tax deductable when actual expense is incurred

Tax base = CA – amount deductable for tax purposes in future (R150 000 – R150 000)

	CA	ТВ	Temp Dif	
Provision for warranty cost	150 000	0	150 000	
Journal entry: Def tax		DF	R CR	
Deferred tax asset (SFP) (15	50 000*.28)	42	2 000	
Deferred tax expense (S	CI) (150 000*.28)	42 000	

Important

- Use the SFP approach or no marks
- Learn the structure (Please use structure, else no marks will be allocated) refer to example 11 of tut MO001
- Slot figures into the structure.
- Calculations should be on the body of the answer or separately but ensure that you transfer the results to your structure.
- If results of calculations are not transferred to the correct position in the notes no marks can be allocated.
- Change in tax rate If change is from 29% to 28% then use 1/29 fraction multiplied by deferred tax balance at the beginning of the year. See tutorial letter MO001 P 102
- The deferred tax expense/income is the movement between the current and prior year deferred tax balances.

Capital gains tax

Capital gains tax

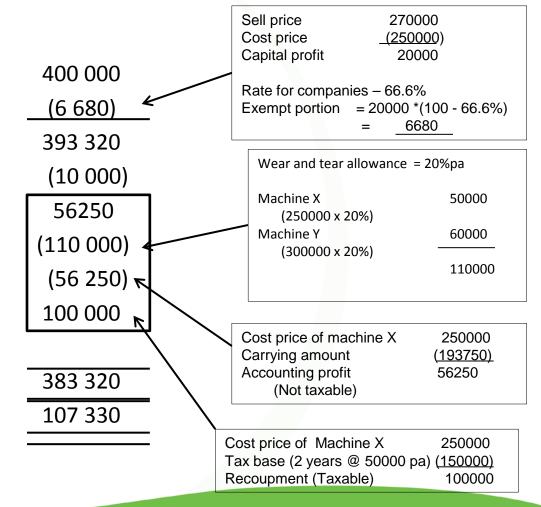
- Capital gains = Selling price Cost price
- Base cost price will be provided and does not need to be calculated.

- CGT Rate for companies = 66.6%
- Note: Difference between CP and TB is a profit on sale and thus temporary difference

Capital gains tax (Continued)

Capital gains tax (Example 15 P119tut MO001/2015)

- Profit before tax
- Exempt difference:
- Cap profit on sale of asset
- Temporary differences
- Depreciation
- Wear and tear allowance
- Profit on disposal
- Recoupment of wear and tear
- Taxable income
- Current tax



IAS 8 Accounting policies, changes in accounting estimates and errors

Acronyms Used

- AP accounting policy
- Tx transaction
- FS financial statements

Accounting policies, changes in accounting estimates and errors

- CHANGE IN ACCOUNTING POLICIES
- CHANGE IN ACCOUNTING ESTIMATES
- ERRORS

Accounting policies, changes in accounting estimates and errors

CHANGE IN ACCOUNTING POLICIES

- Definition: Specific principals, bases, conventions, rules and practices applied by an entity in preparing FS.
- Examples:
 - LIFO or FIFO method inventory valuation
 - Completed contract method vs. % of completion
- Selection of an AP:
 - Statement / Interpretation
 - Management judgement relevant and reliable (faithful, substance over form, neutral, prudent and complete)
- AP's are disclosed as note 1 to the FS 'Accounting Policies'

AP's should be applied consistently – so why change an AP?

- REQUIRED by a Standard / Interpretation
- VOLUNTARY to provide more reliable and relevant information to the users of the FS.

How is the change applied?

- Transitional provisions (if applicable)
- Retrospective application

Definition: Applying a new AP to tx's, other events and conditions as if that policy has always been applied.

- Implication of Retrospective Application:
 - adjust the opening balance of each affected component of equity for the earliest prior period presented; AND
 - adjust comparative amounts disclosed.

