
List of chapters

1	The development of UK GAAP.....	1
2	The quest for a conceptual framework for financial reporting	27
3	Revenue recognition	83
4	Group financial statements	117
5	Foreign currencies.....	269
6	Fixed assets and depreciation.....	383
7	Investment properties	457
8	Investments	473
9	Research and development	495
10	Capitalisation of borrowing costs.....	513
11	Stocks and long-term contracts.....	543
12	Share and loan capital	587
13	Off-balance sheet transactions.....	635
14	Leases and hire purchase contracts.....	685
15	Government grants.....	731
16	Segmental reporting.....	741
17	Pension costs	767
18	Taxation	835
19	Extraordinary items and prior year adjustments	897
20	Earnings per share.....	939
21	Post balance sheet events	973
22	Contingencies.....	991
23	Statements of cash and funds flow	1007
24	Related parties	1049
25	Directors' and officers' loans and transactions	1077
26	Directors' remuneration.....	1109

Appendix

Specimen financial statements.....	1133
------------------------------------	------

Detailed contents

CHAPTER 1 THE DEVELOPMENT OF UK GAAP 1

1	The development of Accounting Standards	1
1.1	The history of the Accounting Standards Committee.....	1
1.1.1	The creation of the ASC	1
1.1.2	The objects and terms of reference of the ASC.....	2
1.1.3	The Watts Report.....	3
1.1.4	The McKinnon Report.....	3
1.1.5	The replacement of the ASC.....	3
1.2	The creation of the Accounting Standards Board	3
1.2.1	The need for a review of the standard-setting process	3
1.2.2	The Dearing Committee's recommendations.....	4
1.2.3	The implementation of the Dearing proposals.....	7
2	Accounting standards and the concept of 'true and fair'	7
2.1	The introduction of the true and fair concept.....	7
2.2	What authority do SSAPs have?.....	8
2.3	The role of International Accounting Standards.....	9
2.4	The US experience.....	10
2.5	The Canadian experience	11
2.6	Germany	12
3	What is UK GAAP?.....	13
3.1	'Principles' or 'practice'?.....	13
3.2	What is 'generally accepted'?.....	14
4	GAAP for small companies.....	15
4.1	The Big GAAP/Little GAAP debate.....	15
4.2	Exemptions for 'small companies'	16
4.3	Is this the small company solution?.....	17
5	Summary financial statements	18
5.1	The required form of a summary financial statement.....	18
5.2	Commentary	23
6	Conclusion.....	24

PTER 2 THE QUEST FOR A CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING 27

roduction.....	27
What is a conceptual framework?	28
Why is a conceptual framework necessary?.....	28
History of the quest for a conceptual framework.....	29
4.1 Introduction	29
4.2 The Accounting Principles Board of the AICPA.....	30
4.2.1 Accounting Research Studies.....	30
4.2.2 APB Statement No. 4	32
4.2.3 The Wheat and Trueblood Committees.....	32
4.3 The FASB Conceptual Framework Project.....	33
4.4 The Corporate Report.....	34
4.5 The Sandilands Report.....	36
4.5.1 Current Purchasing Power accounting	36
4.5.2 Value accounting.....	37
4.5.3 Cash flow accounting	40
4.5.4 Current cost accounting (CCA).....	41
4.6 The Macve Report	44
4.7 The Stamp Report	46
The FASB conceptual framework.....	47
5.1 Introduction	47
5.2 The objectives of financial reporting	48
5.3 The qualitative characteristics of accounting information	50
5.3.1 The decision-makers.....	50
5.3.2 The cost/benefit constraint.....	50
5.3.3 Understandability.....	50
5.3.4 Relevance and reliability.....	52
5.3.5 Comparability	54
5.3.6 Materiality.....	54
5.3.7 Conservatism	54
5.4 The elements of financial statements.....	55
5.4.1 Assets.....	55
5.4.2 Liabilities.....	56
5.4.3 Equity.....	56
5.4.4 Investments by owners.....	56
5.4.5 Distributions to owners.....	56
5.4.6 Comprehensive income.....	57
5.4.7 Revenues, expenses, gains and losses	57

5.5	Recognition and measurement.....	58
5.6	Conclusion.....	59
6	Contemporary conceptual framework projects.....	60
6.1	Introduction	60
6.2	The ICAS discussion document: 'Making Corporate Reports Valuable'	60
6.2.1	Background to the study.....	60
6.2.2	Users and their needs.....	61
6.2.3	Valuation of assets and liabilities.....	62
6.2.4	The proposed new information package.....	63
6.2.5	Additional information.....	64
6.2.6	Conclusion	65
6.3	The IASC conceptual framework.....	65
6.4	The Solomons Report	67
6.5	The CICA financial statement concepts	71
7	SSAP 2: Disclosure of accounting policies	72
7.1	Fundamental accounting concepts	72
7.1.1	The going concern concept.....	72
7.1.2	The accruals (or matching) concept.....	72
7.1.3	The consistency concept.....	73
7.1.4	The prudence concept.....	73
7.2	Accounting bases	73
7.3	Accounting policies.....	73
7.4	The missing accounting concepts: substance over form and materiality	74
7.4.1	Substance over form.....	74
7.4.2	Materiality.....	74
8	The way ahead	75

