Equity analysis, Credit analysis



A firm's ability to service and repay its debt (Credit risk)

- > The analysis of a company's financial reports
- > A broad assessment of a company's operations

Credit analysis

- Z score
 - Z = 1.2 A + 1.4 B + 3.3 C + 0.6 D + 1.0 E
 - A = WC / TA
 - B = RE / TA
 - C = EBIT / TA
 - D = MV of Equity / BV of Debt
 - E = Revenue / TA
- If Z<1.8 Bankruptcy

Summary



- ➤ Importance: ☆☆☆
- Content:
- · DuPont analysis of return on equity.
- · Ratios used in equity analysis and credit analysis.
- Exam tips:
- 使用杜邦分析分解ROE。(计算题)
- 股票估值和信用分析中所用到的财务比率。(结合权益)



Inventory Accounting and Inventory Valuation Method

Tasks:

- Distinguish between costs included in inventories and costs recognized as expenses in the period in which they are incurred.
- Describe different inventory valuation methods (cost formulas).

Inventory accounting



Cost of good sold (COGS)

COGS = beginning inventory + purchases - ending inventory

- Purchase cost contains two parts: Inventory and COGS
- When the inventory sold, inventory goes to income statement as COGS



Inventory accounting

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Product costs

- These costs, known as product costs, are capitalized in the Inventories account on the balance sheet and include:
 - ·Purchase cost less trade discounts and rebates.
 - Conversion costs including labor and overhead.
 - •Other costs necessary to bring the inventory to its present location and condition.
- By capitalizing inventory cost as an asset, expense recognition is delayed until the inventory is sold and revenue is recognized.

Inventory accounting



Period costs

- Not all inventory costs are capitalized; some costs are expensed in the period incurred. These costs, known as period costs, include:
 - Abnormal waste of materials, labor, or overhead.
 - Storage costs (unless required as part of production).
 - Administrative overhead.
 - Selling costs.

Inventory valuation method



Firms must select a cost flow method (under GAAP or IFRS) to allocate the inventory cost to the income statement (COGS) and the balance sheet (ending inventory).

- Under IFRS, the permissible methods are:
 - Specific identification.
 - First-in, first-out. (FIFO)
 - Weighted average cost.
- Under GAAP, the permissible methods are:
 - Same methods under IFRS
 - · Last-in, first-out. (LIFO)

Inventory valuation method



Specific identification method

- Under the specific identification method, each unit sold is matched with the unit's actual cost.
 - Specific identification is commonly used by firms with a small number of costly and easily distinguishable items such as jewelry.
 - Specific identification is also appropriate for special orders or projects outside a firm's normal course of business.



Inventory valuation method



First-in, first-out (FIFO)

Under the first-in, first-out (FIFO) method, the first item purchased is assumed to be the first item sold.

- The advantage of FIFO is that ending inventory is valued based on the most recent purchases, arguably the best approximation of current cost.
- Conversely, FIFO COGS is based on the earliest purchase costs. In an inflationary environment, COGS will be understated compared to current cost. As a result, earnings will be overstated.

Inventory valuation method



Last-in, first-out (LIFO)

Under the last-in, first-out (LIFO) method, the item purchased most recently is assumed to be the first item sold.

- In an inflationary environment, LIFO COGS will be higher than FIFO COGS, and earnings will be lower. Lower earnings translate into lower income taxes, which increase cash flow.
- Under LIFO, ending inventory on the balance sheet is valued using the earliest costs. Therefore, in an inflationary environment, LIFO ending inventory is less than current cost.

Inventory valuation method



Weighted average cost

The average cost per unit of inventory is computed by dividing the total cost of goods available for sale (beginning inventory + purchases) by the total quantity available for sale.

- To compute COGS, the average cost per unit is multiplied by the number of units sold.
- Similarly, to compute ending inventory, the average cost per unit is multiplied by the number of units that remain.
- During inflationary or deflationary periods, the weighted average cost method will produce an inventory value between those produced by FIFO and LIFO.

Inventory valuation method-Example



Purchase A, B, C, D on Jan 1, 2, 3, 4 respectively for \$5, \$6, \$7, \$8 and then sold A,C on Jan 30

	Ending Inventory	cogs
Specific Identification	6+8=14	5+7=12
FIFO	7+8=15	5+6=11
LIFO	5+6=11	7+8=15
Weight Ave	(5+6+7+8)/4*2=13	(5+6+7+8)/4*2 =13



• Summary



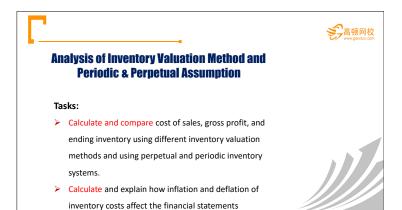
➤ Importance: ☆☆☆

Content:

- · Accounting for inventories.
- · Inventory valuation methods.

