Technical Update Test (Q1 2003) Worked Solutions

Corporate Financial Management

Question 1 (financial accounting)

Which method for accounting for goodwill is now proposed in recent IASB Phase I consultation documents on accounting for business combinations?

(a) Amortisation with useful economic life limited to 15 years
(b) Amortisation with useful economic life limited to 25 years
(c) No amortisation of goodwill but the use of periodic impairment reviews
(d) Either (b) or (c)
(e) Don't know

Answer

The correct answer is (c) No amortisation of goodwill but the use of periodic impairment reviews.

The IASB's intention in Phase I of its project on business combinations is to bring international standards into line with US standards on accounting for business combinations which were released in 2002. The ASB has however expressed some reservations regarding the proposals, for example, in relation to the rigour of proposed impairment tests for goodwill and potential lack of symmetry between accounting for goodwill and for other intangible assets. For more detail, refer to January 2003 Hotline, p.11.or visit www.asb.org.uk and www.iasb.org.uk to view the consultation papers.

Question 2 (financial accounting)

And in the same consultation, what is the proposed accounting treatment for the combination of two businesses of equal size and bargaining power?

(a) Merger accounting similar to that presently used under FRS6
(b) Merger accounting based on a stricter definition of a merged business
(c) Merger accounting with revised provision for fair value adjustment
(d) Acquisition accounting with new rules to identify an acquirer (even where none may exist)
(e) Don't know

Answer

The correct answer is (d) Acquisition accounting with new rules to identify an acquirer even where none exists.

For more detail, refer to January 2003 Hotline, p.11.or visit www.asb.org.uk and www.iasb.org.uk to view the consultation papers.

Question 3 (company law review)

Which proposal contained in the Department of Trade & Industry (DTI) consultation on its review of company law was NOT supported by the ACT in its response?

- (a) The continuing responsibility of directors towards creditors when devising policy and making disclosures
- (b) The abolition of the position of "corporate director"
- (c) The instigation of a careful review prior to relaxing requirements for private companies to have a company secretary
- (d) The enhancement of the Operating and Financial Review (OFR) to include a more holistic approach to risk management
- (e) Don't know

Answer

The correct answer is (b) The abolition of the position of "corporate director"

The ACT believes that the abolition of the corporate director could have adverse implications for corporate finance structures and occupational pension schemes. All the other proposals listed here were broadly supported by the ACT. For more information, see January 2003 Hotline, p. 12 or the "Corporate Governance" topic within the ACT Consultation Responses web pages at visit http://www.treasurers.org/treasury_resources/technical-papers.cfm#corporate

CAPITAL MARKET & FUNDING

Question 4 (ratings)

In its initial response to the US Securities and Exchange Commission (SEC) interim report on the role of rating agencies, what did the ACT identify as a key barrier to wider competition amongst corporate ratings service providers?

- (a) The high level of rating agency fees
- (b) Customer acceptance of an additional ratings methodology and ratings system
- (c) The amount of corporate management time required to manage relationships with multiple agencies or to 'switch' to an alternative provider
- (d) Lack of capacity in the market to sustain a major new player
- (e) Don't know

Answer

The correct answer is (c) The amount of corporate management time required to manage relationships with multiple agencies or to 'switch' to an alternative provider.

Further details in the article by John Grout, ACT Technical Director, in The Treasurer, March 2003 p. 17 or online at http://www.treasurers.org/news/SEC_Rating.cfm.

Question 5 (loan documentation)

Which aspect(s) in relation to the Loan Markets Association (LMA) syndication confidentiality letters may be of potential concern to borrowers?

(a) The confidentiality undertakings fall away as soon as the loan facility or transfer document is signed
(b) The borrower is denied the right to veto amendments to confidentiality agreements
(c) The confidentiality letter designed for use in the secondary markets is not transaction specific and so borrowers cannot request amendments
(d) All of the above
(e) Don't know

Answer

The correct answer is (d) All of the above

Please refer to February 2003 Hotline, p. 10 for an update courtesy of Slaughter & May. For ACT guidance for borrowers on LMA documentation, visit our dedicated pages at http://www.treasurers.org/treasury_resources/LMA_guide.cfm.

MANAGING THE TREASURY FUNCTION

Question 6 (compliance)

The Model Code prevents directors making transactions in their company shares during price sensitive periods such as immediately before and after results are announced. Which recent additional clarification has been introduced to the Model Code?