CHAPTER 3 REVENUE RECOGNITION 83

1	The nature of revenue	83
2	Realised profits.....	84
3	The timing of revenue recognition.....	86
3.1	The critical event approach.....	87
3.1.1	The recognition of revenue at the completion of production.....	87
3.1.2	The recognition of revenue at the time of sale.....	88
3.1.3	The recognition of revenue subsequent to delivery.....	89
3.2	The accretion approach.....	91
3.2.1	The use by others of enterprise resources.....	91
3.2.2	Long-term contracts	91
3.2.3	Natural growth.....	91

3.3	The revenue allocation approach.....	91
	ndamental recognition criteria.....	92
4.1	IAS 18.....	92
4.1.1	The sale of goods	93
4.1.2	The rendering of services.....	94
4.1.3	The use by others of enterprise resources.....	95
4.2	Canada.....	95
4.3	The US	96
4.3.1	'The general rule'	96
4.3.2	SFAC No. 5.....	97
4.3.3	FASB statements.....	97
4.4	Summary	97
	problem areas.....	99
5.1	Receipt of initial fees.....	99
5.1.1	Franchise fees	99
5.1.2	Advance royalty/licence receipts.....	101
5.1.3	Loan arrangement fees.....	103
5.1.4	Commitment fees.....	103
5.1.5	Credit card fees	104
5.2	Goods sold subject to reservation of title	104
5.3	Subscriptions to publications.....	105
5.4	Advertising revenue	105
5.5	Software revenue recognition	106
5.5.1	Granting the right to use, but not to own, software.....	106
5.5.2	Products sold with significant vendor obligations.....	107
5.5.3	Post-delivery customer support services.....	108
5.5.4	Data services.....	109
5.6	The disposal of land and buildings.....	110
5.7	Film exhibition rights.....	113
5.8	Sale and leaseback transactions	114
	Conclusion.....	114

CHAPTER 4 GROUP FINANCIAL STATEMENTS 117

	the concept of a group.....	117
1.1	Introduction	117
1.2	What is a subsidiary?.....	118
1.2.1	The legal definition — pre Companies Act 1989	118
1.2.2	The EC Seventh Directive.....	120
1.2.3	The legal definition — post Companies Act 1989.....	120

1.2.4	The approach used in other countries.....	125
1.3	Consolidating partly-owned subsidiaries.....	127
1.3.1	The entity concept.....	127
1.3.2	The proprietary concept.....	127
1.3.3	Comparison between the different concepts of a group	127
1.3.4	ED 50 proposals.....	129
1.4	Principles of business combinations.....	130
2	Historical development of rules on group financial statements	130
2.1	Origins of group financial statements.....	130
2.2	The UK legislative background.....	131
2.3	Accounting standards in the UK	131
3	Consolidation of subsidiaries.....	132
3.1	Basic principles.....	132
3.2	Uniform accounting policies.....	132
3.3	Coterminous accounting periods.....	133
3.4	Elimination of unrealised profits/losses on inter-company transactions.....	135
4	Exemptions from preparing group financial statements.....	136
4.1	Intermediate holding companies.....	137
4.2	Small and medium-sized groups.....	140
4.3	Exemptions contained in ED 50.....	141
5	Exclusion of subsidiaries from group financial statements	142
5.1	Sources of rules on exclusion of particular subsidiaries.....	142
5.2	Dissimilar activities.....	143
5.3	Lack of control.....	147
5.4	Operating under severe restrictions.....	149
5.5	Control intended to be temporary.....	151
5.6	Other Companies Act exclusions	153
5.7	General disclosure requirements in respect of excluded subsidiaries	155
6	Equity accounting	156
6.1	Introduction	156
6.2	The definition of an associate.....	157
6.2.1	SSAP 1.....	157
6.2.2	The Companies Act 1985	158
6.2.3	ED 50.....	159
6.2.4	IAS 28	159
6.3	The accounting treatment of associates	160
6.4	Other particular issues	162
6.4.1	Non-coterminous periods.....	162
6.4.2	Deficiency of assets.....	163
6.4.3	Investor not preparing group financial statements.....	164

6.4.4	Joint ventures	166
6.4.5	Loss of associate status	168
6.4.6	Elimination of unrealised profits on transactions with associates.....	169
6.5	Disclosure requirements regarding associates.....	171
6.5.1	Profit and loss account	171
6.5.2	Balance sheet	171
6.5.3	Notes.....	172
6.5.4	Acquisitions/Disposals.....	174
6.5.5	Stock Exchange requirements	174
6.5.6	Proportionately consolidated joint ventures.....	174
	Business combinations.....	175
7.1	Introduction	175
7.1.1	ED 3.....	175
7.1.2	Merger relief.....	176
7.1.3	ED 31	177
7.1.4	SSAP 23	178
7.1.5	Companies Act 1989.....	179
7.1.6	ED 48	182
7.1.7	IAS 22	184
7.2	Acquisitions: basic principles.....	184
7.3	Acquisitions: measuring the fair value of the consideration.....	185
7.3.1	Securities.....	185
7.3.2	Monetary items.....	187
7.3.3	Non-monetary items.....	187
7.3.4	Deferred consideration.....	188
7.3.5	Contingent consideration.....	188
7.3.6	Acquisition costs.....	192
7.3.7	Pre-acquisition dividends	192
7.4	Acquisitions: measuring the fair value of the net assets acquired.....	193
7.4.1	Basic principles	193
7.4.2	The use of hindsight	194
7.4.3	Proposed requirements for individual assets and liabilities.....	195
7.4.4	Subsequent amendments to fair value.....	202
7.4.5	'Push-down accounting'	205
7.5	Acquisitions: accounting for goodwill.....	205
7.5.1	Introduction.....	205
7.5.2	Immediate write-off: which reserve?	208
7.5.3	Effect on realised profits of writing off goodwill.....	216
7.5.4	Amortisation.....	218
7.5.5	Negative goodwill.....	220

