ACA MASTERS

Corporate Reporting: Open Book Notes

These notes summarise the key Financial Reporting and Audit issues for the most examinable parts of the CR syllabus and therefore serve as a useful and time effective look up in the exam. The notes also include calculation proformas and reminders.

The Exam Technique Guidance section provides specific advice as to how to approach the different types of exam question in the CR exam. Our classroom and online tuition classes demonstrate how to apply these techniques to recent CR exam papers.

Always remember to tailor your answer to the specific scenario. The audit risks and procedures included below are a sample of common risks and procedures for each area and whilst they feature regularly in the answers, you should tailor your risks and procedures to the specific issues in the scenario. Nothing annoys the examiner more than a student who tries to dump a pre-prepared list of risks and procedures!

Contents:

IAS19 Pensions

Defined contribution

- Company only has an obligation to make a certain level of contributions to employee's pension fund
- Therefore, liability is the amount of contributions unpaid - *easy*

Defined benefit

- Company has an obligation to provide a certain level of income to the employee throughout their retirement (i.e. their pension income)
- Any difference between the liability (future retirement payments) and the asset (contributions invested) is shown as a net liability or asset
- An actuary estimates the level of pension payments the company will have to make in the future based on mortality rates, life expectancy etc. This is discounted to PV

IAS19: Pensions

	Liability	Asset	Double entry	Explanation
B/f	(x)	x		Future pension amounts payable to employees and the funds to be used to make those payments
Interest cost on liability	(x)		Dr P&L, Cr Liability	The future liability to make pension payments to retirees is measured at PV: this records the unwinding of the discount each year
Interest on Plan assets		x	Cr P&L, Dr Asset	Return (dividends, interest etc) on the plan assets (shares, bonds etc), so increases pension plan assets: gains are included in P&L
Current service cost	(x)		Dr P&L, Cr Liability	Employee services provided in the current period which increases the value of their pension (and the entity's obligation to pay these benefits)
Past service cost / Curtailment	x		Cr/Dr P&L, Dr/Cr Liability	Increases / decreases the value of their pension (and the entity's obligation to pay these benefits) e.g. a cutailment: where employers reduce future pension entitlement
Contributions paid out	x	(x)	Dr Liability, Cr Asset	Paying out benefits so reducing entity's obligation but also reducing the assets in the pension fund
Contributions paid in		x	Dr Asset, Cr Cash	Paying cash into fund pension plan so increasing pension plan assets and reducing cash
	(x)	x		
Actuarial Gain / (Loss)	x	(x)	Dr/Cr OCI, Cr/Dr Liability	Changes in the obligation to make future pension payments due to salary changes, turnover levels and interest rates. Relates to non-trading factors so gain / loss is recorded in OCI
C/f	(x)	x		

Audit Risks	Audit Procedures
➢ Actuarial assumptions may be incorrect	• Ascertain competence and independence of actuary • Consider whether it is appropriate to rely on the actuary's work • Obtain an understanding of the assumptions used and compare to assumptions in prior years • Enquire about any material changes to the data, assumptions and methods used by actuary • Obtain written representation from directors confirming the assumptions are consistent with their understanding • Review correspondence between company and actuary
➢ Valuation of plan assets and liabilities may be incorrect	• Obtain confirmation of the scheme assets and liabilities • Agree additional pension entitlement to employment contracts • Review minutes to determine whether additional benefits authorised • Review the validity and accuracy of the actuarial valuation • Agree actuary valuation to SFP figures
➢ Error in calculation/ posting to SPL/ SFP	• Agree the cash contributions paid into the scheme to the bank statement • Agree benefits paid to pension scheme statements • Recalculate the net interest component using market rate • Agree opening balances to last year's actuarial report and financial statements • Agree closing balances to final actuarial report • Review postings of actuarial differences to ensure compliant with IAS19 • Check disclosures for IAS19

TAX

IAS12

Current Tax

- Current tax is the amount actually payable to the tax authorities in relation to the current year i.e. the tax liability in the tax comp
- The Financial Statements are prepared before the Tax Comp is submitted to the tax authorities so the P&L number for Current tax is based on a draft Tax Comp - Dr P&L, Cr Tax Payable
- This estimate is then adjusted for in next year's Financial Statements to take account of the tax liability in the final Tax Comp i.e. if the liability was actually lower than the draft Tax Comp then Cr P&L, Dr Tax Payable

