OMNIPRO
Supporting Irish Accountants

# Top FRS 102 Issues

## Examples

**www.FRS102.com**

**Here to guide you and your clients through the transition to FRS 102 and beyond**

Contents

***Section 16: Investment property***

***Example 1****: Investment Property Fair value movements and deferred tax impact*

Company A purchased a property on 1 February 2015 for CU200,000 which was rented out on 1 March 2015 and therefore met the definition of investment property. Legal costs of CU10,000 were incurred on the purchase and property assessment costs were incurred of CU5,000. At the 31 December 2015 and 2016 the fair value was CU250,000 and €190,000 respectively. The sales deferred tax rate is 20% (Capital Gains tax rate). Assume indexation is not applicable. The accounting requirements are as follows are

| **On initial recognition** | **CU** | **CU** |
|---|---|---|
| Dr Investment Property | 210,000 | |
| (property assessment costs are not directly attributable) | | |
| Cr Bank | | 210,000 |

**On 31 December 2015**

| | **CU** | **CU** |
|---|---|---|
| Dr Investment Property | 40,000 | |
| Cr Fair Value Movement on Investment Property in P&L (other operating income) | | 40,000 |
| Dr Deferred Tax P&L (CU40,000*20%) | 8,000 | |
| Cr Deferred Tax in Balance Sheet | | 8,000 |

Being journal to reflect the movement in fair value during the year including the deferred tax impact

Note if the client wants to it may be a good idea to identify the upward movement on the investment property above original cost separately in the profit and loss reserves so that distributable profits can be tracked as this would be non-distributable.

| | **CU** | **CU** |
|---|---|---|
| Dr Profit and loss reserve (40k-8k) | 32,000 | |
| Cr Non-distributable reserve | | 32,000 |

**On 31 December 2016**

| | **CU** | **CU** |
|---|---|---|
| Dr Fair Value Movement on Investment Property in P&L | 60,000 | |
| Cr Investment Property | | 60,000 |
| Dr Deferred Tax in Balance Sheet (CU40,000*20%) | 8,000 | |
| Cr Deferred Tax in P&L | | 8,000 |

Being journal to reflect the movement in fair value during the year including the deferred tax impact. Note a deferred tax asset has not been recognised on the basis that there are no other chargeable gains to utilise this loss

---

Note deferred tax is only recognised where it will be subject to CGT on disposal – if the future disposal is exempt then no deferred tax liability should be recognised (e.g. CGT exemption for certain properties purchased during a certain period (7/12/11-31/12/14) if it is probable they will be held for the required period – in this situation only when the exemption period is up (7 years) should deferred tax be recognised and this should be based on the rules stated by tax authorities)

***Example 1a: Investment Property Fair value movements and deferred tax impact***

Company A purchased a property on 30 December 2014 for CU210,000 which was rented out on 1 March 2015 and therefore met the definition of investment property. At the 31 December 2015 the fair value was CU250,000 and did not change during the 7 year period. The sales deferred tax rate is 20% (Capital Gains tax rate). Assume indexation is not applicable. Assume this property meets the requirement for CGT exemption and at 31 December it is probable it will be held until the

elapsing of a 7 year period. This property was sold in year 10 and the value remained the same throughout.

**The journals required for year ended 31 December 2015 was:**

| | **CU** | **CU** |
|---|---|---|
| Dr Investment Property | 40,000 | |
| Cr Fair Value Movement on Investment Property in P&L (other operating income) | | 40,000 |

Being journal to reflect the movement in fair value during the year. No deferred tax impact as it is exempt from CGT.

**The journals required at 31 December 2021 and before:**

No journal required as full gain of €250,000 is exempt.

**The journals required at 31 December 2022:**

| | **CU** | **CU** |
|---|---|---|
| Dr Deferred Tax in P&L ((CU250,000-210,000) / 8yrs * 1yr )*20%) | 1,000 | |
| Cr Deferred Tax in Balance Sheet | | 1,000 |

***Example 2 – Modification to financial liabilities/assets***

***Section 11: Basic financial instruments***

*Loan at market rates with transaction costs – modification to financial instruments but not deemed substantial*

Company A obtains a loan from the bank for CU100,000 on 1 January 2015. Arrangement fees of CU10,000 was charged by the bank. The loan carries a market rate of interest of 5% per annum which is charged annually. It is repayable after 5 years. Entity A would calculate the amortised cost and effective interest rate in the following way:

Step 1: Assess whether the instrument meets the definition of a basic instrument and the category it falls into

As this loan meets the definition of a debt instrument where there is no unusual interest rates, then this meets the definition of a basic debt instrument.

Step 2: Determine the method in which the debt instrument should be measured (does section 11.14 (b) apply

As using the amortised cost basis does not create a measurement inconsistency and as this is not a group managed debt instrument where the performance of the group is evaluated on a fair value basis, then it is correct to use the amortised cost basis

Step 3: Assess if there is a financing transaction within the arrangement i.e. is the transaction at non

market rates; is unusual extended credit terms provided?

Here the loan is at market rates, therefore there is no financing transaction.

Step 4: Determine amount to be recognised on initial recognition.
The amount to be recognised is the total value of the loan received of CU100,000 less the transaction costs of CU10,000 i.e. CU90,000

Step 5: Determine the effective interest rate and determine the carrying amount on subsequent measurement

The effective interest rate is the rate of interest that exactly discounts the estimated future cash flows through the expected life. In this case the rate is 7.469%. This 7.469% can be determined through -trial and error or through the use of a mathematical formula in Microsoft Excel.

| Calculated EIR | 7.469% | | | |
|---|---|---|---|---|
| | | | | |
| **Period Ending** | **Opening Balance** | **Interest for Period at 7.469% *** | **Cashflow** | **Closing Balance** |
| | | | | |
| 31/12/2015 | 90,000 | 6,722 | (5,000) | 91,722 |
| 31/12/2016 | 91,722 | 6,851 | (5,000) | 93,573 |
| 31/12/2017 | 93,573 | 6,989 | (5,000) | 95,562 |
| 31/12/2018 | 95,562 | 7,138 | (5,000) | 97,699 |
| 31/12/2019 | 97,699 | 7,301 | (5,000) | 100,000 |
| 31/12/2019 | 100,000 | - | (100,000) | 0 |

Step 6: Decide the journals to be posted at each period end

The journals to be posted in 2015 excluding the payment of the interest are as detailed below such that the amortised cost at 31/12/15 is CU91,708. This will be continued year on year:

| | **CU** | **CU** |
|---|---|---|
| Dr Loan Liability | 10,000 | |
| Cr Bank | | 10,000 |

Being journal to recognise the arrangement fee charged

| | CU | CU |
|---|---|---|
| Dr Interest Expense | CU6,722 | |
| Cr Loan Liability | | CU6,722 |

Being journal to recognise effective interest charge for 2015. The effective interest charge will be posted in each of the 5 years as detailed above. The CU5,000 will be set against the liability as paid.

---

**Changes in cash flow estimates**

Section 11.20 states the entity shall adjust the carrying amount of the financial asset or financial liability to reflect actual and revised estimated cash flows. The entity shall recalculate the carrying amount by computing the present value of estimated future cash flows at the financial instrument's original effective interest rate. The entity shall recognise the adjustment as income or expense in profit or loss at the date of the revision. See example below. This will be a common calculation as it is likely that an unforecasted cash flow will be made which will then need a reassessment of the amortised cost model. Note if anything other than the cash flows are altered (e.g. change in term/maturity date, change from fixed to floating rate or vice versa; material change in covenants/conversion terms before and after the change etc.) then an entity will need to consider if a substantial modification has occurred (See example 14b in this case).

---

***Example 2a:*** *change in estimate*

If we take example 2 and assume that a repayment of CU10,000 was made at the end of year 2 (i.e. 31/12/16). Therefore the new principal to be repaid at 31/12/19 is CU90,000 and the new interest charge is CU4,500 (i.e. 90,000*5%) for 2017 to 2019.

Calculate the net present value of estimated future cash flows as per below.

| Period Ending | Cashflows | Formula to get PV factor | Discount rate at 7.469% PV factor | Present value of cash flow |
|---|---|---|---|---|
| 31/12/2016 | - | 1 | 1 | - |
| 31/12/2017 | 4,500 | 1/(1.7469)^1 | 0.9305 | 4,187 |
| 31/12/2018 | 4,500 | 1/(1.7469)^2 | 0.8658 | 3,896 |
| 31/12/2019 | 4,500 | 1/(1.7469)^3 | 0.8057 | 3,625 |
| 31/12/2019 | 90,000 | 1/(1.7469)^3 | 0.8057 | 72,509 |
| **Total NPV** | | | | **84,218** |

The actual carrying amount at 31/12/16 as per the amortised cost table above in example 2 was CU93,573. If we then take account of the additional payment of CU10,000 made on 31/12/16, the carrying amount in the financial statements is CU83,573. The difference of CU645 (CU83,573-CU84,218) is debited to the interest cost in the profit and loss account at 31/12/16.