7.6	Step-by-step acquisitions	223
7.6.1	Background	223
7.6.2	Example	224
7.6.3	Conclusion	228
7.7	Mergers.....	229
7.7.1	Basic principles.....	229
7.7.2	Equity eliminations.....	229
7.7.3	Expenses of the merger.....	231
7.7.4	Non-coterminous accounting periods.....	231
7.7.5	Dividends of the subsidiary.....	233
7.8	Disclosure requirements relating to business combinations	233
7.8.1	General.....	233
7.8.2	Acquisitions.....	234
7.8.3	Mergers.....	240
7.8.4	Transactions involving merger relief	241
7.8.5	Post Companies Act 1989	242
8	Disposals.....	243
8.1	Basic principles.....	243
8.2	Effective date of disposal	243
8.3	Partial disposals.....	245
8.4	Goodwill of subsidiaries disposed of.....	246
8.5	Deemed disposals	248
8.6	Disclosure requirements relating to disposals	248
9	Group reorganisations.....	250
9.1	Introduction	250
9.2	Setting up a new top holding company	251
9.3	Changing direct ownership of a company within a group.....	252
9.3.1	Subsidiary moved 'up'	252
9.3.2	Subsidiary moved 'along'	254
9.3.3	Subsidiary moved 'down'	255
9.4	Divisionalisation of an existing group.....	256
9.5	Demergers	257
9.6	Capital contributions	259
9.6.1	Treatment in the financial statements of the paying company.....	260
9.6.2	Treatment in the financial statements of the receiving company.....	260
10	Conclusion.....	260

CHAPTER 5 FOREIGN CURRENCIES

269

1	The development of an accounting standard in the UK	269
1.1	Background	269
1.2	SSAP 6	270
1.3	ED 16	270
1.4	ED 21	270
1.5	ED 27	271
1.6	SSAP 20	272
2	Requirements of SSAP 20	272
2.1	Objectives of translation	272
2.2	Definitions of terms	272
2.3	Individual companies	273
2.3.1	Recording of transactions	273
2.3.2	Retranslation of monetary/non-monetary assets and liabilities at balance sheet date	273
2.3.3	Treatment of exchange differences	274
2.3.4	Worked examples	274
2.3.5	Examples of accounting policies	275
2.3.6	Exchange gains where there are doubts as to convertibility or marketability	275
2.3.7	Foreign equity investments financed by borrowings	275
2.3.8	Forward contracts	277
2.4	Consolidated accounts	278
2.4.1	Scope	278
2.4.2	Choice of method	278
2.4.3	Closing rate/net investment method	278
2.4.4	Temporal method	281
2.4.5	Foreign equity investments financed by borrowings	285
2.4.6	Associated companies	288
2.4.7	Foreign branches	289
2.5	Disclosures	290
2.5.1	Requirements of SSAP 20	290
2.5.2	Examples of disclosures	291
3	Problem areas	293
3.1	Individual companies	293
3.1.1	Date of transaction	293
3.1.2	Use of average rate	294
3.1.3	Dual rates or suspension of rates	295
3.1.4	Monetary or non-monetary	295
3.1.5	Treatment of exchange differences	299

3.2	Exchange gains on long-term monetary items	301
3.2.1	In what circumstances do 'doubts as to convertibility or marketability' arise?	301
3.2.2	Past exchange losses	302
3.2.3	Settled or unsettled transactions	302
3.2.4	Current portion of long-term item	302
3.2.5	Restriction of gain	303
3.3	Forward contracts, currency swaps and currency options	303
3.3.1	Forward contracts	303
3.3.2	Currency swaps	312
3.3.3	Currency options	313
3.4	Consolidated accounts — closing rate/net investment method	314
3.4.1	Subsidiary with non-coterminous year end	314
3.4.2	Dual rates or suspension of rates	316
3.4.3	Calculation of average rate	316
3.4.4	Change from closing rate to average rate or vice versa	319
3.4.5	Which reserve should exchange differences be taken to?	321
3.4.6	Post-acquisition capital or revaluation reserves	322
3.4.7	Treatment of exchange differences on disposal of subsidiary	325
3.4.8	Change from closing rate/net investment method to temporal method or vice versa	328
3.4.9	Hyperinflation	328
3.4.10	Goodwill on consolidation	331
3.4.11	Inter-period comparisons	332
3.4.12	Branches	334
3.5	Cover method	335
3.5.1	What are 'foreign currency borrowings'?	335
3.5.2	Borrowings taken out before or after the investment	335
3.5.3	Repayment of borrowings	339
3.5.4	Goodwill on consolidation	341
3.5.5	All investments/borrowings?	342
3.5.6	Must currencies be the same?	343
3.5.7	Pooled basis?	346
3.5.8	What is meant by condition (b) of paragraph 51 and condition (c) of paragraph 57?	348
3.5.9	What should happen in the year of change of the above conditions not being met?	350
3.6	Intra-group long-term loans and deferred trading balances	353
3.6.1	General requirement	353
3.6.2	Paragraphs 20 and 43	354
3.6.3	How permanent is permanent?	354
3.6.4	What happens in year of change?	355