Deferred Tax

- The same expenditure can have difference consequences for accounting and tax purposes e.g. PPE
- Differences between accounting and taxable profits can be identified as either: Permanent – e.g. entertaining, or Temporary – e.g. Depr' v CAs
- Deferred tax is an *accounting measure* which is used to eliminate the temporary differences between the accounting and tax treatment
- In the end, the amount of tax and accounting profits will be the same so deferred tax is used to offset the increase / decrease in current tax created by temporary differences
- Remember, deferred tax is an accounting device. It does *not* represent tax payable to the tax authorities

Exam approach

1. *Is there a difference between this year's accounting profit and taxable profit that will reverse in future periods because the difference is only temporary?*
2. *Decide whether the tax payable to the tax authorities will be higher or lower in the future. If higher, then you have a DTL, if lower then you have a DTA*
3. *Calculate DTA/DTL at the future tax rate with the other side of the entry going to P&L / OCI / Equity depending on where the underlying accounting entry went*

Common Examples

- PPE qualifying for Capital Allowances – In the future, tax will be higher or lower due to the difference between the TWDV (future tax deductions) and Carrying Amount (future depr')
- PPE not qualifying for Capital Allowances – Exemption applies, no DT
- PPE Revaluation – In the future, tax will be higher as the higher CA will have to be depr' or sold at a profit creating a taxable gain. Therefore, creates DTL with the charge recorded in OCI
- Interest taxed when paid not accrued – In the future, tax will be higher. Therefore, creates DTL
- Provisions – In the future, tax will be lower if you only get a deduction when expense is paid, rather than provided for in the PL. Therefore, creates DTA
- Losses c/f – In the future, tax will be lower as you can offset losses against future profits. Therefore, creates DTA provided there will be future profits
- Pensions – If you have a deficit, then future tax will be lower as you will make more tax relieving contributions in the future. Therefore, creates DTA. If you have a pension surplus, then DTL
- SBP – In the future, tax will be lower as you only get a deduction when the shares are exercised. Therefore, creates DTA. Part Cr will be recorded in Equity if the future deduction is greater than the IFRS2 charge

Example

- Company buys PPE for £10k with UEL of 5 years and tax capital allowances of 18% p/a
- For tax, accounting depr' expenditure is disallowed and replaced with capital allowances
- Therefore, the difference between tax and accounting profits is the depr' amount v capital allowances amount
- This difference is 'temporary' because by the end of the asset's life the £10k cost will have been written off completely for both tax and accounting
- Some differences e.g. entertaining are never deductible for tax so the difference between accounting and tax is permanent

Tax Comp

PBT	£ 10,000
add back:	
Disallowable expenditure	£ 1,000
Depr'	£ 2,000
deduction:	
Capital allowances	£ (1,800)
Dividends not taxable	£ (3,000)
Taxable Profits	£ 8,200
Tax@20%	£ (1,640)

SFP

PPE	Carrying amount	Tax Base	Temp difference	DTA@20%
Cost	£ 10,000	£ 10,000		
Depr'	£ (2,000)			
Capital allowances		£ (1,800)		
C/f	£ 8,000	£ 8,200	£ 200	£ 40

Makes sense that we have an asset because if tax deductible balance is higher than accounting carrying amount then future tax deductions will be higher than future depr' so less tax to pay in future

Current tax impact of:

Depr' minus Capital allowances (Tax comp)	£ 200
Tax@20%	£ (40)

Deferred impact of:

Tax asset on future tax deductions	£ 40

DT offsets the current tax charge so that 'temporary differences' do not distort the overall tax charge (P&L) from year to year

Audit Risks	Audit Procedures
➢ Recoverability of assets assumptions may be unreasonable	• Review future forecasts to confirm that losses can be offset against future taxable profits
➢ Complex calculations lead to an inherent risk ➢ Incorrect measurement of deferred tax balances	• Obtain a copy of the deferred tax workings and the corporation tax computation • Check the arithmetical accuracy of the deferred tax working • Agree the opening position on the deferred tax account to the prior year financial statements • Agree the figures used to calculate timing difference to those on the tax computation and the financial statements • Review any correspondence with HMRC for evidence that the tax computation may require changes
➢ Incorrect disclosures	• Review disclosures in reference to IAS 12 • Review any changes in accounting policy and discuss reasons for change