Exam tips:

- 辨析存货的资本化和费用化。(存货的资本化过程)
- · 熟练掌握和对比四种存货计量方法。(主要是FIFO和LIFO)

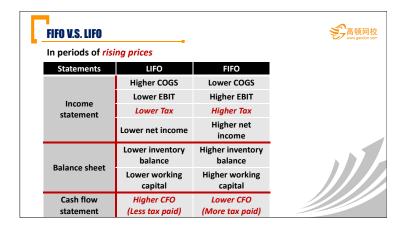


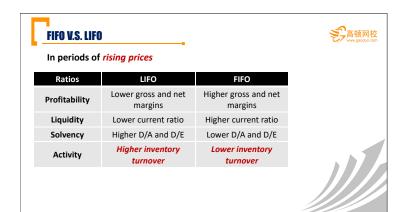
FIFO V.S. LIFO



Being the time of raising price

- LIFO provides the most useful estimate of COGS on the I/S.
- > FIFO provides the most useful estimate of Inventory value on the B/S.





Inventory valuation method

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Periodic inventory system

- Inventory value and COGS are determined at the end of an accounting period.
- Need a purchase account.

Perpetual inventory system

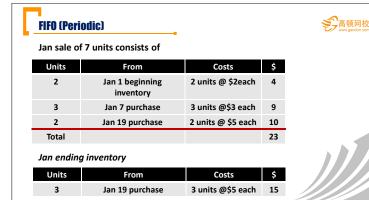
- Inventory value and COGS are updated continuously.
- Inventory purchased and sold is recorded directly in inventory.
- > A purchase account is not necessary.
- > Same result for FIFO & Specific identification method
- > Different result for LIFO & AVCO

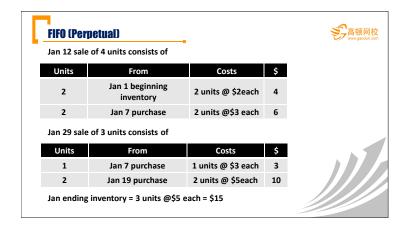
Inventory valuation method

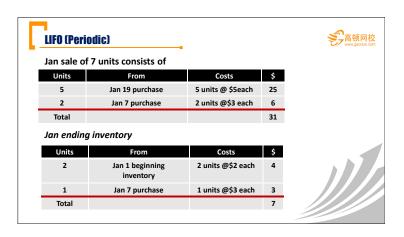
Calculate COGS and ending inventory under the FIFO and LIFO cost flow method using the two inventory systems.

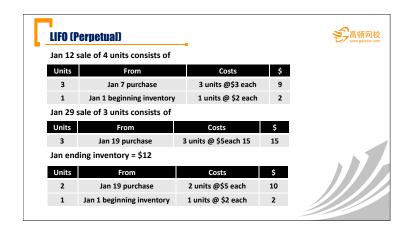
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Jan 1 beginning inventory	2 units @\$2 each	
Jan 7 purchase	3 units @ \$3 each	
Jan 12 sale	4 units	
Jan 19 purchase	5 units @ \$5each	
Jan 29 sale	3 units	















Impairment of Inventory under IFRS & GAAP

Tasks:

- Describe the measurement of inventory at the lower of cost and net realisable value.
- Explain issues that analysts should consider when examining a company's inventory disclosures and other sources of information.

Measurement of inventory



Inventory in IFRS

- Inventory is the lower of the cost or Net realizable value.
 - NRV = Selling price Selling cost
- If cost > NRV
 - · Inventory is written down to NRV on B/S.
 - · A loss is recognized in I/S. (COGS)
 - Can be written up and a gain is recognized in I/S.
 (COGS)

Measurement of inventory



Inventory in U.S. GAAP

- Inventory is the lower of the cost or market.
 - If replacement cost > NRV (net realizable value)
 market = NRV
 - If replacement cost < NRV normal profit margin market = NRV – normal profit margin
 - If NRV normal profit margin < replacement cost < NRV market = replacement cost
- If cost > market
 - Inventory is written down to market on B/S.
 - A loss is recognized in I/S. (COGS)
 - · No subsequent written up is allowed.