(a) The closed period for transactions coinciding with annual results has been extended from two to three months
(b) The closed period for transactions coinciding with interim results has been extended from one to two months
(c) Additional disclosures to the Board regarding directors' share dealing have been introduced
(d) The scope of the Code has been extended to cover synthetic instruments and spread bets linked to equity share prices

(e) Don’t know

Answer

The correct answer is (d) The scope of the Code has been extended to cover synthetic instruments linked to equity share prices.

For more information, refer to the February Hotline, p. 9 or visit www.fsa.gov.uk/pubs/cp/cp164.pdf . The Model Code can also be downloaded in full at www.fsa.gov.uk/pubs/ukla/chapt16-3.pdf.

Question 7 (treasury audit)

The DTI recently announced proposals for significant changes to the regulation of the UK auditing and accounting profession. One proposal was the compulsory rotation of a company’s lead external audit partner. According to the consultation document, what is the maximum time period that a lead partner should spend in the role before it is rotated?

(a) 3 years
(b) 5 years
(c) 7 years
(d) 10 years
(e) Don’t know

Answer

The correct answer is (b) 5 years.

See March Hotline item, p. 12 or visit the DTI website for more information on their “Post-Enron” projects at www.dti.gov.uk/cld/post_enron.htm.

RISK MANAGEMENT

Question 8 (pensions)

In the Inland Revenue consultation paper on Pensions (which coincided with the Department of Work and Pensions Green Paper on Pensions Reform) a new “life time” limit on pensions savings which would qualify for tax relief was proposed. What was the limit?

(a) GBP1M
(b) GBP1.2M
(c) GBP1.4M
(d) GBP 2M

(e) Don't know

Answer

The correct answer is (c) GBP1.4M.

For more on the Inland Revenue pensions consultation, read February Hotline, p. 9. For more details on the Pension Green Paper, including the ACT response, see February Hotline, p. 12 or visit http://www.treasurers.org/treasury_resources/technical-papers.cfm#pensions.

Question 9 (OFR)

Which additional provision did the ASB recently introduce to its revised Statement on the Operating and Financial Review (OFR)?

(a) The disclosure of "key performance indicators" and any accounting policies requiring a significant exercise of judgement and to which results are most sensitive
(b) The inclusion of analytical discussion rather than numerical analysis
(c) The mandatory preparation of an OFR by quoted UK companies
(d) The inclusion of references to earlier reported comments if expectations have not been met
(e) Don't know

Answer

The correct answer is (a) The disclosure of "key performance indicators" and any accounting policies requiring a significant exercise of judgement and to which results are most sensitive.

Answers (b) and (d) are existing OFR recommendations. Although the OFR is not yet a mandatory requirement for quoted or unquoted companies, the ASB already encourages the inclusion of an OFR by quoted companies. The DTI is however considering introducing a mandatory OFR for large companies as part of its Company Law Review. See the February Hotline, p. 9. or visit www.asb.org.uk.

Question 10 (derivatives documentation)

The 1992 ISDA Master Agreement was recently replaced by the 2002 Master. What change was made to the early termination provisions in the new version?

(a) The first method or "walkaway" provision is now the sole method for computing a payment on termination and the market quotation measurement approach applies in computing the amount due
(b) The first method or "walkway" provision is now the sole method for computing a payment on termination and a new closeout amount measurement approach applies in computing the amount due
(c) The second method or "full two way payment" provision is now the sole method for computing a payment on termination and the market quotation measurement approach applies in computing the amount due
(d) The second method or "full two way payment" provision is now the sole method for computing a payment on termination and a new closeout amount measurement approach applies in computing the amount due
(e) Don't know

Answer

The correct answer is (d) The second method or "full two way payment" provision is now the sole method for computing a payment on termination and a new closeout amount measurement approach applies in computing the amount due

The revised Section 6 (Early Termination; Close-Out Netting) of the 2002 Master, in broad terms, dispenses with the "First Method" and blends the "Market Quotation" and "Loss" electives into a new concept - "Close-out Amount". A contractual set-off provision has also been introduced as standard into the main body of the agreement. For details of the 2002 Master Agreement, please refer to the February2003 Hotline, p.10 and to the article by Gary Walker in the May Treasurer, p17.