The remaining difference of CU5,782 (CU90,000-CU84,218) is then charged to the profit and loss account over the remaining life as follows (assuming there is not a substantial modification as discussed further below):

| Period Ending | Opening Balance | Interest for Period at 7.469% * | Cashflow | Closing Balance |
|---|---|---|---|---|
| At 31/12/2016 | 84,218 | | 0 | 84,218 |
| 31/12/2017 | 84,218 | 6,290 | (4,500) | 86,008 |
| 31/12/2018 | 86,008 | 6,424 | (4,500) | 87,932 |
| 31/12/2019 | 87,932 | 6,568 | (4,500) | 90,000 |
| 31/12/2019 | 90,000 | - | (90,000) | - |

**Example 2b – Substantial modification financial liability (Section 11.36-11.38 of FRS 102)**

Company A took out a loan for CU1,000,000 on 01/01/15 with a bank which was due to be repaid on 31/12/18. Interest was charged at a rate of 7% (CU70,000 per annum) and arrangement fees of CU5,000. Due to poor trading conditions at 31/12/16, the company renegotiated the facility with the bank. The revised terms are as follows:

- loan is now repayable on 31/12/22
- Interest – 6.25% (6.25%*CU800,000= CU50,000)
- Maturity – 31/12/23
- Final principal due on maturity of CU800,000
- Cost of renegotiation of CU4,000

Should the above be treated as a modification of an existing loan (i.e. not a substantial modification) or an extinguishment of an existing loan and its replacement by a new loan (i.e. substantial modification)?

Step 1: Amortise old facility up to date of the modification. The effective interest rate has been determined through the use of Excel.

| Period Ending | Opening Balance | Interest for Period 7.148% | Cashflow | Closing Balance |
|---|---|---|---|---|
| | | | | |
| 31/12/2015 | 995,000 | 71,123 | (70,000) | 996,123 |
| 31/12/2016 | 996,123 | 71,203 | (70,000) | 997,325 |
| 31/12/2017 | 997,325 | 71,289 | (70,000) | 998,614 |
| 31/12/2018 | 998,614 | 71,386 | (70,000) | 1,000,000 |
| 31/12/2018 | 1,000,000 | | (1,000,000) | 0 |

Step 2: Calculate present value of future estimated cash flows under revised terms discounted at original EIR of 7.148%

| Period Ending | Cashflows | Formula to get PV factor | Discount rate at 7.148% PV factor | Present value of cash flow |
|---|---|---|---|---|
| 31/12/2016 | 4,000 | 1 | 1 | 4,000 |
| 31/12/2017 | 50,000 | 1/(1.07148)^1 | 0.9333 | 46,664 |
| 31/12/2018 | 50,000 | 1/(1.07148)^2 | 0.8710 | 43,551 |
| 31/12/2019 | 50,000 | 1/(1.07148)^3 | 0.8129 | 40,646 |
| 31/12/2020 | 50,000 | 1/(1.07148)^4 | 0.7587 | 37,934 |
| 31/12/2021 | 50,000 | 1/(1.07148)^5 | 0.7081 | 35,404 |
| 31/12/2022 | 50,000 | 1/(1.07148)^6 | 0.6608 | 33,042 |
| 31/12/2023 | 50,000 | 1/(1.07148)^7 | 0.6168 | 30,838 |
| 31/12/2023 | 800,000 | 1/(1.07148)^7 | 0.6168 | 493,403 |
| **Total NPV** | | | | **- 765,482** |

Determine if a substantial modification has occurred i.e. is the modification 10% or more

$$\text{Extent of modification} = \frac{A - B}{A} = \frac{(997{,}325 - 765{,}482)}{997{,}325} = 23.2\%$$

Where A = The present value of remaining cash flows under original terms using original EIR = CU997,325

Where B = The present value of revised cash flows using original EIR of CU765,482

As the difference of CU231,843 (CU997,325-CU765,482) is greater than 10%, this is treated as an extinguishment. Therefore, the journal required to derecognise are:

| | **CU** | **CU** |
|---|---|---|
| Debit Financial Liability | 997,325 | |
| Dr Interest Expense | 2,675 | |
| Cr Cash | | 1,000,000 |

In effect what gets written off to the P&L is the unamortised element of the initial arrangement fee of CU5,000.

The fair value of the new financial liability would then be recognised, the fair value could be obtained by discounting the cash flows of the modified loan at the interest rate at which the company could have obtained this new loan at in the market. If we assume the fair value of the new loan is CU999,000, the accounting journals would be:

| | **CU** | **CU** |
|---|---|---|
| Dr Cash | 1,000,000 | |
| Cr Financial Liability | | 999,000 |
| Cr Interest Expense | | 1,000 |

If the above was not above 10% and therefore was not deemed to be a substantial modification, there is a choice as to how to account for the unamortised expenses. The unamortised expenses can be amortised over the remaining life of the negotiated instrument net of any associated fees (can be on a straight line basis or a revised EIR basis so as to allow the unamortised element to come to the capital value at the end of its life e.g. in the example above the CU993,325 (CU997,325-CU4,000 fees) would be amortised such that the capital amount comes to CU800,000 by the end of 2023) or as would be done for a change in estimated cash flows, the current carrying amount is adjusted to reflect the revised present value of estimated cash flows and the remaining amount amortised over the original effective rate of interest (See example 13a for example of same).

***Example 3**: Prior period error*

Section 10

During the 31 December 2015 year end, Company A noticed that the prior year financial statements omitted stock of CU100,000 which was material to the financial statements. Stock in the same location was also omitted at year ended 31 December 2013. The inventory in this location at that time was CU95,000. Given the materiality, this error requires a prior year adjustment. Assume a corporation tax rate of 10%. The adjustments required to correct this error are:

In the 31 December 2014 accounts to restate the opening balance

| | **CU** | **CU** |
|---|---|---|
| Dr Inventory | 95,000 | |
| Cr Profit and Loss Reserves (CU95,000-CU9,500 of current tax) | | 85,500 |
| Cr Corporation Tax Liability (CU95,000*10%) | | 9,500 |

Being journal to reflect adjustment in respect of prior years' including the additional tax payable

| | **CU** | **CU** |
|---|---|---|
| Dr Inventory | 5,000 | |
| Cr Cost of Sales | | 5,000 |
| Dr Current Income Tax in P&L (CU5,000*10%) | 500 | |
| Cr Corporation Tax Liability | | 500 |

Being journal to reflect movement on stock incorrectly excluded from 2013 to 2014 and the related corporation tax payable as a result

See below an example of how this should be disclosed so as to meet the disclosure requirements.

**EXAMPLE DISCLOSURES APPLICABLE FOR FULL FRS 102 & SECTION 1A**

**Profit and Loss Account**

| | 2015<br>CU | 2014<br>Restated<br>CU |
|---|---|---|
| **Turnover** | 1,600,000 | 1,500,000 |
| Cost of sales | (1,220,000) | (1,100,000) |
| **Operating profit** | 380,000 | 400,000 |
| Interest receivable | 5,000 | 5,000 |
| Interest payable | (1,000) | (10,000) |
| **Profit before taxation** | 384,000 | 395,000 |
| Tax on profit | (38,400) | (39,500) |
| **Profit for the financial year** | 345,600 | 355,500 |

**Balance Sheet**

| | 2015<br>CU | 2015<br>Restated<br>CU |
|---|---|---|
| **Fixed assets** | | |
| Tangible assets | 190,000 | 150,000 |
| **Current assets** | | |
| Inventory | 400,000 | 300,000 |
| Cash at bank and in hand | 360,000 | 150,000 |
| | 760,000 | 450,000 |
| **Creditors - amounts falling due within one year** | (99,700) | (95,300) |
| **Net current assets** | 660,300 | 354,700 |
| **Total assets less current liabilities** | 850,300 | 504,700 |
| **Capital and reserves** | | |
| Called up share capital presented as equity | 100 | 100 |
| Profit and loss account | 850,200 | 504,600 |
| **Shareholders' funds** | 850,300 | 504,700 |

## Prior year adjustment

**Prior year adjustment - material error**
The prior year adjustment is due to the omission of inventory located in an outside warehouse being excluded from the inventory at 31 December 2014 and 31 December 2013. The value of the inventory at 31 December 2014 was CU100,000 and the value of the inventory at 31 December 2013 was CU95,000. The financial statements for 2014 has been restated to correct this error.

The prior year adjustment resulted in an increase to the inventory balance at 31 December 2013 and 2014 of CU95,000 and CU100,000 respectively. This has resulted in the cost of sales for 31 December 2014 year end decreasing by CU5,000 and the profit and loss reserves increasing by CU85,500 being the net of tax adjustment and the tax charge for 2014 increasing by CU500. The effect of the restatement on each financial statement line item affected is shown below.