Inventory valuation under GAAP and IFRS



The following information relates to Zoom Inc

Original cost \$ 210
 Estimated selling price \$ 225
 Estimated selling cost \$22
 Replacement cost \$197
 Normal profit margin \$12

What are the per unit carrying value of Zoom's inventory

under IFRS and U.S.GAAP?

Inventory valuation under GAAP and IFRS



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Answer:

Under IFRS

- NRV = \$225 22 = \$203
- Original cost = \$210
- The carrying value should be the lower (\$203 with a impairment loss of \$7 immediately recognized in I/\$)
- Under U.S.GAAP
 - Replacement cost = \$197
 - NRV- normal profit margin = \$203 \$12 = \$191
 - NRV = \$203
 - NRV- normal profit margin < Replacement cost < NRV
 - Market = RC = \$197
 - The carrying value should be the lower (loss of \$13 in I/S)

Inventory disclosure



Similar under U.S. GAAP and IFRS

- Cost flow method used (LIFO, FIFO, etc.)
- ➤ The carrying value of inventory (Fair value selling costs)
- COGS for the period
- > The amount of inventory write downs
- The *reversal* of inventory write downs (*IFRS only*)

Summary

► Importance: ☆☆☆

Content:

- Measurement of inventory at the lower of cost and net realizable value.
- · Presentation of and disclosures relating to inventories.

Exam tips:

- 美国和国际准则下存货的减值测试以及减值损失计量。
- 了解与存货相关的披露要求。

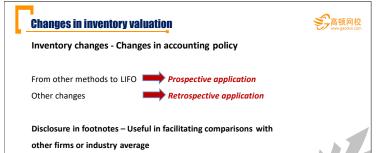




Changes in Inventory Valuation, LIFO Reserve and LIFO Liquidation

Tasks:

- Explain LIFO reserve and LIFO liquidation and their effects on financial statements and ratios.
- Convert a company's reported financial statements from LIFO to FIFO for purposes of comparison.
- Analyze and compare the financial statements of companies, including companies that use different inventory methods



Activity Ratios and Inventory Method



Inventory turnover ratio (COGS/avg. inventory)

- With LIFO, numerator reflects current prices; denominator reflects historical prices, not useful
- With FIFO, numerator reflects historical prices; denominator reflects current prices, may be more useful than LIFO.

Best method: Use *LIFO COGS* and *FIFO average inventory* (current cost method)

Solvency Ratios and Inventory Method



FIFO produces a higher value of equity because of the higher inventory value on the left side of the balance sheet.

- Under FIFO, the debt ratio and debt-to-equity ratio are lower (and more meaningful).
- Under LIFO, analysts should add the LIFO reserve to both inventory and equity to generate more meaningful solvency ratios.

LIFO Reserve



LIFO Reserve

- The difference between the reported LIFO inventory carrying amount and the inventory amount that would have been reported if the FIFO method had been used.
- ➤ LIFO Reserve = FIFO Inventory LIFO Inventory



LIFO Liquidation

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LIFO Liquidation

- A LIFO liquidation incurs when purchased volume is less sales volume. Or, the decrease in volume or quantity of inventory.
- In this case, the prices for goods being sold are no longer recent prices.

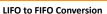
LIFO Liquidation



LIFO Liquidation (If Price Is Rising)

- COGS does not reflect current costs.
- LIFO reserve may decline.
- An analyst should adjust COGS for decrease in LIFO reserve.

LIFO & FIFO Conversion



- ➤ Inventory_{FIFO} = Inventory_{LIFO} + LIFO Reserve
- > COGS_{FIFO} = COGS_{LIFO} ΔLIFO Reserve

Income Statement Changes

- $ightharpoonup NI_{\text{LIFO}} + \Delta LIFO \text{ Reserve} \times (1 Tax)$
- COGS_{FIFO} = COGS_{LIFO} ΔLIFO Reserve

Balance Sheet Changes

- Inventory_{FIFO} = Inventory_{LIFO} + LIFO Reserve
- \rightarrow *R/E_{FIFO} = R/E_{LIFO} + LIFO Reserve_{Ending}× (1 Tax)
- \rightarrow *Cash_{FIFO} = Cash_{LIFO} LIFO Reserve_{Ending} \times (Tax)

Summary

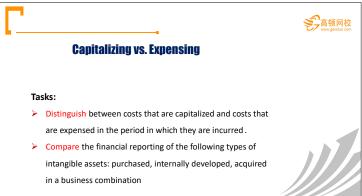


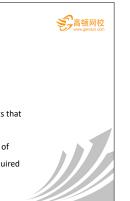
- ➤ Importance: ☆☆☆
- Content:
- · LIFO reserve and LIFO liquidation.
- · LIFO & FIFO Conversion.