3.6.5	Is such a treatment allowed in the company financial statements?	357
3.6.6	If so, how should loans be translated?.....	358
3.6.7	UK subsidiary with loan from overseas parent company.....	359
3.7	Other intra-group transactions	359
3.7.1	Dividends.....	359
3.7.2	Unrealised profits.....	361
4	Main criticisms of SSAP 20 and suggested solutions.....	362
4.1	Forward contracts and similar hedging contracts	362
4.1.1	Criticisms.....	362
4.1.2	Solution.....	363
4.2	Cover method.....	363
4.2.1	Criticisms.....	363
4.2.2	Solution.....	363
4.3	Reserve accounting.....	364
4.3.1	Criticism.....	364
4.3.2	Solution.....	364
4.4	Conclusion.....	365
5	Related Companies Act 1985 requirements.....	365
5.1	Realised profits.....	365
5.1.1	Schedule 4, paragraph 12	365
5.1.2	Section 262(3)	365
5.1.3	Settled transactions	366
5.1.4	Short-term monetary items	366
5.1.5	Long-term monetary items.....	366
5.2	Distributable profits.....	368
5.2.1	Section 263(3)	368
5.2.2	Long-term monetary items.....	368
5.2.3	Section 275 and Schedule 4, paragraph 89.....	368
5.2.4	Cover method	369
5.2.5	Branch accounting.....	370
5.3	Disclosure	371
5.3.1	Basis of translation.....	371
5.3.2	Treatment of exchange differences in profit and loss account.....	372
5.3.3	Reserve movements	372
5.3.4	Movements on provisions for liabilities and charges	372
5.3.5	Movements on fixed assets.....	372
5.4	Alternative accounting rules.....	373
5.4.1	Schedule 4, Part II, section C.....	373
5.4.2	SSAP 20, paragraph 66.....	373

6	Comparison with US and IASC pronouncements	374
6.1	US	374
6.1.1	General comment	374
6.1.2	Main differences	374
6.2	IASC	376
6.2.1	Cover method	376
6.2.2	Forward exchange contracts	376
6.2.3	Disclosure	376
6.2.4	IAS E32	377

CHAPTER 6	FIXED ASSETS AND DEPRECIATION	383
------------------	--------------------------------------	------------

1	Introduction	383
1.1	The meaning of fixed assets	383
1.2	Background	384
1.3	Criteria for recognition of fixed assets	384
1.3.1	General criteria	384
1.3.2	Criteria for intangible fixed assets	384
1.3.3	The brands debate: which intangible assets are capable of being accounted for?	389
2	Cost	392
2.1	Basic requirement	392
2.2	Purchase price	392
2.3	Production cost	393
2.4	Directly and indirectly attributable costs	393
2.5	The period of production	394
2.6	Abnormal costs and cost inefficiencies	395
2.7	Improvements and repairs	396
3	Depreciation	397
3.1	Introduction	397
3.2	The requirements of the Companies Act	398
3.3	The development of an accounting standard in the UK	398
3.4	The requirements of SSAP 12	399
3.4.1	Scope	399
3.4.2	Definitions	399
3.4.3	Accounting treatment	399
3.4.4	Asset lives	400
3.4.5	Permanent diminutions	400
3.4.6	Change in method	400
3.4.7	Depreciation on revalued assets	400

3.4.8	Depreciation on land and buildings	400
3.5	Useful economic life	400
3.6	Residual values	401
3.7	Depreciation methods	402
3.7.1	Straight line method	402
3.7.2	Reducing balance method	402
3.7.3	Other reducing balance methods	403
3.7.4	Annuity method	404
3.7.5	Unit of production method	404
3.7.6	Choice of depreciation method	404
3.8	Changes in method of providing depreciation	405
3.9	Changes in estimated life	405
3.10	Treatment of minor items	406
3.11	Non-depreciation of property	408
3.11.1	Reasons for not depreciating buildings	408
3.11.2	High standards of maintenance as a reason for not providing depreciation	408
3.12	Non-depreciation of other fixed assets	410
4	Permanent diminutions	410
4.1	Introduction	410
4.2	Companies Act requirements	411
4.3	SSAP 12 and permanent diminutions	411
4.4	The estimation of recoverable amount	411
4.5	Diminutions in value of individual assets or portfolio of assets	413
5	Revaluations	413
5.1	Introduction	413
5.1.1	Background	413
5.1.2	ED 51	415
5.2	Bases of valuation	416
5.2.1	General principles	416
5.2.2	Open market value of land and buildings	420
5.2.3	Depreciated replacement cost of land and buildings	425
5.2.4	Valuations of other assets	426
5.2.5	The comparability of valuations	426
5.3	Accounting for revaluations	426
5.3.1	Accounting for revaluation surpluses	427
5.3.2	Depreciation of revalued assets	429
5.3.3	Disposal of revalued assets	430
5.3.4	Downward valuations and provisions for permanent impairment	432
5.3.5	Other uses of the revaluation reserve	435

