Technical Update Test (Q2 2004) Worked Solutions

Question 1

The FSA has proposed measures to modernise the UK listing regime. These proposals include a change to the requirements on Prospective Financial Information. Which of the following reflects the ACT position on the proposals?

(a) Reporting requirements for Prospective Financial Information should not be relaxed at all.
(b) If reporting requirements are to be relaxed, there is still a need for a test of "audit reasonableness" to avoid the Prospective Financial Information becoming a wish list.
(c) Justification for the Prospective Financial Information should be entirely the responsibility of the sponsor to the listing
(d) The content of the Prospective Financial Information should be unregulated as promises left unfulfilled are rarely forgotten.
(e) Don't know

Answer

The right answer is (b) If reporting requirements are to be relaxed, there is still a need for a test of "audit reasonableness" to avoid the Prospective Financial Information becoming a wish list.

The Treasurer, April 2004, Hotline p11

Question 2

IFRS 2 concerns share-based payments. What accounting value is prescribed in the Standard for cash-settled share-based payments to employees and those providing similar services?

(a) The fair value of equity instruments granted at the grant date.
(b) The fair value of the equity instruments at each reporting date until settlement, with changes in value taken directly to reserves.
(c) The fair value of the equity instruments at each reporting date until settlement, with changes recognised in the profit and loss account for the period.
(d) At zero value until the cash settlement is known, and then the cash value should be recognised in the profit and loss account.
(e) don't know

Answer

The right answer is (c) The fair value of the equity instruments at each reporting date until settlement, with changes recognised in the profit and loss account for the period.

The Treasurer April 2004, Hotline p12

Question 3

The Chief Executive of the FSA, John Tiner, has expressed concern over the Basel II capital adequacy rules for banks. What is the substance of his concern?

(a) Basel II has been imposed after too short a testing period
(b) The Basel II framework for calculating the appropriate level of capital is just too complex to be applied by the world's less sophisticated banks.
(c) The Basel II rules have been developed without consultation with the major securities regulator, the SEC.
(d) The Basel II rules have been developed without agreement from any of the major US financial regulators.
(e) don't know

Answer

The right answer is (c) The Basel II rules have been developed without consultation with the major securities regulator, the SEC.

The SEC is introducing new capital adequacy regulations for US broker/dealers which differ from Basel II in a number of areas.

The Treasurer April 2004, News p15

Question 4

Credit Rating Agencies (CRAs) have been criticised following their failure to predict the demise of major corporations such as Parmalat, Worldcom and Enron. The ACT, together with its French and US equivalents, has published proposals for a Code of Standard Practices for Participants in the Credit Rating Process.

Which of the following reflects the proposal for CRAs dealing with confidential information?

(a) Each CRA should document its systems and policies to protect confidential information.
(b) Each CRA should have a regulatory requirement to implement agreed systems for dealing with confidential information.
(c) Each CRA should register any confidential information gained with the client's national regulatory authority

(d) CRAs should never have access to confidential information.
(e) don't know

Answer

The right answer is (a) Each CRA should be required by regulation to document its systems and policies to protect confidential information.

The Treasurer May 2004, Hotline and An Agreed Code of Practice p18 by Martin O'Donovan. The full exposure draft is available at www.treasurers.org

Question 5

Both the ASB and the DTI have begun a consultation process which will culminate in the convergence of UK law and accounting standards with the IFRS. The DTI is primarily concerned with changes in law that may be required in order to allow UK companies to comply with IFRS.

In accounting for dividends the 1985 Companies Act requires paid and proposed dividends to be shown in the profit and loss account for the period to which they relate. What accounting treatment is now proposed?

(a) Only dividends actually paid and liable to be paid by the balance sheet date should be included in the P&L account.
(b) Only dividends approved and liable to be approved by the balance sheet date should be included in the P&L account.
(c) Only dividends paid, liable to be paid and relating to this accounting period should be included in the P&L account.
(d) All dividends should be shown as a contingent payment in a note to the accounts.
(e) don't know.

Answer

The right answer is (a) Only dividends actually paid or liable to be paid by the balance sheet date should be included in the P&L account. Any final dividend proposed, but not yet approved by the shareholders will need to be included in a note to the accounts

The Treasurer May 2004, Hotline; www.dti.gov.uk/cld/current.htm

Question 6

A new draft of regulation for the Operating and Financial Review was published by the DTI at the beginning of May. It is proposed that the ASB will prepare the standards required of the OFR and that these rules will be applicable to all quoted companies.

Which of the following describes the proposed potential enforcement mechanism for failure to comply with these rules?

(a) The “rules” are voluntary therefore there is no enforcement mechanism.
(b) There will be a formal ‘naming and shaming’ process of those companies who are judged to be non-compliant.
(c) There will be a new civil offence of ‘accounting without due care and attention’
(d) There will be a new criminal offence of ‘knowingly or recklessly approving an OFR that does not comply with the relevant provisions of the Act’
(e) Don’t know

Answer

The right answer is (d) There will be a new criminal offence of ‘knowingly or recklessly approving an OFR that does not comply with the relevant provisions of the Act’.

The Treasurer, June 2004, Hotline; www.dti.gov.cld/financialreview.htm gives the draft regulations and another publication: Practical Guidance for Directors by Rosemary Radcliffe