Exam tips:

此部分对应今年考纲新增部分,掌握LIFO和FIFO的互相转化,并理解如何影响利润表及资产负债表。

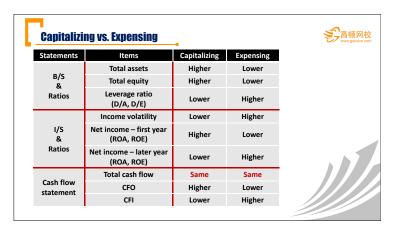


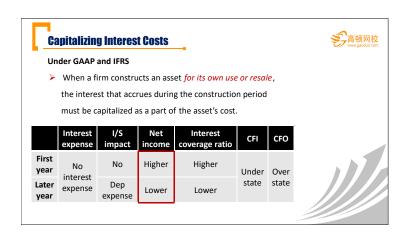


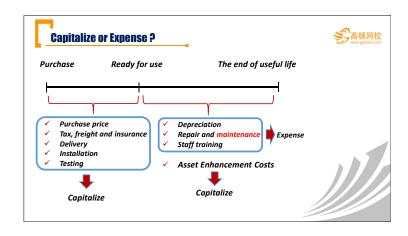


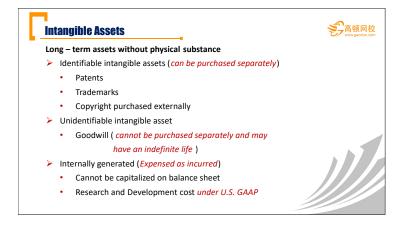
多高顿网校 **Capitalizing vs. Expensing** Inventory COGS Tangible Depre Recognize assets Non assets ciation in B/S Is there any current future Intangibl Amorti assets e assets zation economic benefit for the Recognized expenditure? expenses in the Selling expenses income Incom Administrative cost statement when General expenses... incurred

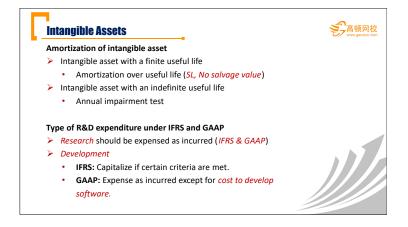
Capitalizing vs. Expensing How to treat an expenditure depending on the nature of the expenditure Capitalize as an asset on the B/S Recognize as an expenses in the I/S The asset you capitalized today will be expensed in the future > Impact on the Cash flow statement Capitalized expenditures are classified as CFI Expensed expenditures are classified as CFO











Intangible Assets

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Development cost under U.S.GAAP

- For sales to others
 - Expensed as incurred.
 - Once economic feasibility is established, subsequent production costs can be capitalized.
- For own internal use
 - Capitalized

Summary



- ► Importance: ☆☆☆
- Content:
- · Capitalizing versus expensing measurement.
- · Intangible assets.
- Exam tips:
- 辨析资本化和费用化的会计处理。
- 辨析资本化和费用化对于财务报表和比率的影响。
- 记忆无形资产的分类以及做账特征。 (Goodwill的特征很重要)



Accounting for Depreciation



- Calculate depreciation expense.
- Describe how the choice of amortization method and assumptions concerning useful life and residual value affect financial ratios.





Two important depreciation terms

- Carrying (book) value
 - The net value of an asset or liability on the balance sheet. For property, plant, and equipment, carrying value equals historical cost minus accumulated depreciation.
- Historical cost
 - The original purchase price of the asset including installation and transportation costs. Historical cost is also known as gross investment in the asset.