Goodwill

- The 'excess' of what the P pays for its share in the S and the value of S's assets on its SFP
- A company is nearly always worth more than the value of the assets on its SFP as many assets of the business are not recognised in the FS e.g. internally generated intangibles, reputation
- The 'excess' of what P pays is 'goodwill' and relates to these attributes of S which are not recognised in the accounts

Consideration + NCI – FV of net assets acquired = Goodwill

- Note: we use the equity section to calculate NA as 'A-L = NA = E'
- All assets in S are remeasured to FV to allocate this 'excess' to specific assets as far as possible e.g. PPE, Customer lists etc. Therefore, more assets exist in Group FS than in individual FS
- Test GW annually for impairment – Dr P&L, Cr GW
- Can be remeasured within first 12m of acquisition
- Cumulative impairments are recorded in Retained earnings
- Any 'gain on bargain purchase' is recognised immediately in the P&L

Consideration

- Everything that P is giving in exchange for its shares in S needs to be included
- E.g. Cash, deferred cash, shares, contingent cash
- Measured at FV and / or PV if payment is in future periods

Step Acquisitions

- The original investment is treated as if it were disposed of at fair value and re-acquired at fair value with any gain/loss recorded in P&L (unless investment was held as FVOCI)
- This previously held interest at fair value, together with any further consideration transferred, is the 'cost' of acquisition used in calculating the goodwill

NCI

- The shares which are not owned by the controlling company need to have their ownership interest (equity) reflected in the accounts
- Two methods of valuing NCI: **% of Net Assets** and **FV method**
- FV nearly always gives a higher amount as it attributes the NCI's proportion of the goodwill to the NCI, rather than just the NCI's proportion of the Net Assets

					Tips
W1	Establish group structure				Make sure you identify correctly or your whole answer will be wrong!
W2	Net assets summary				
		At Y/E	At Acq	Post Acq	
	Share Capital	x	x		Use Equity balances to calculate net assets (NA) as quicker that listing all assets and liabilities
	Share Premium	x	x		
	Revaluation reserve	x	x		
	Contingent liability	(x)	(x)		
	Retained Earnings	x	x		
	- IFA now recognised	x	x		Measured at FV. Include assets / liabilities not recognised in S's accounts if they meet A/L definitions
	- additional amortisation	(x)			
	- PPE upift	x	x		
	- additional depr'	(x)			
	- Purps	(x)			
		X	X	X	Y/E - At Acq = Post Acq earnings of Sub
W3	Goodwill				
	Consideration	x			Measured at FV / PV of the cash / shares transferred. Include contingent consideration even if not probable.
	NCI at acq	x			Measured as % share of net assets at Acq or % of NA + GW in sub (FV method)
	FV of previously held interest	x			Measured at FV of previously held investment in Sub /Associate / Investment
	FV of net assets at acq (above)	(x)			Measured at FV. Include assets / liabilities not recognised in S's accounts if they meet A/L definitions. Include contingent liabilities if measured reliably
	Goodwill / Gain on bargain purchase	X / (X)			
	Impairments	(x)			Cumulative; shared with NCI if NCI's share of GW is recognised
	Goodwill	X			GW in the subsidiary business: asset on C-SFP
W4	Calculate NCI at Y/E				
	NCI at acq (above)	x			
	NCI % of GW (if FV method used)	x			NCI only has share of GW recognised if FV method used (see above)
	NCI % of GW impairment (if FV method used)	(x)			NCI only has share of GW recognised if FV method used (see above)
	% share of NCI Post Acq earnings	x			Sub's earnings split between P and NCI based on ownership %
	NCI % of Fex loss on retranslation of sub's NA	(x)			Gains/losses split between P and NCI based on ownership %
	NCI % of Fex loss on retranslation of sub's GW (if FV method used)	(x)			NCI only has share of GW recognised if FV method used (see above)
	NCI	X			
W5	Group Retained earnings				
	P (100%)	x			
	P's % of S's Post Acq reserves	x			Sub's earnings split between P and NCI based on ownership %
	P's % of A's Post Acq reserves	x			
	Goodwill impairment	(x)			Cumulative
	Associate Impairment	(x)			Cumulative
	P's PURP	(x)			
	Group retained earnings	X			