5.3.6	Distributable profits and revaluations of fixed assets.....	436
6	Disclosure.....	437
6.1	Introduction	437
6.2	Directors' report.....	437
6.3	Balance sheet and profit and loss account	439
6.4	Accounting policies.....	440
6.5	Notes to the financial statements.....	441
6.6	Additional disclosures for items carried at valuation	444
7	Comparison with US and IASC.....	448
7.1	US.....	448
7.2	IASC.....	449
CHAPTER 7 INVESTMENT PROPERTIES		457
1	The development of an accounting standard in the UK	457
2	The requirements of SSAP 19	458
2.1	Definition of investment property	458
2.2	Balance sheet valuation.....	459
2.3	Revaluation reserve.....	459
2.4	Disclosure	459
3	Issues arising from SSAP 19	459
3.1	Relevant Companies Act requirements	459
3.1.1	Disclosure on use of 'true and fair override'	459
3.1.2	Diminutions in value.....	460
3.1.3	Revaluation reserve.....	461
3.1.4	Balance sheet classification	461
3.2	Frequency of independent valuation.....	462
4	Comparison with US and IASC pronouncements	462
4.1	US.....	462
4.2	IASC.....	462
5	Issues specific to property companies.....	464
5.1	Profit and loss account presentation	464
5.2	Reclassifications from investment property to trading property	466
5.3	Reclassifications from trading property to investment property	467
5.4	Turnover definition.....	468
5.5	Revenue recognition	469
5.6	Lessee accounting.....	469
6	Conclusion.....	469

CHAPTER 8 INVESTMENTS

473

1	Introduction.....	473
2	The requirements of the Companies Act.....	475
2.1	Classification.....	475
2.2	Accounting rules.....	476
2.2.1	Fixed asset investments.....	476
2.2.2	Current asset investments.....	477
2.2.3	Assigning purchase price to particular investments.....	477
2.3	Disclosure requirements.....	478
3	The proposed requirements of ED 55.....	484
3.1	Classification.....	484
3.2	Accounting requirements.....	485
3.2.1	Fixed asset investments.....	485
3.2.2	Current asset investments.....	486
3.2.3	Requirements for all investments.....	487
3.2.4	Income recognition.....	488
3.2.5	Redeemable interest bearing securities.....	488
3.2.6	Investments held for hedging purposes.....	489
3.2.7	Summary of main measurement rules.....	489
3.3	Disclosure requirements.....	490
4	Comparison with US and IASC pronouncements.....	491
4.1	US.....	491
4.2	IASC.....	491
4.2.1	IAS 25.....	491
4.2.2	E32.....	491

CHAPTER 9 RESEARCH AND DEVELOPMENT

495

1	Introduction.....	495
1.1	Possible accounting treatments of research and development expenditure.....	495
1.1.1	Charge all costs to expense when incurred.....	495
1.1.2	Capitalise all costs when incurred.....	496
1.1.3	Capitalise costs when incurred if certain conditions are met.....	496
1.1.4	Accumulation of costs in a special category.....	497
1.1.5	Which treatment should be adopted?.....	497
1.2	Development of accounting standards in the UK.....	497
1.2.1	ED 14.....	497
1.2.2	ED 17.....	497
1.2.3	SSAP 13.....	498

1.2.4	ED 41	498
1.2.5	SSAP 13 (Revised)	498
2	Requirements of SSAP 13	499
2.1	Definitions	499
2.2	Accounting	500
2.2.1	Fixed assets	500
2.2.2	Pure and applied research	500
2.2.3	Development expenditure	500
2.3	Disclosure	501
2.4	Current reporting practice	502
3	Requirements of the Companies Act 1985	504
3.1	Accounting	504
3.2	Disclosure	505
3.2.1	Financial statements	505
3.2.2	Directors' report	505
3.3	Distributable profits	505
4	Problem areas	506
4.1	What activities should be included within research and development?	506
4.2	What costs should be included within the category of research and development?	507
4.3	Availability of choice between immediate write off and capitalisation of development expenditure	507
4.4	Elimination of uncertainty in respect of development expenditure	508
4.4.1	Expenditure previously not capitalised	508
4.4.2	Deferred expenditure previously capitalised and subsequently written down	508
5	Comparison with US and IASC pronouncements	508
5.1	US	508
5.2	IASC	509

CHAPTER 10 CAPITALISATION OF BORROWING COSTS 513

1	Introduction	513
1.1	The development of the practice of capitalisation	513
1.2	Arguments for and against capitalisation	515
1.3	The accounting alternatives	516
1.3.1	Account for interest on debt as an expense of the period in which it is incurred	516
1.3.2	Capitalise interest on debt as part of the cost of an asset when prescribed conditions are met	517

