FINANCIAL REPORTING

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Other Current Liabilities at net realisable value, changes in that value are recognised in profit or loss in the period of the change commodity brokers and dealers who measure their inventories at fair value less costs to sell. When such inventories are measured at fair value less costs to sell, changes in fair value less costs to sell are recognised in profit or loss in the period of the change.

Fundamental principle of IAS 2

Inventories are required to be stated at the lower of cost and net realisable value (NRV). [IAS 2.9]

Measurement of inventories

Cost should include all: [IAS 2.10]

Costs of purchase (including taxes, transport, and handling) net of trade discounts received costs of conversion (including fixed and variable manufacturing overheads) and other costs incurred in bringing the inventories to their present location and condition

IAS 23 Borrowing Costs identifies some limited circumstances where borrowing costs (interest) can be included in cost of inventories that meet the definition of a qualifying asset. [IAS 2.17 and IAS 23.4]

Inventory cost should not include: [IAS 2.16 and 2.18]

Abnormal waste storage costs administrative overheads unrelated to production selling costs foreign exchange differences arising directly on the recent acquisition of inventories invoiced in a foreign currency interest cost when inventories are purchased with deferred settlement terms.

The standard cost and retail methods may be used for the measurement of cost, provided that the results approximate actual cost. [IAS 2.21-22]

For inventory items that are not interchangeable, specific costs are attributed to the specific individual items of inventory. [IAS 2.23]

For items that are interchangeable, IAS 2 allows the FIFO or weighted average cost formulas. [IAS 2.25] The LIFO formula, which had been allowed prior to the 2003 revision of IAS 2, is no longer allowed.

The same cost formula should be used for all inventories with similar characteristics as to their nature and use to the entity. For groups of inventories that have different characteristics, different cost formulas may be justified. [IAS 2.25]

Write-down to net realisable value

NRV is the estimated selling price in the ordinary course of business, less the estimated cost of completion and the estimated costs necessary to make the sale. [IAS 2.6] Any write-down to NRV should be recognised as an expense in the period in which the write-down occurs. Any reversal should be recognised in the income statement in the period in which the reversal occurs. [IAS 2.34]

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Disclosures in the financial statements of lessee

- Disclosures should be made of the amount of the assets that are subject of finance leases at each balance sheet date. Liabilities, differentiating between the current and long-term portions.
- Commitments for minimum lease payments under finance leases and under non-cancellable operating lease with a term of more than one year should be disclosed in summary form giving the amounts and periods in which the payments will become due.
- Disclosures should be made of significant financing restrictions, renewal or purchase options, contingent rentals and other contingencies arising from leases.
- Disclosures should be made of the basis used for allocating income so as to produce a constant periodic rate of return, indicating whether the return relates to the net investment outstanding or the net cash investment outstanding in the lease. If more than one basis is used, the bases should be disclosed.
- When a significant part of the lessor's business comprises operating leases, the lessor should disclose the amount of assets by each major class of asset together with the related depreciation at each balance sheet date.
- Apart from the disclosures recommended above the lessor should disclose the accounting policies followed with regard to accounting for income under finance lease, valuation of assets given on the lease and charge for depreciation.

Accounting Entries in the Books ofthe Lessor

1. Gross Investment In The Lease

This is the total of:

a) The minimum lease payments receivable by the lessor under finance leases.
b) Any unguaranteed residue value accruing to the lessor.

2. Net Investment In The Lease

This is the gross investment in the lease discounted at the interest rate implicit in the lease i.e. it is the present value of the gross investment discounted at the interest rate implicit in the lease.

3. Un Earned Finance Income

This is the difference between the gross investment in the lease and the net investment in the lease:

NB

i) The lessor should recognise the assets under finance leases in their balance sheet and present them as receivables at an amount equal to the gross investment.
ii) The initial direct costs that may be incurred by the lessor e.g. legal fees for negotiating and securing a lease agreement, commission etc. should be included in the initial measurement of the finance lease receivable. Subsequently, the amounts received by the lessor should be allocated over the lease term on a systematic basis.

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- Property, plant and equipment is revalued by an entity (under IAS 16), but no equivalent adjustment is made for tax purposes. This also applies to long-term investments.

The standard also looks at the deferred tax implications of business combinations and consolidations. will There are two circumstances given in the standards where the rule that all taxable temporary differences give rise to a deferred tax liability does not apply.

a) The deferred tax liability arises from the initial recognition of goodwill.

b) The deferred tax liability arises from the initial recognition of an asset or liability in a transaction which:

i. is not a business combination ,and
ii. at the time of the transaction affects neither accounting profit nor taxable profit.

Try to understand the reasoning behind the recognition of deferred tax liabilities on taxable temporary
differences.

(a) When an asset is recognised, it is expected that its carrying amount will be recovered in the form of economic benefits that flow to the entity in future periods.
(b) If the carrying amount of the asset is greater than its tax base, then taxable economic benefits will also be greater than the amount that will be allowed as a deduction for tax purposes.
(c) The difference is therefore a taxable temporary difference and the obligation to pay the resulting income taxes in future periods is a deferred tax liability.
(d) As the entity recovers the carrying amount of the asset, the taxable temporary difference will reverse and the entity will have taxable profit.
(e) It is then probable that economic benefits will flow from the entity in the form of tax payments, and so the recognition of all deferred tax liabilities (except those excluded above) is required by IAS 12.

Illustration 3

Taxable Temporary Differences

A company purchased an asset costing shs.1,500 at the end of 2008 the carrying amount is shs.1,000. The cumulative depreciation for tax purposes is shs.900 and the current tax rate is 25%.

Required;

Calculate the deferred tax liability for the asset.

Solution

Firstly, what is the tax base of the asset? It is shs.1,500 – shs.900 = shs.600.

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