**Option 1:**

| **Analysis of prior year adjustments** | 2014<br>CU |
|---|---|
| **Cost of sales for year ended 31 December 2014** | |
| Cost of sales as previously stated | 1,005,000 |
| Adjustment for inventory previously excluded | (5,000) |
| Cost of sales as restated | 1,100,000 |
| | |
| **Inventory for year ended 31 December 2014** | |
| Inventory at 31 December 2014 as previously stated | 200,000 |
| Adjustment for inventory previously excluded | 100,000 |
| Inventory as restated | 300,000 |
| | |
| **Income tax expense for year ended 31 December 2014** | |
| Income tax expense as previously stated | 39,000 |
| Tax effect on adjustment for inventory previously excluded | 500 |
| Income tax expense as restated | (39,500) |
| | |
| **Income tax payable** | |
| Income tax payable at 31 December 2014 as previously stated | (39,000) |
| Tax effect on adjustment for inventory previously excluded | (9,500) |
| Tax effect on adjustment for inventory previously excluded | (500) |
| Income tax payable as restated | (49,000) |
| | |
| **Profit and loss reserves at 31 December 2014** | |
| Profit and loss reserves at 31 December 2014 as previously stated | 414,600 |
| Adjustment for inventory previously excluded net of tax at 31 December 2013. | 85,500 |
| Adjustment for movement of inventory previously excluded net of tax in the 31 December 2014 year | 4,500 |
| Profit and loss reserves at 31 December 2014 as restated | 504,600 |
| | |
| **Profit and loss reserves at 1 January 2014** | |
| Profit and loss reserves at 1 January 2014 as previously stated | 63,600 |

| | |
|---|---|
| Adjustment for inventory previously excluded net of tax | 85,500 |
| Profit and loss reserves at 1 January 2014 as restated | 149,100 |

**Profit for the year after taxation for year ended 31 December 2014**

| | |
|---|---|
| Profit after tax for year ended 31 December 2014 as previously stated | 351,000 |
| Movement on inventory previously excluded net of tax | 4,500 |
| Profit after tax for year ended 31 December 2014 as restated | 355,500 |

**Profit for the year after taxation for year ended 31 December 2013**

| | |
|---|---|
| Profit after tax for year ended 31 December 2013 as previously stated | 63,600 |
| Inventory previously excluded net of tax | 85,500 |
| Profit after tax for year ended 31 December 2013 as restated | 149,100 |

**Option 2**

The other option here is to show the prior year P&L and balance sheet with the adjustment & then the restated version as per below – you would still need the narrative in the section above,

**Profit and Loss Account**

| | 2014 As previously stated CU | Adjustments CU | 2014 Restated CU |
|---|---|---|---|
| **Turnover** | 1,500,000 | - | 1,500,000 |
| Cost of sales | (1,105,000) | 5,000 | (1,100,000) |
| **Operating profit** | 395,000 | 5,000 | 400,000 |
| Interest receivable | 5,000 | - | 5,000 |
| Interest payable | (10,000) | - | (10,000) |
| **Profit before taxation** | 390,000 | 5,000 | 395,000 |
| Tax on profit | (39,000) | (500) | (39,500) |
| **Profit for the financial year** | 351,000 | 4,500 | 355,500 |

**Balance Sheet**

| | 2014 As previously stated CU | Adjustments CU | 2015 Restated CU |
|---|---|---|---|
| **Fixed assets** | | | |
| Tangible assets | 150,000 | - | 150,000 |
| **Current assets** | | | |
| Inventory | 200,000 | 100,000 | 300,000 |
| Cash at bank and in hand | 150,000 | - | 150,000 |
| | 450,000 | 100,000 | 450,000 |
| **Creditors - amounts falling due within one year** | (85,300) | (10,000) | (95,300) |
| **Net current assets** | 354,700 | 90,000 | 354,700 |
| **Total assets less current liabilities** | 504,700 | 90,000 | 504,700 |
| **Capital and reserves** | | | |
| Called up share capital presented as equity | 100 | - | 100 |
| Profit and loss account | 504,600 | 90,000 | 504,600 |
| **Shareholders' funds** | 504,700 | 90,000 | 504,700 |

**Statement of changes in Equity or Movement in profit and loss reserves note**

Note the lines **'**Prior year adjustment – change in accounting policy (see note X)' is just included for illustrative purposes

| | **Called up Share Capital CU** | **Profit and Reserves CU** | **Total Equity CU** |
|---|---|---|---|
| Balance at 1 January 2014 as previously reported | 100 | 63,600 | 63,600 |
| Prior year adjustment – change in accounting policy (see note X) | - | - | - |

| | | | |
|---|---|---|---|
| Prior year adjustment – cc of material error (see note | | 85,500 | 85,500 |
| Balance at 1 January 2014 as restated | 100 | 149,100 | 149,100 |
| Profit for the year as previously reported | | 351,000 | 351,000 |
| Prior year adjustment – change in accounting policy (see note X) | - | - | - |
| Prior year adjustment – correction of material error (see note X) | | 4,500 | 4,500 |
| Profit for the year as restated (see note X) | | 355,500 | 351,000 |
| **Balance at 31 December 2014** | **100** | 504,600 | 504,700 |
| **Balance at 1 January 2015** | **100** | **504,600** | **504,700** |
| Profit for the year | | 345,600 | 345,600 |
| **Balance at 31 December 2015** | **100** | **850,200** | **850,300** |

Note the inventory comparative figures would also be update and the word 'Restated' would be included under the comparative year as was done for the profit and loss and balance sheet above. Note the above shows a statement of changes in equity however a movement on profit and loss reserves note is only required if Section 1A is applied. So therefore, the P&L reserves column would only be required here.

**Example 4: Exceptional item layout**

**Section 10**

**Example Accounting policies**

**(xxviii) Exceptional items**

Exceptional items are those that the Directors' view are required to be separately disclosed by virtue of their size or incidence to enable a full understanding of the Company's' financial performance. The Company believe that this presentation provides a more informative analysis as it highlights one off items. Such items may include significant restructuring costs. The Group/Company has adopted an income statement format that seeks to highlight significant items within the Group/Company results for the year.

**OR THE BELOW CAN BE USED**

The Group has adopted an income statement format that seeks to highlight significant items within the Group results for the year. Such items may include restructuring, impairment of assets, profit or loss on disposal or termination of operations, litigation settlements, legislative changes and profit or loss on disposal of investments. Judgement

**1) Example layout of exceptional item if shown on the face of the Profit and Loss Account**

**Profit and Loss Account**
**For the Year Ended 31 December 2015**

| | Notes | 2015 CU | 2014 CU |
|---|---|---|---|
| **Turnover** | 1 | XXXXX | XXXXX |
| Cost of sales | | (XXXX) | (XXXX) |
| **Gross profit** | | XXXX | XXXX |
| Selling and distribution costs | | (XXX) | (XXX) |
| Administrative expenses | | (XXX) | (XXX) |
| Other operating income | | XXX | XXX |
| **Operating profit** | 3 | 900,000 | XXX |
| Operating profit before exceptional item | | 1,200,000 | XXX |
| Impairment of tangible fixed assets | | 150,000 | XXX |
| Restructuring provision | | 150,000 | XXX |
| Operating profit | | **900,000** | **XXX** |
| Income from shares in group undertakings | 4 | XXX | XXX |
| Income from shares in other financial assets | 4 | XXX | XXX |
| Income from shares in participating interests | 5 | XXX | XXX |
| **Profit before interest and taxation** | | XXXX | XXXX |
| Interest receivable and similar income | 6 | XXX | XXX |
| Interest payable and similar expenses | 7 | (XXX) | (XXX) |
| **Profit before taxation** | | XXXX | XXXX |

| | | | |
|---|---|---|---|
| Tax on profit | 8 | (XXX) | (XXX) |
| **Profit for the financial year** | | 1,000,000 | 500,000 |
| **Profit for the financial year attributable to:** | | | |
| Owners of the parent company | | 1,000,000 | 500,000 |
| | | 1,000,000 | 500,000 |

**2) Extract from notes to the financial statements**

**Exceptional item - impairment charge**

| | 2015 | 2014 |
|---|---|---|
| | CU | CU |
| Restructuring costs (see (i) below) | 8,000 | - |
| Impairment of tangible fixed assets | 8,000 | - |
| Amortisation of deferred grants arising on impairment of related assets | (500) | - |
| | 7,500 | - |

(i) During the year the company announced a formal plan to restructure the operations and as a result announced a plan to let employees go. This amount represents the expected cost of redundancy as a result of this decision.

(ii) The directors have reviewed the carrying value of tangible fixed assets, net of associated deferred grants, at the year end in accordance with Section 27 "Impairment of Assets". As a result, a net impairment loss of CU150,000 (2014: CUNil) has been charged to the profit and loss account for the year. The impairment of CU150,,000 represents an impairment of tangible fixed assets net of a release of related deferred grants of CU10,000. The impairment losses have been allocated to fixed assets categories on a pro-rata basis relative to their pre-impairment carrying values. The impairment loss arose as a result of the material change in the market in which the company operates. Deferred tax has been recognised as a result of this adjustment.