Limitations on Retrospective Application

- IMPRACTICABLE to determine the period specific effects adjust the opening balance of the earliest period that retrospective application is practicable/possible.
- IMPRACTICABLE to determine the cumulative effect at the beginning of the current period – PROSPECTIVELY from the earliest date practicable/possible.
- Definition IMPRACTICABLE: Cannot apply after making every reasonable effort
- **Definition PROSPECTIVELY:** Applying the new AP to tx's, other events and conditions occurring **after** the date at which the policy is changed

Disclosure

- IAS 1 (revised) requires that a statement of financial position should be presented as at the beginning of the earliest comparative period if:
 - Retrospective application of AP's
 - Retrospective restatement of errors
 - Reclassified items in the FS
- Minimum requirement 3 periods (statement of financial position and notes thereto):
 - End of current period
 - End of prior period
 - Beginning of earliest comparative period

Disclosure - Change in Accounting Policy

- Title of Standard/Interpretation (if applicable)
- Change ito transitional provision (if applicable)
- Nature of the change in AP
- Reason why change will result in more reliable and relevant information (if applicable)
- Description of transitional provision (if applicable)
- Effect on future periods (if applicable)
- Amount of the adjustment for the current period and all prior periods presented:
 - Each line item affected
 - Basic and diluted earnings per share (not applicable to your module)
- Amount of adjustment for periods before those presented practicable?
- Retrospective application impracticable circumstances that led to the existence of that condition and description of how and from when the change in AP has been applied.

XXX

EXAMPLE

Elegance Limited

Notes for the year ended 30 September 20x9

4. Change in accounting policy

'Description of the nature of the change in the accounting policy'

The effect is as follows:

20x9 20x8 1/10/20x7

Increase in inventory xxx xxx xxx

Increase in current tax due (xx)

Increase in deferred tax liability (xx) (xx)

Increase in equity <u>xxx xxx xxx</u>

Adjustment to retained earnings at the

beginning of the year 20x8

Change in accounting policies

Practical implications

- Tax issues for a change in Accounting Policy
- SARS decides NOT to open prior year assessments.
- SARS decides to open prior year assessments.

Accounting policies, changes in accounting estimates and errors

CHANGE IN ACCOUNTING ESTIMATES

- Definition: Adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from NEW information or NEW developments and, accordingly, are not corrections of errors.
- Due to inherent uncertainties, certain items cannot be measured with precision and has to be estimated. Examples of estimates:
 - Bad debt
 - Obsolete stock
 - FV of financial assets and liabilities (not applicable to your module)
 - Useful lives and depreciation methods
 - Warranty obligations

- A change in an accounting estimate is recognised
 PROSPECTIVELY and included in profit or loss from operating activities in:
 - The period of the change; OR
 - The period of the change and future periods
- Definition Prospectively:
 - Recognising the effect of the change in accounting estimate in the current and future periods affected by the change

Disclosure

- Nature and Amount of the change i.t.o. current and future periods, unless it is impracticable to estimate the effect on future periods.
- Impracticable to estimate the effect on future periods disclose this fact

Practical implications

- Tax issues for a change in Accounting Estimate
- Deferred Tax
- Current Tax

Accounting policies, changes in accounting estimates and errors

ERRORS

- Definition: Prior period errors are omissions from, and misstatements in, the entity's FS for one or more prior periods arising from a failure to use, or misuse of, reliable information that
 - was available; OR
 - could have reasonable be expected to have been obtained.
- Examples of prior period errors:
 - Mathematical miscalculations;
 - Misinterpretation of facts; or
 - Fraud.

Retrospective Restatement

- Definition: Correcting the recognition, measurement and disclosure of amounts of elements of FS as if the prior period error had never occurred
- Impracticable to determine
 - Period specific effects restate the opening balances of assets, liabilities and equity for the earliest period for which retrospective restatement is practicable
 - Cumulative effect at the beginning of the current period restate prospectively from the earliest date practicable

Disclosure

- IAS 1(revised)
- Nature of the prior period error
- Each period presented (practicable?) amount of correction for each FS line item affected
- Amount of correction at beginning of period earliest presented
- Retrospective restatement impracticable circumstances that led to the existence of that condition and description of how and from when the error has been corrected

Practical implications

- Tax issues for Errors
- Deferred Tax
- Current Tax

Exam

- Exams are to test knowledge NOT to catch you out.
- The exam will consist of 2 questions.
- Integrated questions.
- Disclosure in this module is very IMPORTANT therefore study the disclosure to save time in the exam.
- Make a summary of **DISCLOSURE** for each chapter and STUDY this.
- Make sure that you identify all the issues in the question.
- All topics will be included in the exam
- Write the exam the only way to pass!!!

Thank you