1.3.3	Capitalise interest on debt and imputed interest on owners' equity in respect of qualifying assets during their production period.....	517
2	A comparison between the UK, US and IASC.....	518
2.1	The current UK position.....	518
2.1.1	ED 51.....	519
2.2	US.....	520
2.2.1	Qualifying and non-qualifying assets.....	520
2.2.2	Capitalisation rate.....	521
2.2.3	Capitalisation period.....	522
2.2.4	Disclosure.....	522
2.3	IASC.....	522
3	Issues arising in practice.....	524
3.1	Qualifying assets.....	524
3.2	Period of production.....	525
3.2.1	Commencement of capitalisation period.....	525
3.2.2	End of capitalisation period.....	526
3.2.3	Interruptions and delays during development.....	527
3.3	Determination of amount to be capitalised.....	527
3.3.1	Borrowings and capitalisation rate.....	527
3.3.2	Limitation on interest capitalised.....	531
3.3.3	Gross or net of tax relief.....	532
3.3.4	Compounding.....	533
3.3.5	Accrued costs.....	534
3.3.6	Asset not previously held at cost.....	534
3.4	Group financial statements.....	534
3.4.1	Borrowings in one company and development in another.....	534
3.4.2	Qualifying assets held by investments accounted for using the equity method.....	534
3.5	Other issues.....	536
3.5.1	Provisions for diminution in value.....	536
3.5.2	Change of policy to capitalise interest.....	536
3.5.3	Exchange differences as a borrowing cost.....	536
3.5.4	Assets produced by others.....	537
3.5.5	Depreciation.....	537
4	Disclosure.....	537
4.1	Balance sheet and related notes.....	537
4.2	Profit and loss account and related notes.....	538
4.3	Accounting policy.....	539
5	Conclusion.....	540

CHAPTER 11 STOCKS AND LONG-TERM CONTRACTS

543

1	Introduction.....	543
1.1	The importance of stocks and long-term contracts within financial statements	543
1.2	What are stocks and long-term contracts?.....	543
1.3	Objectives of stock measurement	544
2	Determining the cost of stock.....	545
2.1	Direct costing vs. full absorption costing.....	546
3	Determining the cost of sales	546
3.1	Cost flow assumptions based on the physical flow of goods.....	547
3.1.1	Specific identification/actual cost	547
3.1.2	FIFO (first-in, first-out)	547
3.2	Cost flow assumptions which disregard the physical flow of goods.....	548
3.2.1	Weighted average.....	548
3.2.2	LIFO (last-in, first-out).....	548
3.2.3	Base stock.....	549
3.3	Illustration of the effect of different cost flow assumptions	550
4	The development of SSAP 9 (revised)	553
4.1	The original SSAP 9.....	553
4.2	The need for revision	553
4.3	SSAP 9 (Revised).....	554
5	The requirements of the Companies Act 1985	555
5.1	Lower of cost and net realisable value	555
5.2	Stock included at a fixed amount.....	555
5.3	Determination of purchase price or production cost.....	555
5.4	Costing method	556
5.5	Current cost	557
6	Stocks.....	558
6.1	The accounting and disclosure requirements of SSAP 9 (Revised).....	558
6.1.1	Suitable analysis of stocks.....	558
6.1.2	Accounting policies	559
6.2	Comparison with US and IASC pronouncements.....	560
6.2.1	US.....	560
6.2.2	IASC.....	560
6.3	Problem areas.....	561
6.3.1	Constituents of cost	561
6.3.2	Net realisable value	564
6.3.3	The valuation of high volumes of similar items of stock	566
6.3.4	Marking to market	

7	Long-term contracts.....	568
7.1	The accounting and disclosure requirements of SSAP 9 (Revised).....	568
7.1.1	Definition.....	568
7.1.2	Turnover, related costs and attributable profit.....	569
7.1.3	Accounting policies	570
7.1.4	The financial statement presentation of long-term contracts	571
7.1.5	Illustrative examples of the disclosure of long-term contracts	572
7.2	Comparison with US and IASC pronouncements.....	578
7.2.1	US	578
7.2.2	IASC.....	578
7.3	Problem areas.....	579
7.3.1	How much profit?.....	579
7.3.2	How much turnover?	581
7.3.3	Approved variations and claims.....	582
7.3.4	Should profits be accrued on short-term contracts?	583
7.3.5	Inclusion of interest.....	583

CHAPTER 12 SHARE AND LOAN CAPITAL 587

1	Introduction.....	587
2	Present requirements.....	588
2.1	The measurement of share and loan capital.....	588
2.1.1	Share capital.....	588
2.1.2	Loan capital.....	589
2.2	Disclosure requirements.....	590
2.2.1	Share capital.....	590
2.2.2	Loan capital.....	594
2.3	The purchase of a company's own shares.....	597
2.4	Scrip dividends	603
3	TR 677.....	608
4	Accounting for particular types of instrument.....	609
4.1	Bonds with no rights to conversion.....	609
4.1.1	Stepped bonds.....	609
4.1.2	Deep discounted bonds	610
4.1.3	Bonds with variable interest rates or redemption payments.....	612
4.2	Share options and warrants.....	612
4.3	Convertible bonds	613
4.3.1	Traditional convertible bonds.....	613
4.3.2	Bonds with share warrants attached.....	614
4.3.3	Convertible bonds with premium puts.....	615