The company's activities were considered, due to their nature, to form one income-generating unit for the purposes of the impairment review. A pre-tax discount rate of 6%, representing the estimated market rate of return on an investment with equal risk, was applied to the expected future cash flows in the value in use calculation. Value in use was considered to exceed estimated net realisable value. Cash flows have been projected over five years based on management forecasts and budgets. After that a steady growth rate of 1% has been assumed.

**3) Note where exceptional item is not shown on the face of the profit and loss**

| **Exceptional item** | 2015<br>CU | 2014<br>CU |
|---|---|---|
| Administrative expenses in the profit and loss account includes the following exceptional charges: | | |
| Provision against investment in subsidiary/joint venture/associate | XX | XX |
| | XX | XX |

**Exceptional item**

The exceptional item arose as a result of a settlement reached in respect of litigation initiated against the company upon termination of a licence agreement prior to the year end. This amount which includes provision for all legal and other costs relating to the matter which will be borne by the company is also included within accruals and other liabilities in note XX of the financial statements.

| **Or Exceptional items** | 2015<br>CU | 2014<br>CU |
|---|---|---|
| (i) Movement in provision for operating costs to date of closure | XX | XXX |
| (ii) Gain on settlement of pension scheme (see (a) below) | XX | (XXX) |
| Total | XXX | XXX |

(a) Following the closure of the company, the defined benefit pension scheme was wound up with effect from 31 December 2015. On wind-up, the pension scheme had sufficient assets to meet the liabilities of the scheme. The gain arose on closure of the scheme.

**Example 5: Debt versus Equity – Preference shares**

**Section 22**

***Example 22:*** *Redeemable preference shares at option of the holder with mandatory coupon*

Company A issued 200,000 10% preference shares of CU1 each in return for CU200,000. The rights attaching to the shares are such that:

- 10% dividend must be paid annually in arrears i.e. CU20,000 mandatory
- The preference shares are redeemable at their par value at the option of the holder at some time in the future.

Given that Company A has a contractual obligation to pay a dividend yearly and is contractually obliged to redeem the shares, these shares would be classified as debt in Company A's financial statements. The journals required on issue would be to:

| | **CU** | **CU** |
|---|---|---|
| Dr Bank | 200,000 | |
| Cr Preference Shares Liability | | 200,000 |

The journal required at the end of each year for the dividend payable is:

| | **CU** | **CU** |
|---|---|---|
| Dr Interest Expenses with Preference Dividend | 20,000 | |
| Cr Bank/Preference Dividend Accrual | | 20,000 |

---

***Example 5a:*** *Non-redeemable preference shares with mandatory coupon at market rate*

Company A issued 200,000 10% preference shares of CU1 each in return for CU200,000. The rights attaching to the shares are such that:

- 10% dividend must be paid annually in arrears i.e. CU20,000 mandatory
- The preference shares are non-redeemeable or redeemable at the option of the issuer (i.e. Company A) at any time

Given that Company A has a contractual obligation to pay/accrue a dividend yearly, these shares would be classified as debt in Company A's financial statements as the stream of cash flow is into perpetuity. The journals required in this case are the same as example 1.

---

***Example 5b:*** *Non-redeemable preference shares with mandatory coupon at non-market rate*

Company A issued 200,000 10% preference shares of CU1 each in return for CU200,000. The market coupon rate on such shares should be 12%. The rights attaching to the shares are such that:

- 10% dividend must be paid year on year i.e. CU20,000 mandatory
- The preference shares are non-redeemeable or redeemable at the option of the issuer (i.e. Company A) at any time

In this particular circumstance, there is both a liability and equity component to these shares. This is in effect a compound financial instrument. The liability element being the mandatory present value of the dividend payable into perpetuity and equity element being the residual. Therefore a certain element of the proceeds will be shown in equity and liabilities. See section on compound financial instruments below (example 17).

Note if the above example was at market rate but it also contained rights which stated that additional dividends on top of the coupon rate may be paid at the discretion of the board, it would also be a

compound instrument and the market rate for an instrument with the additional option would have to be applied so as to ascertain the liability and equity component.

---

***Example 5c:*** *Shares redeemeable at the option of the holder*

'Ordinary shares' that can be converted into debt, based on fair value of the shares at the date of conversion at the option of the holder

Here this is accounted for as a financial liability on the basis that once converted which is at the option of the holder, there is a contractual obligation to redeem for cash, hence the issuer cannot avoid paying in cash.

---

***Example 5d:*** *Non redeemable preference shares with discretionary dividend*

Company A issued 200,000 preference shares of CU1 each in return for CU200,000. The rights attaching to the shares are such that:

- Dividend is payable at the discretion of the company
- The preference shares are non-redeemable

Given that company A has no contractual obligation to redeem or pay dividends, this should be classified as equity in the financial statements. The journal required on issue of the shares are:

| | **CU** | **CU** |
|---|---|---|
| Dr Bank | 200,000 | |
| Cr Equity –Preference Share Capital | | 200,000 |

Where a discretionary dividend is paid on these equity shares the journal required is to:

| | **CU** | **CU** |
|---|---|---|
| Dr Equity-Profit and Loss Reserves | XXX | |
| Cr Bank | | XXX |

If the dividend was approved by the members prior to the year end, then the dividend can be accrued.

---

***Example 5e:*** *Redeemable preference shares at option of issuer with discretionary dividend*

Company A issued 200,000 preference shares of CU1 each in return for CU200,000. The rights attaching to the shares are such that:

- Dividend are payable at the discretion of the company
- The preference shares are redeemable at the issuers option at some future date

Given that Company A has no contractual obligation to pay cash, this should be classified as equity in the financial statements. The treatment of any discretionary dividends are posted to equity as in example 5 above. Note even if there was a coupon attached to these preference shares that was only payable at the option of the Company, they would still be classed as equity. Whether the company has a history of paying dividends in the past is irrelevant, it would still be classed as equity as it does not have a contractual obligation to make the dividend payment.

---

***Example 5f*** *Redeemable preference shares at option of issuer with mandatory dividend*

Company A issued 200,000 10% preference shares of CU1 each in return for CU200,000. The rights attaching to the shares are such that:

- 10% dividend must be paid annually in arrears i.e. CU20,000 mandatory

- The preference shares are redeemable at the issuers option at some future date

Here assuming the coupon rate of 10%, is the market rate on issue, as Company A has a contractual obligation to pay/accrue a dividend annually, this would be classified as a financial liability. See example 3 for how this would be accounted for if the rate was a non-market rate.

---

***Example 5g:*** *Mandatory redeemable preference shares at fixed amount at a fixed or future date with mandatory dividend*

Company A issued 200,000 10% preference shares of CU1 each in return for CU200,000. The rights attaching to the shares are such that:

- 10% dividend must be paid annually in arrears i.e. CU20,000 mandatory

- The preference shares are redeemable at a fixed or future date

Given that Company A has a contractual obligation to pay/accrue a dividend yearly, these shares would be classified as debt in Company A's financial statements. The journals required in this case are the same as example 1.

---

***Example 5f:*** *Mandatory redeemable preference shares at fixed amount at a fixed or future date with dividend payable at the discretion of the issuer*

Company A issued 200,000 preference shares of CU1 each in return for CU200,000. The rights attaching to the shares are such that:

- Dividend is payable at the discretion of the company

- The preference shares are mandatory redeemable at a fixed or future date

Here this is in fact a compound instrument as it contains both an equity and liability component. The liability component is the present value of the redemption amount and equity component is equal to the proceeds less liability component. Any dividends paid are taken to relate to the equity component. The present value rate that should be used is the rate that would be charged by a bank for period up to the mandatory redemption date on a similar instrument.

For example assume in the above example, it is mandatory redeemable at the end of year 5 and the market rate of interest for a similar loan would be 8%. Then the present value of CU200,000 is CU136,117 (CU200,000/((1.08^5)). Therefore the amount to be recognised as a liability is CU136,117 and the amount to be recognised in equity is CU63,883. The journal required on intial recognition is:

| | **CU** | **CU** |
|---|---|---|
| Dr Bank | 200,000 | |
| Cr Preference Share Liability | | 136,117 |
| Cr Equity | | 63,883 |

The CU136,117 is then amortised at the effective interest rate of 8% over the 5 year period as per below

| Year | Opening balance | Capital element | Interest for Period 8% | Cash flow | Closing balance |
|---|---|---|---|---|---|
| | | | | | |
| 1 | 136,117 | 136,117 | 10,889 | - | 147,006 |
| 2 | 147,006 | 147,006 | 11,760 | - | 158,766 |
| 3 | 158,766 | 158,766 | 12,701 | - | 171,468 |
| 4 | 171,468 | 171,468 | 13,717 | - | 185,185 |
| 5 | 185,185 | 185,185 | 14,815 | (200,000) | - |

Therefore the journal that would be posted at end of year 1 would be:

| | CU | CU |
|---|---|---|
| Dr Interest Cost | 10,889 | |
| Cr Preference Share Liability | | 10,889 |

If a dividend was declared and paid on these shares of CU10,000 during year 1 for example, the following journal would be posted:

| | CU | CU |
|---|---|---|
| Dr Equity-Profit and Loss Reserves | 10,000 | |
| Cr Bank | | 10,000 |

**However,** where any unpaid dividend is added to the redemption amount and this is included in the share rights, the whole instrument is classed as a liability component i.e. CU200,000 and the dividend accrued increases the liability.