Depreciation calculation



Three methods to calculate depreciation

> Straight-line depreciation

 $Depreciation \ expense = \frac{cost - residual \ value}{useful \ life}$

> Accelerated depreciation

 $Depreciation \ expense = \frac{2}{useful \ life} \times (original \ cost - accumulative \ depreciation)$

Units of production

 $Depreciation \ expense = \frac{output \ units \ in \ the \ period}{life \ in \ output \ units} \times (cost-residual \ value)$

Practice for depreciation calculation



Miguel Rodriguez of MARIO S.A., an Uruguayan corporation, is computing the depreciation expense of a piece of manufacturing equipment for the fiscal year ended 31 December 2009. the equipment was acquired on 1 January 2009. Rodriguez gathers the following information:

Cost of the assissment	¢1 200 000	
Cost of the equipment	\$1,200,000	
Estimated residual value	\$200,000	
Expected useful life	8 years	
Total production capacity	800,000 units	
Production in FY2009	135.000 units	

Calculate the depreciation expense recognized in the income statement for FY2009 using three depreciation methods.

Practice for depreciation calculation



Three methods to calculate depreciation

Straight-Line

(\$1,200,000 - \$200,000)/8 years = \$125,000 p.a.

DDB

2/8 × \$1,200,000 = \$300,000

Units – of – production

 $(\$1,200,000 - \$200,000) \times (135,000 \text{ units / } 800,000 \text{ units })$ = \$168,750



Depreciation effect



Depreciation impacts in early years

Items	Straight line	DDB
Depreciation expense	Lower	Higher
Net income	Higher	Lower
Assets	Higher	Lower
Equity	Higher	Lower
ROA	Higher	Lower
ROE	Higher	Lower
Total asset turnover	Lower	Higher
Cash flow - Tax	Same	Same



Accounting treatments of depreciation



Allocation of depreciation expense

- COGS Affect gross profit margin
- SG&A Affect operating profit margin

longer useful life & higher residual value

Lower depreciation expense and higher net income

Estimation of residual value under GAAP & IFRS

- U.S. GAAP: Downward only
- > IFRS: Allowed to adjusted residual value either upward or downward.

Summary



- ➤ Importance: ☆☆☆
- Content:
- · Calculate depreciation and amortization expense.
- · Analysis of Depreciation Effect.
- > Exam tips:
 - 掌握三种折旧方法的计算。(定量)
 - 了解不同折旧方法是如何影响财务报表和比率的。(定性)
 - 使用年限和残值是如何影响折旧费用和净利润的。







Tasks:

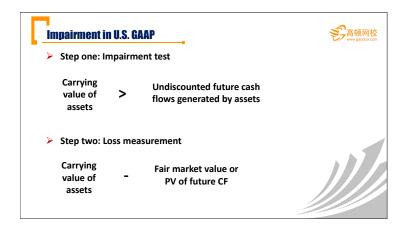
- Explain and evaluate how impairment, revaluation, and derecognition of PP&E.
- Describe the revaluation model.

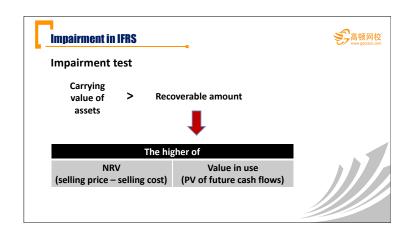
Impairment of Long-Lived Assets

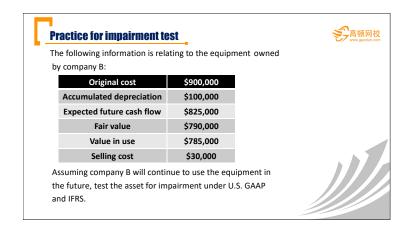


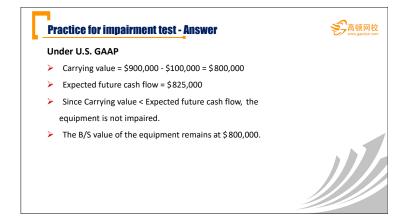
Impairment of two assets classes

- Tangible assets
 - Held for use mpairment test
 - Held for sale
 - ✓ No depreciation
 - ✓ Immediate impairment test if Carrying value > NRV
- Intangible assets (eg: goodwill...)
 - Held for use main nual impairment test
 - Held for sale
 - ✓ No amortization
 - ✓ Immediate impairment test if Carrying value > NRV







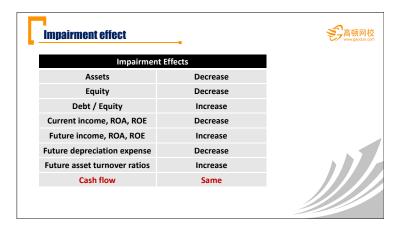


Practice for impairment test - Answer



Under IFRS

- > Carrying value = \$900,000 \$100,000 = \$800,000
- Fair value less cost to sell = \$790,000 \$30,000 = \$760,000
- Value in use = \$785,000
- Recoverable amount = \$ 785,000
- Carrying value > recoverable amount, the equipment is impaired. The B/S value of the equipment is reduced to \$785,000 with a impairment loss of \$15,000 in I/S.