4.3.4	Convertible capital bonds	618
4.4	Preference shares	621
4.4.1	Redeemable preference shares.....	621
4.4.2	Convertible preference shares.....	622
4.5	Interest rate swaps.....	625
5	Comparison with US and IASC pronouncements	628
5.1	US.....	628
5.1.1	Share capital.....	628
5.1.2	Redeemable shares	628
5.1.3	Treasury stocks	629
5.1.4	Additional paid-in capital.....	629
5.1.5	Dividends.....	630
5.1.6	Debt	630
5.1.7	Convertible debt and debt issued with warrants.....	632
5.1.8	Convertible bonds with a 'Premium Put'.....	632
5.1.9	Financial instruments project	632
5.2	IASC.....	632
6	Conclusion.....	633

CHAPTER 13 OFF-BALANCE SHEET TRANSACTIONS 635

1	Introduction.....	635
1.1	What are 'off-balance sheet transactions'?.....	635
1.2	Justifications for entering into off-balance sheet transactions	635
1.3	Why the concern with off-balance sheet transactions?.....	636
2	The development of an accounting standard.....	641
2.1	ICAEW Technical Release.....	641
2.2	ED 42.....	642
2.3	ED 49.....	644
3	Common forms of off-balance sheet finance	647
3.1	Quasi subsidiaries.....	647
3.1.1	Off-balance sheet transactions involving quasi subsidiaries.....	647
3.1.2	The old Companies Act definition.....	654
3.1.3	Problems with the old definition of subsidiary	655
3.1.4	The new definition of a subsidiary undertaking.....	657
3.1.5	ED 49	658
3.2	Consignment stocks	659
3.3	Sale and repurchase agreements.....	661
3.4	Factoring of debts.....	665
3.5	Securitised mortgages.....	668

3.6	Loan transfers	673
4	Current disclosure requirements affecting off-balance sheet transactions	674
5	Comparison with US and IASC pronouncements	678
5.1	US	678
5.1.1	General	678
5.1.2	Quasi subsidiaries	678
5.1.3	Sale of assets	678
5.1.4	Project financing	679
5.1.5	Transfers of receivables with recourse	679
5.1.6	Financial instruments	680
5.2	IASC	682
6	Conclusion	682

CHAPTER 14 LEASES AND HIRE PURCHASE CONTRACTS 685

1	Introduction	685
1.1	Historical development	685
1.2	What are leases and hire purchase contracts?	685
1.3	The tax position	685
1.4	SSAP 21	686
1.5	Accounting requirements of SSAP 21	687
2	Determining the lease type	687
2.1	The 90% test	687
2.1.1	The fair value	688
2.1.2	The implicit interest rate	688
2.1.3	The minimum lease payments	688
2.1.4	An unguaranteed residual value	689
2.1.5	The lease term	689
2.2	90% test example	690
2.3	Determining the lease type — other factors	690
3	Accounting by lessees	691
3.1	Introduction	691
3.2	Capitalised fixed asset	691
3.3	Finance lease obligation	692
3.4	Methods of allocating finance charges to accounting periods	693
3.5	Carrying values	694
3.6	Operating leases	695
4	Disclosure by lessees	695
4.1	SSAP 21 requirements	695
4.2	Related Companies Act requirements	696

4.3	Disclosure in practice	697
5	Accounting by lessors	703
5.1	Introduction	703
5.2	Operating leases	703
5.3	Finance leases	704
5.4	Choice and disclosure of methods	704
5.5	Allocation of gross earnings — finance leases	704
5.5.1	Introduction	704
5.5.2	Methodology	705
5.5.3	Assumptions	708
5.5.4	Other methods	708
5.5.5	Net investment or net cash investment	709
5.6	Allocation of gross earnings — hire purchase contracts	709
5.6.1	Introduction	709
5.6.2	Methodology	710
5.6.3	Choice of method	710
6	Disclosure by lessors	710
6.1	SSAP 21 requirements	710
6.2	Related Companies Act requirements	711
6.3	Disclosure in practice	711
7	Problem areas	714
7.1	Classification of leases	714
7.1.1	Current practice	714
7.1.2	SSAP 21	714
7.1.3	Technical Release 664	715
7.1.4	Leasing as an off-balance sheet transaction	715
7.2	Termination of leases	717
7.2.1	Lease classification	717
7.2.2	Operating leases	718
7.2.3	Finance leases — lessee	718
7.2.4	Finance leases — lessor	718
7.3	Tax variation clauses	719
7.3.1	Introduction	719
7.3.2	Adjustments	719
7.3.3	Lessee	719
7.3.4	Lessor	720
7.4	Sale and leaseback transactions	720
7.4.1	Introduction	720
7.4.2	Purchaser/lessor	720
7.4.3	Vendor/lessee	720
7.4.4	Leaseback under a finance lease	720

7.4.5	Leaseback under an operating lease.....	722
7.5	Manufacturers/dealers.....	724
7.5.1	Introduction.....	724
7.5.2	Allocating the total profit of the manufacturer/dealer.....	724
7.6	Sub-leases and back-to-back leases.....	725
7.6.1	Introduction.....	725
7.6.2	The original lessor and the ultimate lessee.....	725
7.6.3	The intermediate party.....	725
8	Comparison with US and IASC pronouncements.....	726
8.1	US.....	726
8.2	IASC.....	727

