# 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

**Tax**
**Concept of tax:** Amount of money you have to pay to Government so that it can fund public services

**Current tax**
**Def:** Amount of income taxes payable/(recoverable) in respect of the taxable profit/(loss) for the year.

This is the tax collected by the SA Revenue service. Follows the rules and related regulations of the income tax act. The principle of matching of income and expenses is thus ignored.

**Deferred tax**

**Deferred tax Asset**
**Def:** Amounts on income tax recoverable in future periods in respect of: -
- •Deductable temporary difference
- •Carry forward of unused tax losses; and
- •Carry forward of unused tax credits

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

The principle of matching income and expenses is applied

# IAS 12 Income tax

## Current Tax

# Current tax

**Current tax calculation (Example)**

| | |
|---|---|
| Profit before tax | 227000 |
| Exempt differences | (7500) |
| Dividends received | (10000) |
| Fines paid | 2500 |
| Profit after exempt differences | 219500 |
| Temporary differences | (106750) |
| Depreciation | 85000 |
| Wear and tear allowances | (161750) |
| Prepayments – tax deductable | (30000) |
| Taxable income for tax purposes | 112750 |
| Current tax expense at 28% | 31500 |

Accounting profit as per SCI

Non tax deductable /Taxable items in SCI

Will result in taxable/deductable amounts in future

As per SCI (Add back deduction. Not allowed by SARS)

Allowed by Income Tax act.

Not recorded in P/L but deductable in current year in terms of Income tax act.

Amount that will be paid to SARS once the company is assessed.

Income on which tax will be based for the current year

Rate at which company is taxed

# 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.

- Deferred Tax

# Deferred tax

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

# Deferred tax

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.

# Deferred tax

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** | **TB** | **Temp Dif** |
|---|---|---|---|
| | **R** | **R** | **R** |
| Cost | 120000 | 120000 | 0 |
| Acc Dep / Tax allowance | (24000) | (40000) | 16000 |
| CA / TB | 96000 | 80000 | 16000 |

- 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 | TB | 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** | **TB** | **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** | **TB** | **Temp Dif** |
|---|---|---|---|
| Provision for warranty cost | 150 000 | 0 | 150 000 |

| **Journal entry: Def tax** | **DR** | **CR** |
|---|---|---|
| Deferred tax asset (SFP) (150 000*.28) | 42 000 | |
| Deferred tax expense (SCI) (150 000*.28) | | 42 000 |

# Deferred tax

- 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 | 400 000 |
| Exempt difference: | (6 680) |
| Cap profit on sale of asset | 393 320 |
| Temporary differences | (10 000) |
| Depreciation | 56250 |
| Wear and tear allowance | (110 000) |
| Profit on disposal | (56 250) |
| Recoupment of wear and tear | 100 000 |
| Taxable income | 383 320 |
| Current tax | 107 330 |

| | |
|---|---|
| Sell price | 270000 |
| Cost price | (250000) |
| Capital profit | 20000 |

Rate for companies – 66.6%
Exempt portion = 20000 *(100 - 66.6%)
= 6680

Wear and tear allowance = 20%pa

| | |
|---|---|
| Machine X (250000 x 20%) | 50000 |
| Machine Y (300000 x 20%) | 60000 |
| | 110000 |

| | |
|---|---|
| Cost price of machine X | 250000 |
| Carrying amount | (193750) |
| Accounting profit (Not taxable) | 56250 |

| | |
|---|---|
| Cost price of Machine X | 250000 |
| Tax base (2 years @ 50000 pa) | (150000) |
| Recoupment (Taxable) | 100000 |

# 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

# 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'

# Change in 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.

# Change in accounting policies

- 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.

# Change in accounting policies

## 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

# Change in accounting policies

## 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

# Change in accounting policies

## 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.**

# Change in accounting policies

## 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 |
|---|---|---|---|
| Decrease in cost of sales | xxx | xxx | |
| Increase in taxation expense | (xx) | (xx) | |
| **Increase in profit** | **xxx** | **xxx** | |
| | | | |
| Increase in inventory | xxx | xxx | xxx |
| Increase in current tax due | (xx) | | |
| Increase in deferred tax liability | (xx) | (xx) | |
| **Increase in equity** | **xxx** | **xxx** | **xxx** |
| | | | |
| **Adjustment to retained earnings at the beginning of the year 20x8** | | | **xxx** |

# 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

# Changes 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

# Changes in accounting estimates

- 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

# Changes in accounting estimates

## 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

# Changes in accounting estimates

## Practical implications

- **Tax issues for a change in Accounting Estimate**

- Deferred Tax
- Current Tax

# Accounting policies, changes in accounting estimates and errors

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.

# Errors

**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

# Errors

## 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

# Errors

**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**

Learn without limits.

UNISA college of accounting sciences