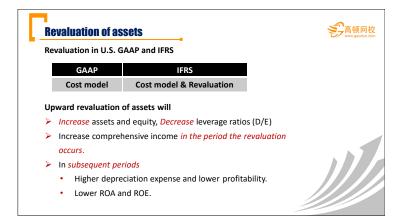


Recoveries for Impairment



Once an asset is written down

- Under U.S.GAAP
 - *Held for use* Recoveries are not allowed
 - Held for sale
 Recoveries are allowed
- Under IFRS
 - · Recoveries are allowed except for goodwill.



Revaluation of assets



US GAAP:

Company only can choose depreciated cost method

- Long-lived assets are reported on the balance sheet at depreciated cost.
- Depreciated cost equals original cost less accumulated depreciation and any impairment charges.
- Impairment loss reduce the asset value and cannot reversal generally except for asset held for sale.

Revaluation of assets



Under IFRS:

Company can choose depreciated cost or revaluation model

- Under depreciated cost
 - Same as U.S. GAAP, except for previous impairment can be recovery to original amount
- Under Revaluation model
 - B/S asset reduced to FMV
 - Loss taken to I/S
 - Subsequent reversals (逆转) of value recognized in I/S up to historical cost
 - Increase in value above historic cost taken to revaluation surplus (OCI-equity)



Investment property



Investment property: Held for the purpose of earning rental income or capital appreciation.

IFRS VS U.S. GAAP

 U.S. GAAP does not distinguish investment property from other kinds of long-lived assets.

Disclose: Fair value model or cost model.

- Fair value model: Determination of fair value
- Cost model: Depreciation method, useful lives, fair value.

Investment property



The cost mode

The cost model for investment property is the same as the cost model for valuing property, plant, and equipment.

The fair value model (Investment Property Only)

- The fair value model is different from the revaluation model.
 - Under the revaluation model, any revaluation above historical cost is recognized as revaluation surplus in owners' equity.
 - For investment property, however, revaluation above historical cost is recognized as a gain on the income statement.



Disposal of Long-Lived Assets



When a long-lived asset is sold

Difference between the sale proceeds and the carrying value of the asset is reported as a G/L, included in income statement.

When a long-lived asset is abandoned

Carrying value is removed from the B/S, loss is recognized in income statement.

When a long-lived asset is exchanged

 G/L is computed by comparing the book value of the old asset with the fair value of the old asset (or fair value of new asset).

Summary



➤ Importance: ☆☆☆

Content:

- · Impairment rules in U.S. GAAP and IFRS.
- Revaluation of long lived assets in U.S. GAAP and IFRS.

Exam tips:

- 掌握美国准则和国际准则的减值测试以及减值损失的计量 方法。(考查计算)
- 长期资产的转回规则。 (重点掌握国际准则下的三个模型)



Accounting for Lease

Tasks:

- Explain and evaluate how leasing rather than purchasing assets affects financial statements and ratios.
- Explain and evaluate how finance leases and operating leases affect financial statements and ratios.

Reasons to Lease



Alternative to borrowing and purchasing asset.

- Short period of use
- Cheaper financing (potentially)
- No down payments
- Fixed rates
- May have less covenants
- Less risk of obsolescence
- Potential financial reporting advantage (operate lease)
- Tax advantages

Classification of leases

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A lease is a contractual arrangement where by the lessor, the owner of the asset, allows the lessee to use the asset for a specified period of time (lease term) in return for periodic lease payment.

Two partied involved in leases

Lessee: use the asset

Lessor: owner of the asset

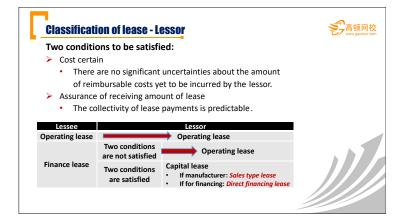
Two types of leases (Classification) Operating lease An operating lease is essentially a rental arrangement. No asset or liability is reported by the lessee. Periodic lease payments are simply recognized as rental expense in the income statement.

