

Technical Update Test (Q1 2004) Worked Solutions

Question 1

Judgment has recently been given in the Spectrum case, clarifying the nature of charges over book debts. Which of the following reflects the nature of book debts as given by the judgment?

- (a) they are floating charges however the bank debenture defines them.
- (b) they are fixed charges however the bank debenture defines them.
- (c) they are floating charges unless the bank debenture specifically defines them as fixed.
- (d) they are fixed charges unless the bank debenture specifically defines them as floating.
- (e) don't know.

Answer

The right answer is (a) they are floating charges however the bank debenture defines them.

In this case the bank argued that the charges were fixed and therefore not available for discharge of preferential creditors.

The Treasurer March 2004 Hotline p16

Question 2

The Financial Collateral Arrangements (No 2) Regulations 2003 came into effect on 1st March 2004. This is an EU Directive whose aim was to create robust arrangements and to lower the cost of capital in Europe.

What is the core impact of the Directive concerning registering charge over financial assets and foreclosure of that charge when in the possession of the holder?

- (a) a charge must be registered, but a court order is not required for foreclosure, documentation permitting.
- (b) a charge must be registered, and a court order is specifically required for foreclosure regardless of individual documentation.
- (c) it is not necessary to register a charge but a court order is required for foreclosure regardless of individual documentation
- (d) it is not necessary to register a charge. If documentation allows the holder, or bank, may foreclose and sell the asset without needing a court order.
- (e) don't know.

Answer

The right answer is (d) It is not necessary to register a charge. If documentation allows the holder, or bank, may foreclose and sell the asset without needing a court order.

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Question 3

In January 2004 the International Financial Reporting Interpretations Committee (IFRIC) released a draft document (D3) to give further guidance on IAS 17 relating to the treatment of leases. The document entitled “Determining whether an arrangement contains a lease” gives guidelines on when the accounting treatment for leases should be followed.

Which of the following is **not** one of the three conditions which, if satisfied, identify a lease under the guidelines?

- (a) the arrangement depends on a specific item of plant or infrastructure which may be identified either implicitly or explicitly.
- (b) the arrangement gives an exclusive right to use an item of plant or infrastructure.
- (c) payments incorporate a finance charge component.
- (d) payments are time-dependent rather than use-dependent.
- (e) don't know.

Answer

The right answer is (c) payments incorporate a finance charge component.

(a) (b) and (d) are the three guidelines from the draft document. Examples quoted in the document of arrangements which can include leases include outsourcing, take-or-pay contracts and telecommunications contracts which give rights to capacity.

The Treasurer March 2004 Hotline p18

http://www.iasb.org/standards/summary_ias01to19.asp

Question 4

The Chancellor, in his pre-budget speech, announced that tax law will be amended so that IFRS accounts will be an acceptable start point for tax purposes. Which of the following specific amendments were announced?

- (a) tax treatment of hedging arrangements using derivatives and currency liabilities will follow the IFRS accounting.
- (b) current tax treatment of hedging arrangements using derivatives and currency liabilities will continue.
- (c) tax relief for R&D expenditure will follow the accounting, i.e. it will match any P&L charge.
- (d) all entertaining expenses will become allowable expenses.
- (e) don't know.

Answer

The right answer is (b) current tax treatment of hedging arrangements using derivatives and currency liabilities will continue.

Unfortunately (d) is unlikely to be the case in the foreseeable future!

The Treasurer Jan/Feb 2004, Tackling the Main Tax Issues by Mohammed Amin, p21

Question 5

IAS39 is due to come into effect for all companies listed on an EU exchange on Jan 1st 2005, but many details of the accounting standard are still under discussion. In particular the ACT has raised two areas where it believes that further development is needed. One of these areas concerns central netting.

Which of the following reflects the ACT's concern with the standard as currently worded?

- (a) an operating company's "hedge" with the central Treasury will not qualify as a hedge.
- (b) the central Treasury's "hedge" with the operating company will not qualify as a hedge.
- (c) for the consolidated accounts the net "hedged" do not qualify as hedges, except for the residual net amount.
- (d) only qualifying hedges are eligible for symmetrical tax treatment.
- (e) don't know.

Answer

The right answer is (c) for the consolidated accounts the net "hedged" do not qualify as hedges, except for the residual net amount.

The Treasurer March 2004 Hotline p16, IAS 39 Roundtable March p29
www.treasurers.org/technical/papers/index.cfm#derivatives

Question 6

IAS39 is due to come into effect for all companies listed on an EU exchange on Jan 1st 2005, and certain details of the accounting standard have been subject to recent discussion and amendment. In particular to qualify as a hedge a transaction must be tested to demonstrate its effectiveness.

Which of the following is the final requirement of the standard?

- (a) Prospective effectiveness tests require 80% - 125% correlation, retrospective tests require movements in the hedged item and the hedging instrument to be "almost fully offset".
- (b) Prospective tests require movements in the hedged item and the hedging instrument to be "almost fully offset", retrospective tests require 80% - 125% correlation.
- (c) Prospective tests and retrospective tests both require 80% - 125% correlation in the movements of the hedged item and the hedging instrument
- (d) Prospective and retrospective tests must demonstrate that the hedge is expected to be, and actually was, reasonably effective.
- (e) Don't know.

Answer

The right answer is (c) at its February 2004 meeting the IASB decided to change the standard so that the prospective effectiveness test would require that the hedge is expected to be highly effective and that retrospectively it actually was highly effective. The application guidance then clarifies that a hedge is highly effective if it falls within the 80% to 125% range. Prior to this recent change answer (b) would have been the correct.

The Treasurer March 2004 Hotline p16, IAS 39 Roundtable March p29
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Interpretation of Scores

- 0-3** This score indicates that your knowledge of current events is below that required of a professional treasurer. Use the "Hotline" section in *The Treasurer* to update yourself on recent developments. Alternatively visit the CPD resources database to gain a more rounded understanding of the wider issues.
- 4-6** Although you have a good grasp of the new developments, the score indicates there is still room for improvement. Re-read your recent copies of *The Treasurer* (in particular the Hotline" section) to update yourself. Alternatively the CPD resources database contains a wide range of articles on recent best practice.
- 7-9** Well done! Your score indicates that you have obviously been keeping yourself up-to-date with recent developments. If there is anything that you are unsure of, the "Hotline" section in *The Treasurer* may prove useful, as will the CPD resources database for more in-depth analysis.
- 10** If the Association gave out gold stars you would be in line for one, well done! You have obviously kept yourself up-to-date and read *The Treasurer* regularly. Why don't you try one of the diagnostic tests now? These examine an issue in more depth, and enable you to measure your development through entry and exit questions.