---

***Example 5g:*** *Redeemable preference shares at holder's option at some future date with dividend payable at the discretion of the issuer*

Company A issued 200,000 preference shares of CU1 each in return for CU200,000. The rights attaching to the shares are such that:

- Dividend is payable at the discretion of the company
- The preference shares are redeemable at some future date at the option of the holder

Here this is in fact a compound instrument as it contains both an equity and liability component assuming that it does not meet the definition in 22.4 (i.e. a puttable instrument in an entity which has a very limited life in which case it would all be classed as equity). The liability component is the present value of the redemption amount and equity component is equal to the proceeds less liability component. Any dividends paid are taken to relate to the equity component. The present value rate that should be used is the rate that would be charged by a bank for period up to the mandatory redemption date. See example 9 for further details.

**However,** where any unpaid dividend is added to the redemption amount and this is included in the share rights, the whole instrument is classed as a liability component i.e. CU200,000.

---

***Example 5h:*** *Preference shares with dividends payable at the discretion of the issuer and only redeemable on the liquidation of the company*

Company A issued 200,000 preference shares of CU1 each in return for CU200,000. The rights attaching to the shares are such that:

- Dividend is payable at the discretion of the company
- The preference shares are redeemable on the liquidation of the company

Here these shares would be classed as equity as per Section 22.3A(b) on the basis that every share becomes repayable on a liquidation even ordinary shares.

If in this example, the shares were redeemable on the appointment of a receiver or administrator these would then be classified as a financial liability.

---

***Example 5i:*** *Preference shares/bonds convertible with a mandatory coupon redeemable at the option at the holder, into a fixed number of ordinary shares at any time up to maturity (see example 17 below).*

---

**Application of Section 22.3(b)(i)**

In relation to Section 22.3(b)(i) it is clear that where a variable number of shares are to be issued from an entity's own equity, these are classified as equity. An example of the application of this section is detailed in the example below:

---

***Example 5j:*** *Preference shares issued which can be redeemed for no set number of share in the future*

Company A issued preference shares of CU1 each in return for CU200,000. The shares are redeemable after 5 years at the option of the holder into ordinary shares up to the value of CU200,000 at that date. Assume at the end of year five the price per ordinary share is CU10

In this particular case it is evident that a variable number of shares will be issued to the holder on redemption depending on the value of the company at that date i.e. at the end of year five 10,000 shares will have to be issued (CU200,000/CU10=CU10,000) hence there is variability which dictates that these shares are therefore classed as equity.

---

***Example 5k:*** *Fixed for fixed arrangement*

An example of where this exemption applies also is where a company receives CU10,000 from another entity/person in return for the company issuing 300 shares in itself in four years time (with no other conditions attached). As the holder will suffer from a loss and benefit from a gain with regard to a fall/uplift in the value of the company, this CU10,000 would be classified as equity on receipt of CU10,000. Another example where the company issue preference shares/loan notes which are convertible into a fixed number of shares at a future date.

---

**Example 6 - Section 29 - Deferred tax recap**

**29.4.2.1 Deferred tax defined and the purpose of deferred tax**

Appendix 1 of FRS 102 defines deferred tax as the income tax payable /(recoverable) in respect of the taxable profit (or tax less) for future reporting periods as a result of past transactions of events.

Deferred tax is recognised on a timing difference plus approach. Deferred tax represents the future consequences of transactions and events recognised in the current and prior periods financial statements. The reason why deferred tax is recognised is due to the fact that this future tax will be payable even where the company decides to cease trading i.e. it is certain the future tax will have to be paid or will be refundable.
The provision for deferred tax ensures the tax charge shown eliminates any timing differences i.e. the tax charge would usually be the profit before tax multiplied by the tax rate less any permanent differences. Any timing differences are deferred on the balance sheet.

**29.4.2.2 Permanent differences**

**29.4.2.2.1 Analysis**

Permanent differences occur as a result of certain types of expenditure/income being posted as a charge/credit in the profit and loss but are added back/deducted in the tax computation as it was never tax deductible/taxable for tax purposes i.e. the tax authorities will never allow a deduction for these costs. As these are permanent they do not come within the scope of deferred tax unless they arise on a business combination as stated section 29.10 and 29.11 of FRS 102 above.

**29.4.2.2.1.1 The one exception for recognising a permanent difference for deferred tax**

Section 29.10 of FRS 102 makes it clear that deferred tax can only be recognised on permanent differences where they arise on a business combination (all other times permanent differences are ignored) see details at 29.5.2.

**29.4.2.2.1.2 Examples of temporary differences for deferred tax purposes**

Examples of permanent differences are:

- Customer entertainment
- Charitable donations not above a certain value
- Amortisation/depreciation on assets not allowable for capital allowance purposes (on initial recognition only if revolution policy chosen)
- Expenses deemed to be capital in nature for tax purposes, but no capital allowances are allowed to be claimed
- Certain payments made on leases
- Write off/provisions against investments, fixed assets (where they are not allowable for capital allowance purposes and/or have not been revalued and are not capital assets for capital gains tax purposes))
- Deemed debit/credit posted to profit and loss on recognition of a loan given/received at non-market rates (assuming the company is not engaged in the giving and receiving of loans as its trade)

**29.4.2.3 Temporary differences**

**29.4.2.3.1 Temporary differences defined**

As detailed in section 29.6 of FRS 102 timing differences arise due to expenses being charged to the profit and loss account or ‘other comprehensive income’ in a period but are not allowable for tax purposes until future periods or where the expense has been allowed for tax purposes but has not hit the profit and loss account by the year end.

**29.4.2.3.2 Definition of deferred tax assets and instances where they arise**

The Glossary to FRS 102 defines a deferred tax asset as income tax recoverable in future reporting periods in respect of: (a) future tax consequences of transactions and events recognised in the financial statements of the current and previous periods; (b) the carry forward of unused tax losses; and (c) the carry forward of unused tax credits.

**29.4.2.3.2.1 When does a deferred tax asset exist including examples**

A deferred tax asset exists where:

- The company has charged an expense/deduction to the profit and loss account during the period but it has not been allowed for tax purposes in that period but it will be allowed as a tax deduction in the future (i.e. the tax authorities will allow the deduction in the future). Examples would include:

    - Instances where capital allowances are claimed over a life greater than the life the asset is depreciated over. (i.e tax written down value greater than NBV)
    - Losses carried forward
    - Pension deductions only allowed on a paid basis
    - General accruals/provisions not allowable until paid
    - Capital items expensed, added back in the tax comp but allowed for capital allowance purposes
    - Revaluation of assets downward
    - Profit/loss on disposal of assets allowed for capital allowance purposes

See further details at 29.4.2.4.1.8

**29.4.2.3.3 Definition of deferred tax liabilities and instances where they arise**

The Glossary to FRS 102 defines a deferred tax liability as Income tax payable in future reporting periods in respect of future tax consequences of transactions and events recognised in the financial statements of the current and previous periods.

**29.4.2.3.3.1 When does a deferred tax liability exist including examples.**

A deferred tax liability exists where:

- The company has obtained a tax deduction in the current or prior accounting period but it has not been charged to the profit and loss account at that time. Examples would include:

    - Instances where capital allowances are claimed over a life shorter than the life the asset is depreciated over (i.e tax written down value less than NBV)

- Income/gain has been recognised in the current or prior accounting period but was not taxed in the tax computation in that period but will be taxable at a future time e.g. interest receivable or revaluation of assets upwards. See further details at 29.4.2.4.1.8

**29.4.2.3.4 Recognition of timing differences - the rules.**

Section 29.6 of FRS 102 requires all timing differences to be recognised as deferred tax on the balance sheet with the exception of timing differences arising from:

**29.4.2.3.4.1 Unrelieved tax losses – The rule recognition or not**

1.) Unrelieved tax losses (i.e. deferred tax asset) where it is not probable that future taxable profits will exist to utilise these tax losses carried forward or stated in section 29.7 of FRS 102. Before

these losses can be recognised as a deferred tax asset it must be probable (more likely than not that there will be taxable profits to utilise the tax losses). Section 29.7 of FRS 102 makes it clear that the very existence of unrelieved tax losses is strong evidence that there may not be other future taxable profits against which the losses can be relieved. Therefore, when assessing whether the deferred tax asset should be recognised care should to be taken to review future projections (it is not enough to just look at prior year results as a basis for future years) and assess how long it will take to recover these losses based on those projections or if in fact it is possible to recover these. Consideration also needs to be given as to whether the losses expire at a point in time. It may be possible to look at future tax strategies to prove the recoverability of losses forward if it is probable these will be put in place.