Classification of leases

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Two types of leases (Classification)

- > Finance lease / Capital lease (U.S.)
 - A finance lease is, in substance, a purchase of an asset that is financed with debt.
 - The lessee will add equal amounts to both assets and liabilities on the balance sheet.
 - Over the term of the lease, the lessee will recognize depreciation expense on the asset and interest expense on the liability.



Classification of lease - Lessor



Under U.S. GAAP, a capital lease is treated as either a sales-type lease or a direct financing lease.

- If the present value of the lease payments exceeds the carrying value of the asset, the lease is treated as a sales-type lease.
- If the present value of the lease payments is equal to the carrying value, the lease is treated as a direct financing lease.

Under IFRS, does not distinguish between a sales-type lease and a direct financing lease.

Similar treatment to a sales-type lease is allowed under IFRS for finance leases originated by manufacturers or dealers.





Sales-type lease

- A sales-type lease is treated as if the lessor sold the asset for the present value of the lease payments and provided a loan to the buyer in the same amount.
- Sales-type leases are typical when the lessor is a manufacturer or dealer because the cost (balance sheet value) of the leased asset is usually less than its fair value.

At the inception of the lease

- The lessor recognizes a sale equal to the present value of the lease payments.
- Cost of goods sold equal to the carrying value of the asset.
- The difference between the sales price and cost of goods sold is gross profit.

Sales Type Lease



In the cash flow statement

- The interest portion of the lease payment is reported as an inflow from operating activities.
- Principal reduction is reported as an inflow from investing activities.

Direct financing lease



Direct financing lease

In a direct financing lease, no gross profit is recognized by the lessor at the inception of the lease.

At the inception of the lease

- The lessor removes the asset from its balance sheet and creates a lease receivable
- As the lease payments are received, the principal portion of each payment reduces the lease receivable.



Direct financing lease

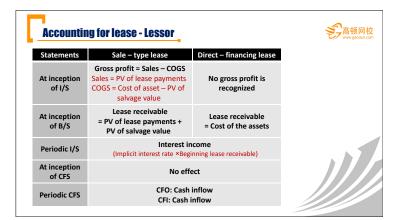
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In the income statement

- > The lessor recognizes interest income over the term of the
- The interest portion of each lease payment is equal to the lease receivable at the beginning of the period multiplied by the interest rate.

In the cash flow statement

- The interest portion of the lease payment is reported as an inflow from operating activities.
- principal reduction is reported as an inflow from investing activities.



Operating lease - Lessor



Operating lease

- If the lease is treated as an operating lease, the lessor simply recognizes the lease payment as rental income.
- The lessor will keep the leased asset on its balance sheet and depreciate it over its useful life.

Total income over the life of the lease is the same for an operating lease and a direct financing lease.

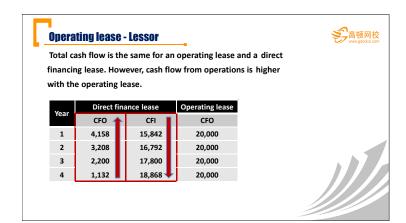
In the early years of the lease, the income reported from the direct financing lease is higher than the income reported from the operating lease.

Operating lease - Lessor



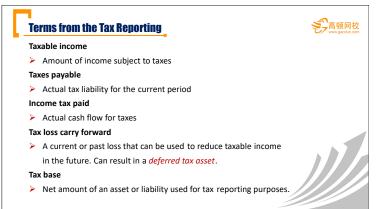
A company purchases an asset for \$69,302 to lease to B company for four years with an annual lease payment of \$20,000 at the end of each year. The implied interest rate in the lease is 6%.

Direct financing lease		Operating lease		
Year	Interest income	Rental income	Depreciation expense	Operating lease income
1	4158	20000	17325.5	2674.5
2	3208	20000	17325.5	2674.5
3	2200	20000	17325.5	2674.5
4	1132	20000	17325.5	2674.5
Total	\$10698			\$10698









Terms from the Financial Reporting

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Accounting profit

> Pre tax financial income, earnings before tax

Income tax expense

Expense recognized in the income statement that includes taxes payable and changes in deferred tax assets and liabilities (DTA and DTL).

Income tax expense = taxes payable + \triangle DTL - \triangle DTA

Deferred tax liabilities (DTL)

Balance sheet item created when taxes payable < income tax expense, due to temporary differences.</p>

Deferred tax asset (DTA)

Balance sheet item created when taxes payable > income tax expense, due to temporary differences.

