



CHARTERED CERTIFIED ACCOUNTANTS

## **April Questions and Answers 2**

**Q. What exchange rate should be used to eliminate unrealised profit on inventories in a group situation?**

**A.** The process of consolidation under FRS 2 ‘Accounting for Subsidiary Undertakings’ and IAS 27 ‘Consolidated and Separate Financial Statements’ requires any unrealised profit on inventories held in group members’ inventory to be eliminated as this profit does not represent profit to the group until the inventory is sold to outsiders. There is no specific guidance in IAS 21 as to the exchange rate which should be applied when eliminating unrealised profit. US GAAP at SFAS 52 ‘Foreign Currency Translation’ requires the actual rate ruling at the transaction date to be applied, or alternatively, a weighted average rate.

**Q. Can a company’s own equity instruments qualify as hedging instruments?**

**A.** Paragraph AG 97 of IAS 39 ‘Financial Instruments: Recognition and Measurement’ specifically state that a company’s own equity instruments are not financial assets or financial liabilities and therefore cannot be designated as hedging instruments.

**Q. I have an actuarial gain on my defined benefit pension scheme? What are the deferred tax implications?**

**A.** An actuarial gain does give rise to a timing difference. The timing difference originates in the year the gain arises because it is not taxed in the year it arises. In a sense, when the timing differences reverse in future years, this results in the gain being recovered and it is when these timing differences reverse that it will be taxed. In the future years, the accounting profit will be adjusted to arrive at taxable profits by replacing the pension costs with the reduce contributions payable. The difference between the two is the amount of the gain that has been recovered in the year. The entity’s taxable profits are arrived at after deducting the employer’s pension contributions payable in the reporting period as opposed to reflecting the pension gains and losses which are recognised in the financial statements.

Care should be taken however to correctly determine whether any pension asset does, in fact, represent a timing difference. FRS 17 ‘Retirement Benefits’ at paragraph 37 specifically states that a pension asset should only be recognised to the extent that it is recoverable through reduced contributions in future years or through refunds from the scheme.

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