---

***Example 6a: Losses forward – recognition of deferred tax***

Company A has losses forward of CU200,000. The projected profits over the next 6 years is CU100,000. In this example given that it is going to take 6 years to recover only CU100,000 of the losses, the entity should at a maximum recognise a deferred tax asset of CU100,000. Whether to recognise this CU100,000 will depend on the strength of projections and how accurate the Company has been with projecting in the past.

---

**29.4.2.3.4.1.1 Deferred tax (inc losses) recoverable against deferred tax liabilities**

Where there are deferred tax liabilities in addition to deferred tax assets than as long as the asset and liabilities arise from the same tax district and are the same type (e.g. deferred tax liabilities and deferred tax assets relate to profits taxable at the same tax rate or deferred tax liabilities and assets which relate to capital (CGT) items. You cannot mix passive income items with trade items or capital items with trader or passive items) then as long as it is probable that the deferred tax assets (e.g. Losses) will be relieved against the reversal of the deferred tax liabilities, the deferred tax assets can be recognised. Section 29.7 and 29.24A of FRS 102 refers. Note however where the deferred tax assets exceed the deferred tax liability then the deferred tax assets should only be recognised to the extent that the net deferred tax overall is nil. Any further amount of the deferred tax assets should only be recognised if it is probable that there will be future taxable profits to utulise the deferred tax assets

**Example 6b: Deferred tax liabilities available to utilise deferred tax assets**

Company A has losses in the year of CU100,000 in tax terms which therefore is a deferred tax asset. The company also has deferred tax liabilities of CU 150000 which are trade related to the net book value of plant being in excess of tax written value. In this case assuming the reversal of the deferred tax liability will reverse simultaneously (with the losses forward) then the entity should recognise a deferred tax liability at CU50,000 in line with section 29.7 of FRS 102 and section 29.24A of FRS 102.

If in this example the losses in tax terms were CU200,000 then only CU150,000 of those losses should be set against the liability (assuming it is probable they will be recovered through the reversal of the deferred tax liability) so as to come to a CUNIL deferred tax balance. Whether the additional CU50000 is recognised as a deferred tax asset will depend on whether it is probable there will be future taxable profits to utilise the losses forward. If these were pension contributions that made up the deferred tax assets the same process would need to be done to access how much can be recognised.

The adequacy of providing for a deferred tax asset in relation to unrelieved assets should be carried out at each reporting period.

**29.4.2.3.4.2 Where conditions for retaining the tax allowances have been met – no requirement to recognise timing differences.**

2.) Assets where the conditions for retaining the tax allowances have been met. This applies where an asset has a certain tax life and after that tax life has elapsed no tax claw back arises. Examples where this applies would include: capital allowances on hotels, industrial buildings, certain property-based incentives.

---

***Example 6c: Conditions for retaining tax allowances have been met***

Company A purchased an industrial property 25 years ago for CU500,000. This property is being depreciated for tax purposes over 50 years but capital allowances are being claimed for tax purposes over 25 years after which no claw back arises for previous tax deductions claimed. Assume the deferred tax rate is 10%. Therefore in the accounts at the end of year 25 the deferred tax liability recognised was:

| | **CU** |
|---|---|
| NBV Per Accounts (CU500,000/50yrs*25yrs)= | 250,000 |
| Tax Written Down Value (CU500,000/25yrs*0yr left)= | (0 ) |
| Deferred Tax Liability | 250,000 |
| Deferred Tax Rate @ 10% | 25,000 |

At the end of year 26, the previous years deferred tax liability can be released in full as the tax life is over and no balancing charge/allowance can arises following a sale.

---

**29.4.2.3.4.3 Non-recognition of timing difference arising as a result of associates/JV's branches subsidiaries in consolidated financial statements where certain conditions exist.**

3.) Income/expenses from an associate, joint venture, branch or subsidiary recognised in the group's consolidated financial statements will be assessed for tax purposes in the future but the reporting entity can control the reversal of the timing difference and it is probable the timing difference will not reverse in the foreseeable future. This would be applicable where there are undistributed profits in the associate, joint venture, branch or subsidiary.

**29.4.2.3.4.4 No recognition of timing difference on goodwill recognised in a business combination**

4.) Goodwill recognised in a business combination.

As detailed in section 29.11 of FRS 102 a temporary difference arising from the recognition of goodwill in a business combination cannot be recognised. Note however permanent differences arising on differences other than goodwill must be recognised. See details at 29.5.2.

**29.4.2.4 Measurement**

**29.4.2.4.0 Initial recognition exception**

Any temporary difference on initial recognition is ignored for deferred tax purposes as it is treated as permanent (other than in the case of business contributions detailed in 29.5.2). See an example at same at 29.4.2.4.1.8.11 and 29.4.2.4.1.2.3

**29.4.2.4.1 What tax rate to use**

Section 29.12 of FRS 102 states that deferred tax should be measured at the tax rates enacted or substantively enacted at the balance sheet date. See example 1 at 29.2.2.1 above where this is illustrated. Note if an item is not taxable based on how it is to be realized then no deferred tax arises.

In measuring deferred tax an entity is required to apply the enacted rate that is expected to apply to the reversal of the timing difference (i.e. the sales tax rate or the trading rate), except in the case of timing differences arising from the:

- revaluation of non-depreciable assets where a revaluation option taken. In this case the sales tax rate (the tax rate on sale of the asset) should be used to measure the deferred tax liability as required by Section 29.15 of FRS 102. An example of this type of asset is land.

- recognition of investment properties at fair value (which is accounted for in accordance with Section 16). In this case the sales tax rate (the tax rate on sale of the asset) should be used to measure the deferred tax liability as required by Section 29.16 of FRS 102.

#### 29.4.2.4.1.1 The rate to use for non- depreciable land and investment property

Section 29.15 and 29.16 of FRS 102 requires non-depreciable land and investment property to be measured at the sales tax rate. For all other assets the rate to use is the rate the deferred tax assets is realised/settled.

#### 29.4.2.4.1.2 Review of the recovery of how a deferred tax asset/liability is recovered/settled

Other than the two items mentioned at 29.4.2.4.1.1 consideration of the manner in which the asset will be recovered/liability settled should be given. The manner in which the asset can be recovered, or liability settled is key in deciding whether to apply the sales tax rate or the trading tax rate. The entity should consider the expected manner of recovery at each reporting date to assess if it is necessary to change the rate used. There are three ways in which an asset can be recovered:

- through use in the business (see 29.4.2.4.1.2.2) or
- through sale of the asset (see 29.4.2.1.1.2.3) or
- through use and sale of the asset (see 29.4.2.4.1.2.4)

Section 29 does not specifically deal with the above in detail.

#### 29.4.2.4.1.2.1 Manner of recovery through use

Where the asset is expected to be recovered through use, then it would be reflected in the depreciation charged during the assets life and it would usually be expected to have a nil residual value. The rate to be used in measuring deferred tax would be the trade rate in this instance (i.e. 12.5% in Ireland or 25% where the entity carries on a passive trade). Examples of assets under this class may include:

- depreciable assets used in its trade
- current assets and liabilities relating to the trade

#### 29.4.2.4.1.2.2 Manner of recovery through sale

Where the asset is expected to be recovered through eventual sale, then the tax rate to use would be the rate that would be applicable on sale (i.e. the capital gains tax rate which would be 33% in Ireland or if there are special tyes of long term investments exit tax at 25% may apply).

Examples of assets under this class may include:

- investments in equities (<20% ownership)
- investment in subsidiaries/associates/joint ventures
- investment property
- land

#### 29.4.2.4.1.2.3 Manner of recovery – dual use

Where the asset has a dual use, Section 29 does not detail the rate that should be used so therefore it is an accounting policy choice as to how best to treat such a situation and judgement will be required. It may be necessary to ascertain the residual value and apply the sales tax rate on this element and apply the trading tax rate to the element that is depreciated.

In developing an accounting policy an entity should use the guidance with regard to the concepts in Section 2 of FRS 102 or alternatively look to the guidance in IAS 12 in IFRS as permitted by Section 10 of FRS 102. The below illustrates the guidance from IFRS.

Example 9: Dual use manner of ***recovery***

Company A acquired a property and some land for €200,000 a number of years ago which is used for the purposes of the trade. The cost was split CU150,000 to the property and CU50,000 to the land. The residual value of the property at the end of its useful life was estimated at CU5,000, therefore the depreciable amount was CU145,000 in relation to the property. The company obtained capital allowances on CU150,000 of the premises cost (CU50,000 was not allowed). A number of years ago the property and land was revalued to CU160,000 and CU60,000 respectively. The carrying amount at the reporting date of the land was CU60,000 and the property was CU100,000. The new residual estimated value at that date was CU6,000 and the tax written down value was CU40,000. The carrying amount of the unallowed portion on the property following the previous revaluation was CU30.000 (if no revaluation had of been undertaken the carrying amount would have been CU20,000). As there is a residual value this will be subject to CGT as it is a capital asset. As Section 29 does not deal with how to account for a dual use asset the entity has decided to follow the guidance in IFRS. Assume a deferred tax rate of 10%.

