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 reference 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:

Exam Technique Guidance (p2)

Assets (p4)

Revenue & Provisions (p14)

Financial Instruments, Equity and Leases (p17)

Pensions & SBP (p31)

Tax (p36)

Groups (p40)

Other Standards (p54)

Financial Statements: single entity (p59)

These materials are protected by copyright law. All breaches will be reported.

The ICAEW Partner in Learning logo, ACA and ICAEW CFAB are all registered trademarks of ICAEW and are used under licence by ACA Masters.

ICAEW takes no responsibility for the content of any supplemental training materials supplied by the Partner in Learning.

Financial Asset: *Right to receive cash, financial assets or equity in another entity*

- Loans / Bonds receivable
- Equity in other entities
- Trade receivable
- Derivatives

Classification and Measurement

Financial Assets

3 Categories based on **business model** and **contractual cash flows:**

- Amortised cost – held to collect cash
- FV through P&L – held for trading
- FV through OCI – held to collect cash and to trade

IFRS9					
Assets	**Criteria**	**e.g**	**Measurement**	**Transaction costs**	**FV Gains/losses**
Amortised cost	Business objective is to hold asset to generate cash. Assets give a contractual right to receive cash	Receivables, Loans	Amortised cost	capitalise	N/A
FV through P&L	Business objective is sell financial assets	Derivatives, Equity	FV every year	expense	P&L
FV through OCI	Business objective is to hold asset to generate cash **and** sell financial assets. Assets give a contractual right to receive cash	Loans, Bonds for trading. Equity can be elected into here if not held for trading	Amortised cost w/ FV at year end	capitalise	OCI (reclassified to P&L on disposal, except equity which is not recycled)

Amortised cost

	b/f	**Interest**	**Cash payment**	**FV uplift (FVOCI only)**	**c/f**
Yr1	x	x	(x)	x	x
Yr2	x	x	(x)	x	x
Yr3	x	x	(x)	x	x

Fair Value calculation

	Cash payment	Discount factor	PV	
Yr 1	x	x	x	
Yr 2	x	x	x	
			X	b/f in amortised cost table

Sale & Leaseback

- Company sells the asset and immediately leases it back
- Therefore, it has a profit / loss on disposal of its asset and then a right-of-use asset from leasing it back

If transfer is a sale under IFRS15 Revenue:

- Part of the asset's Carrying Amount (CA) is retained as a right-of-use asset because company is leasing the asset back. This is treated as a right-of-use asset and a lease (as above)
- The other part of the asset's CA has been disposed of. This is treated as a profit on disposal
- To calculate the part of the asset's value which has been retained and the part which has been disposed of:

$$\frac{\text{PV of future lease payments at transfer date}}{\text{fair value of asset at transfer date}}$$

- For example, if the PV of lease payments is £108k and FV is £120k then 90% of the asset has been retained and 10% has been disposed of
- Therefore, 90% of the asset's CA should be treated as a right-of-use asset
- 10% of the profit on disposal (Proceeds minus CA) is treated as a profit on disposal

- If sale is above FV, then difference between sale proceeds and FV is treated as additional financing provided by the lessor. This reduces PV of lease payments when calculating the part of the asset's value which has been retained / disposed
- If sale is below FV, then difference between sale proceeds and FV is treated as a prepayment of the finance lease. This reduces PV of lease payments when calculating the part of the asset's value which has been retained / disposed

If transfer is not a sale under IFRS15:

- No disposal
- The proceeds received are a loan (IFRS9)

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 computation. This is calculated by multiplying taxable profits by the tax rate
- Taxable profits are calculated by starting with accounting profit and adding back disallowable expenses / deducting non-taxable income
- 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 actual liability was lower than the draft Tax Comp then Cr P&L, Dr Tax Payable as the current tax charge and liability recorded last year was too high

Deferred Tax

- The same expenditure can have different consequences for accounting profits and taxable profits e.g. PPE depr' for accounting profits and PPE capital allowances for taxable profits
- Differences between accounting and taxable profits can be identified as either:
  - Permanent i.e. never allowable or taxable for tax purposes– e.g. entertaining
  - Temporary i.e. allowable or taxable for tax purposes but in a different period – e.g. Depr' v Capital allowances
- Temporary differences cause current tax charge to be temporarily higher / lower even though there is no overall effect on the current charge when looking at multiple years
- Deferred tax is an *accounting technique* which is used to eliminate the temporary effect that temporary differences between accounting and taxable profit have on the current tax charge i.e. deferred tax is used to offset the temporary 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 i.e. an expense which is not allowable for tax purposes / income which is not taxable?*
2. *Decide whether the tax payable to the tax authorities will be higher or lower in the future. If higher, then you have a Deferred Tax Liability (DTL), if lower then you have a Deferred Tax Asset (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*

Audit Risks	Audit Procedures
➢ Use of another auditor for subsidiaries / associates increases risk	• Evaluate the independence, skills, competence and experience of component auditors • Clear instructions to component auditors • Review component auditor's audit strategy and plan • Ensure communication with component auditor under ISA 600 – ethics confirmation, risk identification etc.
➢ Extent of work required on components	• If likely to include significant risks of material misstatement of the group FS, the group auditors will require one of the following: - A full audit using component materiality - An audit of specified account balances related to identified significant risks - Specified audit procedures relating to identified significant risks - Components that are not significant will be subject to analytical review at a group level
➢ Misclassification of investments (Subsidiary v Associate v IFRS9)	• Inspect share certificates / options to determine total number of shares held to calculate % holding • Review contract or agreements between companies to identify key terms which may indicate control and any restriction on control e.g. right of veto of third parties
➢ Acquisition of new subsidiary	• Ensure that the entity has been correctly classified as a subsidiary (i.e. establish that control has been achieved) • Review purchase agreement to identify date of control • Review of valuation of net assets to confirm fair value at acquisition - Review any external/ professional valuation reports - Review trade journals for indication of goodwill - Ensure contingent liabilities included • Review FV measurement of consideration at acquisition (including deferring or contingent consideration using appropriate discount rate) - Agree to bank statement - Agree to purchase agreement • Recalculate goodwill • Impairment review of goodwill based of Sub performance • Review purchase agreement to identify date of control • Review consolidation schedules to ensure amounts have been time apportioned if appropriate