Terms from the Financial Reporting



Carrying value

✓ Balance sheet value of an asset or liability.

Note that both DTLs and DTAs are presented on the balance sheet, *not netted*.

Income Tax Accounting

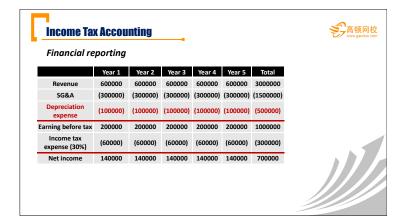


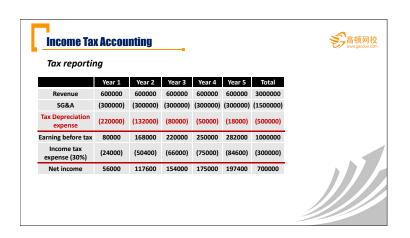
Sources of differences

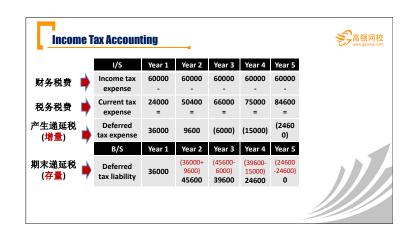
- Timing differences
- Permanent differences

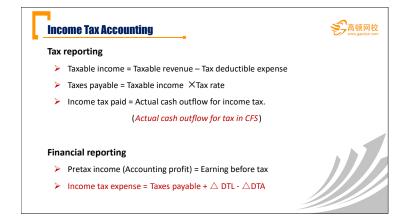
Sources of Timing Differences

- Accrual vs. modified cash accounting.
- > Differences in reporting methods and estimates.











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Calculation for Deferred Tax

Tasks:

- Calculate the tax base of a company's assets and liabilities.
- Balance Sheet approach and Income Statement approach to calculate DTA or DTL.

Balance sheet approach to deferred tax issue



Balance sheet approach

- Identify Accounting base and Tax base for every asset and liability item on balance sheet.
- > Calculate the difference between two bases
 - For assets = accounting base tax base
 - For liabilities = (accounting base) (- tax base)



Positive figure * tax rate = DTL
Negative figure * tax rate = DTA

TA and DTL Example



Depreciable Assets

- A company depreciates a \$21,000 asset use straight-line over three years for accounts:
- > Each year depreciation expense is 7000.
- > Tax uses accelerated depreciation method in it's tax returns:
- First year depreciation expense is 14000
- Second year depreciation expense is 70000
- Sales revenue is 20000 for each year and tax rate is 40%

DTA and DTL Example



Income statement approach

Year one:

- >Accounting profit: 20000-7000=13000
- ➤ Taxable income: 20000-14000=6000
- Tax Payable: 6000*40%=2400 Income tax expense 13000*40%=5200
- ➤ Under tax base, Company need to pay 2800 more in the future compare to the accounting base : 5200-2400=2800
- ▶2800为第一年财务和税务下的税费之差,为当期变量

DTA and DTL Example



Income statement approach

Year two:

- >Accounting profit: 20000-7000=13000
- ➤ Taxable income: 20000-7000=13000
- No addition DTL or DTA due to same accounting profit and taxable income

DTA and DTL Example



Income statement approach

Year three:

- >Accounting profit: 20000-7000=13000
- ➤ Taxable income: 20000-0=20000
- ➤ Tax payable: 20000*40%=8000
- ➤Income tax expense 13000*40%=5200
- >DTA=8000-5200=2800
- >Temporary difference eliminated at year three.

DTA and DTL Example



Balance sheet approach

Year one:

- Tax base = cost accumulated tax allowable depreciation=7000
- Carrying value = cost accumulated depreciation=14000
- Difference (14000-7000) *40%=2800 DTL
- Less tax base lead to less depreciation expense under tax reporting and need to pay more compare to financial reporting
- > 2800 is the B/S ending value

DTA and DTL Example



Balance sheet approach

Year two:

- Tax base = cost accumulated tax allowable depreciation =0
- ➤ Carrying value = cost accumulated accounting depreciation =7000
- Difference (7000-0) *40%=2800 DTL
- No new DTL incurred during the year





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Balance sheet approach

Year three:

- Tax base = cost accumulated tax allowable depreciation =0
- Carrying value = cost accumulated accounting depreciation =0
- > Difference (0-0) *40%=0
- > At three year end, accounting base and tax base is no difference.