**Deferred tax at trading rate on the premises**

| | | | C U |
|---|---|---|---|
| Carrying amount of premises | 100,000 | | |
| Less carrying amount of assets not allowable for Capital allowances purposes (using original cost figures where a revaluation has arisen, if no revaluation then this amount will already be the original cost) | (20,000) | | |
| Less residual amount (including any revaluation element included in carrying amount not extracted in line above (amount of carrying amounts realised through sale) | | (6,000) | |
| | | | 74,000 |
| Less TWDV | | | (40,000) |
| Deferred tax (asset)/liability | | | 34,000 |
| Deferred tax at 10% | | 3,400 | |

If in this example there was a deferred tax asset you would only recognise this asset if it can be recovered through future profits or can be set against other deferred tax liabilities which can be set off against the capital allowances. If it cannot be utilised by future profits – recognise no deferred tax asset should be recognised. Note Section 29 does not state how dual use should be accounted for therefore the above example illustrates the guidance in IFRS for a dual use asset where capital allowances are being claimed. You could possibly ignore taking the residual amount off here and possible not calculate the capital deferred tax asset/liability as there is no guidance in FRS 102.

**Deferred tax at CGT rate on residual value of premises**

| | | |
|---|---|---|
| Residual amount included in carrying amount of premises inc. any Movement on residual amount due to revaluations | | 6,000 |
| Tax cost inc. indexation | (150,000) | |
| Difference | | (144,000) |
| Add timing difference on initial recognition (no Deferred tax recognised on this) (original cost of whole asset of CU150,000-CU5,000 residual value) | | 145,000 |
| Deferred tax asset | | 1,000 |
| Deferred tax 33% | | 330 |

Here this is a deferred asset. This can only be recognised if it can be recovered through future chargeable gains or can be set against other capital deferred tax liabilities. As there is a capital deferred tax liability on the land as calculated below, this can be set off against this assuming the land and buildings will be sold at the same time.

**Deferred tax at CGT rate on land**

| | | |
|---|---|---|
| Carrying amount of land inc. any revaluations | | 60,000 |
| Less carrying amount of assets not allowable for Capital allowances purposes (using original cost figures where a revaluation has arisen, if no revaluation then this amount will already be the original cost) | | (50,000) |
| 10,000 | | |
| Less TWDV | | (-) |
| Deferred tax (asset)/liability | 10,000 | |
| Deferred tax at 10% | 1,000 | |

If the capital deferred tax at CGT rate were a liability on the land, then this gain could be set against that liability assuming that the premises and land would be sold at the same time. This would also be the case if the residual value was nil here but the premises was sold at the end of its life.

**29.4.2.4.1.3 Effect of change in classification of assets**

Section 29 provides no detail on what rate is to be used where investment property is classified from investment properties due to an inability to measure fair value due to undue cost or effort. In this particular circumstance consideration should be given to the manner in which the asset can be recovered. Given that this property had been measured at the sales tax rate while accounted for as an investment property asset under Section 16, it would not be unreasonable to assume the sales tax rate should be used in this instance.

**29.4.2.4.1.4 Determining the value of timing difference**

**29.4.2.4.1.4.1 Overview**

The amount to be considered for deferred tax is the difference between the tax base cost and the assets carrying amount. The tax base cost can be the tax written down value where capital allowances can be claimed on the assets or base cost of the asset where the asset is to be recovered through a sale.

**29.4.2.4.1.4.2 Indexation and how is this accounted for**

Where deferred tax is measured on a sales tax rate basis, Section 29 would require that the tax cost would incorporate any indexation allowed for tax purposes. Indexation is not applicable for assets/liabilities that we recognise  The difference between the carrying amount of the asset in the accounts and the indexed base cost is the deferred tax timing difference. However indexation cannot create or increase a loss. Note indexation only applies where the timing difference is not recovered through use. In the foregoing examples we have ignored inflation.

---

***Example 6d: Indexation of base cost – non depreciable asset***

Company A purchased a piece of land for CU100,000 in 1990. Assume the carrying amount in the accounts is CU500,000 following a revaluation. Under local tax rules, indexation is allowed to be applied when determining the tax to be paid on the sale of the land. If we assume that indexation allowed is 2.5 times the original cost and the deferred tax rate on sale is 20%, the deferred tax asset to be recognised at the year end is:

CU500,000 – (CU100,000*2.5 times)= CU250,000 * the sales tax rate of 20%= CU50,000

Note if no revaluation had of been booked in the accounts, then no deferred tax would be recognised as there is no difference between the carrying amount in the accounts and the tax base cost. Also if the above was a loss, the loss would be restricted to the actual loss excluding indexation. Whether a deferred tax asset should be recognised for the loss will be determined by whether the entity believes the capital loss can be utilised in the foreseeable future.

---

#### 29.4.2.4.1.5 Discounting

As per Section 29.17 of FRS 102, deferred tax cannot be discounted.

#### 29.4.2.4.1.6 Deferred tax impact if unlikely to be taxable/tax deductible on future sale

Note in assessing whether deferred tax needs to be recognised, one should assess if tax is payable on future settlement. If an item is exempt from tax then no deferred tax needs to be recognised (e.g. CGT exempt on certain assets purchased during a certain period).

#### 29.4.2.4.1.7 Steps involved to working out deferred tax

1) Identify the timing differences at the balance sheet date
2) Quantify the timing difference and whether it is a deferred tax asset or liability.
3) Calculate the timing difference before applying the deferred tax rate
4) Apply the tax rate to step 3
5) Decide where to post the deferred tax. The deferred tax posting should be posted to either the P&L, OCI/revaluation reserve. The posting will be to wherever the depreciation/revaluation etc was posted.

See application of the above at 29.4.2.4.1.8

#### 29.4.2.4.1.8 Some examples of timing differences

##### 29.4.2.4.1.8.1 Timing differences on depreciable fixed assets including revaluations (accelerated/decelerated capital allowances).

A timing differences arises on property, plant and equipment due to the fact that an item of PPE might be depreciated in the accounts at a different rate to which a deduction is allowed for tax purposes in the form of capital allowances.

The general rule in this regard is:

- Where the NBV of the PPE > the tax written down value (TWDV) of PPE for tax purposes, then a deferred tax liability exists.
  The reason for this being a liability is due to the fact that in the future there will be more depreciation charged to the accounts which will not be allowed for tax purposes.

- Where the NBV of the PPE < the tax written down value (TWDV) of PPE for tax purposes, then a deferred tax asset exists.
  The reason for this being an asset is due to the fact that in the future there will be less depreciation charged to the accounts but there will still be a deduction allowed for tax purposes.

**29.4.2.4.1.8.1.2 Steps to calculate deferred tax for fixed asset timing differences.**

Where an asset is allowable for tax purposes the way in which the deferred tax should be calculated at each year end is:

1) Determine the NBV of the assets at period end
2) Deduct the net book value of assets not allowable for capital allowance purposes (the net book value here should exclude revaluations on such assets. – i.e. it should be the historical cost less accumulated depreciation on that cost) – this includes NBV of assets held on finance lease
3) Determine the TWDV (or the tax base cost) of the asset at period end
4) Take the NBV (that being step 1 less step 2 above) from the TWDV as determined in step 1 to give the deferred tax asset/liability or for costs which have already been expensed and are being allowed differently for tax purposes take the actual amount to be deducted/taxed in the future
5) If NBV>TWDV then a deferred tax liability exists and vice versa.
6) Apply the deferred tax rate based on the expected use of the asset. The deferred tax should follow where the depreciation/revaluation was posted
7) Post the difference between the prior year deferred tax and the current year as a charge/credit to P&L.

See application of the above guidance at 29.4.2.4.1.8.1.3

**29.4.2.4.1.8.1.3 Application of deferred tax to fixed assets**

**29.4.2.4.1.8.1.3.1 Deferred tax allowable for tax and depreciable.**

---

***Example 6e: Allowable for tax and depreciable***

At the start of year 1, Company A purchased a machine for CU100,000 which is fully allowable for capital allowance purposes. The asset is written off over a life of 10 years for accounting purposes and a life of 8 years for tax purposes. As a result of the mismatch in the life for tax and accounting purposes a timing difference arises as the depreciation charged to the profit and loss each year differs from the capital allowances used to reduce profit in the tax computation for that year. Assume trading tax rate of 10% and the profit before tax is CU50,000. To determine the timing difference at the end of year 1, do the following:

| | **CU** |
|---|---|
| NBV of Machine (CU100,000/10yrs*9yrs)= | 90,000 |
| TWDV of Machine (CU100,000/8yrs*7yrs)= | (87,500) |
| Deferred Tax Timing Difference - Liability | 2,500 |
| Deferred Tax Liability (CU2,500*10%) | 250 |

Journal to post at the end of year 1 is:

| | **CU** | **CU** |
|---|---|---|
| Dr Deferred Tax in Profit and Loss | 250 | |
| Cr Deferred Tax Liability | | 250 |

Being journal to recognise deferred tax.

The reason for the difference is that depreciation was booked in the accounts of CU10,000 in the year whereas CU12,500 was allowed in the tax computation. Applying the accounting profit of CU50,000 and taking the current tax rate at 10% would give a profit of CU5,000 to be shown in the tax line in the accounts. However the actual tax charge is CU4,750 (50,000 accounting profit + depreciation addback of CU10,000 less capital allowance deduction of CU12,500 multiplied by 10%). Therefore by accounting for the deferred tax this CU4,750 is increased to CU5,000 so as to eliminate the effect of this timing difference in the P&L for the year which is what Section 29 tries to achieve.

The deferred tax to be recognised in the profit and loss in year 2 is obtained by taking the deferred tax timing difference at the end of year 2 from the timing difference at the end of year 1.

| | Year 1 | Year 2 |
|---|---|---|
| NBV (CU100,000/10yrs by number of years remaining) | CU90,000 | CU80,000 |
| TWDV (CU100,000/8yrs by number of years remaining) | CU87,500 | CU75,000 |
| | | |
| Deferred Tax Timing Difference Liability | CU2,500 | CU5,000 |
| Deferred Tax Liability (amount*10%) | CU250 | CU500 |

Journal to post at the end of year 2 is:

| | **CU** | **CU** |
|---|---|---|
| Dr Deferred Tax in Profit and Loss | 250 | |
| Cr Deferred Tax Liability (CU500-CU250) | | 250 |

Being journal to recognise deferred tax.

#### 29.4.2.4.1.8.1.3.2 Asset allowable for tax, depreciable and revalued

---

***Example 6f: Asset allowable for tax, depreciable and revalued***

At the start of year 1, Company A purchased an industrial building for CU100,000 which is fully allowable for capital allowance purposes. The asset is written off over a life of 10 years for accounting purposes and a life of 8 years for tax purposes. At the start of year 2 the asset was revalued to CU150,000. As a result of the mismatch in the life for tax and accounting purposes a timing difference arises as the depreciation charged to the profit and loss each year differs from the capital allowances used to reduce profit in the tax computation. Assume trading tax rate of 10%. To determine the timing difference, do the following:

The deferred tax liability at the end of year 1 is as per example 6 above as the numbers are the same. At the end of year 2 the timing difference is as follows:

| | Cost |
|---|---|
| NBV of building | CU133,333* |
| TWDV of Building (CU100,000/8yrs*6yrs)= | (CU75,000) |
| Deferred Tax Timing Difference - Liability | CU58,333 |
| Deferred Tax Liability (CU58,333*10%) | CU5,833 |

*carrying amount of the building at the end of year 1 was CU90,000 plus the revaluation at start of year 2 to bring the value up to CU150,000. Therefore an adjustment of CU60,000 was posted to the revaluation reserve. At time of revaluation the asset is depreciated over the remaining life of 9 years. NBV at the end of year 2 is therefore = CU150,000/9yrs*8yrs=CU133,333

Posting of movement in deferred tax:
Movement = deferred tax liability at end of year 1 of CU250 less deferred tax liability at end year 2 of CU5,833

However where a revaluation is recognised, the deferred tax on initial recognition of the CU60,000 follows how the revaluation was treated under Section 17. Section 17 requires the revaluation to be posted to OCI/revaluation reserve. Therefore the deferred tax on initial recognition of CU6,000 (CU60,000*10%) should be debited to the revaluation reserve/OCI. The journal required at the end of year 2 is:

| | **CU** | **CU** |
|---|---|---|
| Dr Revaluation Reserve | 6,000 | |
| Cr Deferred Tax Liability | | 5,583* |
| Cr Deferred Tax in P&L | | 417 |

Being journal to correctly classify the deferred tax on initial recognition to the revaluation reserve and the balance to the profit and loss (CU417 is the difference between the depreciation charge posted in the year of CU16,667 (CU150,000/9yrs) less the capital allowance claimed of CU12,500 by the 10% tax rate).
For year 3, the deferred tax journal will be CU417

#### 29.4.2.4.1.8.4 Pension contributions/royalty charges

From an accounting perspective pension costs/royalty fees are accounted for on an accruals basis. However only pension contributions/royalties paid are allowable for tax purposes. This creates a timing difference. In effect it creates a deferred tax asset as the deductions will be allowable in the tax computation when paid.

---

***Example 6g: Pensions/royalties***

Company A pays pension contributions for its employees. Total charge posted to the profit and loss in the year was CU100,000, CU20,000 of which had not been paid over to the pension scheme by the year end. Assume tax rate of 10%.

For tax purposes, only the CU80,000 would be allowable. Therefore the remaining CU20,000 will be allowable when it is paid. On this basis a deferred tax asset of CU2,000 should be recognised to reflect this tax asset.

If we assume that a deferred tax asset was in existence in the prior year for CU30,000 in relation to unpaid contributions (i.e. deferred tax asset of CU3,000), the amount to be posted to the profit and loss is a debit of CU1,000 (CU3,000 paid in year re prior year less CU2,000 unpaid at year end).

---

There are circumstances where a one off lump sum if paid into a pension scheme which is posted directly to the profit and loss for accounting purposes in the period it is paid however for tax purposes it is only allowable over a number of years. This also creates timing differences.

---

***Example 6h: Pensions/royalties***

Company A paid a one off lump sum to a directors pension scheme of CU200,000 which is expensed in the year for accounting purposes as required. However assume for tax purposes this is only allowed over two years. Assume the tax rate is 10%.
Therefore, a deferred tax asset of CU10,000 (CU100,000*10%) should be recognised at the year-end assuming there are other taxable profits to utilise this or there are other deferred tax liabilities to set this against.

---

#### 29.4.2.4.1.8.5 Finance leases

Timing differences usually arise where entities hold finance leases. From an accounting perspective in accordance with Section 20 of FRS 102 the asset is recognised on the balance sheet and depreciated over its lease life or longer if the asset has a longer useful life, and the interest on the lease charged to the profit and loss. This differs from a tax perspective in that for tax purposes, the depreciation charge, and interest is added back and instead the actual lease payments are allowed. As a result, a deferred tax difference arises.

In order to determine the deferred tax in this case, the following should be performed:

NBV of the leased asset – carrying amount of the finance lease liability on the balance sheet * deferred tax rate.
If NBV of asset is > finance lease liability = deferred tax liability

If NBV of asset is < finance lease liability = deferred tax asset

---

***Example 6j: Finance lease***
*Company A entered into a finance lease for a machine. From an accounting perspective the asset was capitalised as CU30,000 and a finance liability recognised for CU30,000. The total cost including finance charges is CU36,000 over a two year life. At the end of year 1 the NBV of the asset was CU25,000*

and carrying amount of the finance lease liability was CU16,000. Details on the postings for the year include:

| | |
|---|---|
| Depreciation | CU5,000 |
| Finance Lease Interest | CU4,000 |
| Finance Lease Rentals Paid | CU18,000 |

The deferred tax at the year-end is calculated as follows:

| | |
|---|---|
| NBV of Finance Leased Asset (CU30,000-CU5,000 depreciation) | CU25,000 |
| Carrying Amount of Lease (CU30,000-CU18,000 payments+CU4,000 in lease interest) | CU16,000 |
| Deferred Tax Liability | CU9,000 |
| Deferred Tax at 10% | CU900 |

The reason for the timing difference is that CU9,000 was only charged to the P&L (i.e. depreciation of CU5,000 and finance interest of CU4,000) whereas a tax deduction was allowed for CU18,000.

---

#### 29.4.2.4.1.8.6 Unrelieved tax losses

Timing differences arise due to losses being recognised in the statement of comprehensive income in a year but these losses cannot be utilised for tax purposes until future taxable profits exist. Therefore a deferred tax (see further details at 29.4.2.3.4.1) asset should be recognised for this subject to there being taxable profits to utilise these losses in the future.

Before these losses can be recognised as a deferred tax asset it must be probable (more likely than not that there will be taxable profits to utilise the tax losses). Section 29.7of FRS 102 makes it clear that the very existence of unrelieved tax losses is strong evidence that there may not be other future taxable profits against which the losses can be relieved. Therefore, when assessing whether the deferred tax asset should be recognised care should to be taken to review future projections (it is not enough to just look at prior year results as a basis for future years) and assess how long it will take to recover these losses based on those projections or if in fact it is possible to recover these. Consideration also needs to be given as to whether the losses expire at a point in time. It may be possible to look at future tax strategies to prove the recoverability of losses forward if it is probable these will be put in place.

##### 29.4.2.4.1.8.6.1 Ability to recognise unutilised losses against other deferred tax liabilities

Where there are deferred tax liabilities for the same tax district to offset the deferred tax assets these can also be taken into account. See 29.4.2.3.4.1.1 for further details.