CHAPTER 15 GOVERNMENT GRANTS

731

1	Introduction.....	731
2	The development of SSAP 4 (Revised).....	731
2.1	The original SSAP 4.....	731
2.2	ED 43.....	732
2.3	SSAP 4 (Revised).....	732
3	The requirements of SSAP 4 (Revised).....	732
3.1	Accounting.....	732
3.1.1	Treatment of capital grants.....	732
3.1.2	Treatment of revenue-based grants.....	733
3.1.3	Accounting for receipt and repayment of grants.....	734
3.1.4	Matching grants against related expenditure.....	735
3.2	Disclosure.....	735
4	Problem areas.....	738
4.1	Achieving the most appropriate matching.....	738
4.2	Guidelines.....	739
4.2.1	Should the grant be split into its elements?.....	739
4.2.2	What was the purpose of the grant?.....	739
4.2.3	What is the period to be benefited by the grant?.....	739
4.2.4	Is a grant capital or revenue?.....	740
5	Comparison with the IASC pronouncement.....	740

CHAPTER 16 SEGMENTAL REPORTING

741

1	Introduction.....	741
1.1	Historical background.....	741
1.2	The objectives of segmental reporting	742
1.2.1	Introduction.....	742
1.2.2	The shareholder group.....	742
1.2.3	The investment analyst group.....	742
1.2.4	The lender/creditor group	743
1.2.5	Government	743
2	The UK position.....	743
2.1	Legislative requirements	743
2.2	Stock Exchange requirements.....	744
2.3	Accounting standards.....	745
2.4	SSAP 25.....	746
2.4.1	ED 45	746
2.4.2	General principle	746
2.4.3	Scope.....	746
2.4.4	What is a reportable segment?.....	747
2.4.5	What is to be reported?	749
2.4.6	Disclosure in practice.....	751
2.4.7	Associated undertakings	754
2.4.8	Common costs.....	755
2.4.9	Methods of presentation	755
3	Problem areas.....	757
3.1	How to define a class of business.....	757
3.2	Changes in definition of segments.....	757
3.3	Inter-segment sales	758
3.4	Common costs	758
3.5	Allocation of interest income and interest expense.....	758
3.6	How to define net assets	759
4	Comparison with US and IASC pronouncements	759
4.1	US.....	759
4.1.1	SFAS 14.....	760
4.2	IASC.....	762
4.2.1	Introduction.....	762
4.2.2	IAS 14.....	762
5	Conclusion.....	763

CHAPTER 17 PENSION COSTS

767

1	Introduction.....	767
1.1	Background.....	767
1.2	The development of an accounting standard in the UK.....	768
1.2.1	Napier interim report	768
1.2.2	ED 32	769
1.2.3	Statement of Intent.....	771
1.2.4	ED 39	771
1.2.5	SSAP 24	772
2	Requirements of SSAP 24.....	772
2.1	Scope	772
2.2	Accounting objective	772
2.3	Definition of terms	773
2.4	Defined contribution schemes.....	775
2.4.1	Accounting	775
2.4.2	Disclosure.....	775
2.5	Defined benefit schemes.....	776
2.5.1	Regular pension cost	776
2.5.2	Variations from regular cost	777
2.5.3	Discretionary and ex-gratia pension increases and ex-gratia pensions.....	785
2.5.4	Balance sheet	785
2.5.5	Disclosure.....	789
3	The actuarial aspects of SSAP 24.....	796
3.1	Actuarial valuation methods.....	796
3.1.1	Background	796
3.1.2	The approach taken by the standard.....	797
3.1.3	Possible actuarial methods — accrued benefits methods	798
3.1.4	Possible actuarial methods — projected benefits methods.....	800
3.1.5	Actuarial valuation of assets.....	803
3.1.6	Conclusion	804
3.2	Actuarial assumptions and best estimates.....	804
3.3	The role of the actuary.....	805
4	Problem areas.....	806
4.1	The treatment of interest.....	806
4.2	Variations from regular cost.....	812
4.2.1	Calculation of remaining service lives	812
4.2.2	How should variations be amortised?.....	812
4.2.3	What is a significant reduction in employees?.....	815
4.2.4	Allocation of experience differences to funding consequences.....	815

4.2.5	How to account for the unamortised difference remaining in the year of the next actuarial valuation.....	816
4.2.6	How to treat a balance sheet asset which is shown to have been eroded by a subsequent valuation.....	818
4.3	Negative pension cost.....	819
4.4	Hybrid schemes.....	821
4.5	Foreign schemes.....	821
4.6	Unfunded schemes.....	822
4.7	Deferred tax.....	822
4.8	Transitional provisions.....	823
4.8.1	Prior year adjustment or spread over remaining service lives.....	823
4.8.2	Restrictions on the choice of transitional method.....	825
4.8.3	Comparative figures in the year of implementation.....	826
4.9	Accounting for the pension schemes of an acquired subsidiary.....	826
4.10	Group schemes.....	827
5	Related Companies Act requirements.....	828
5.1	Pension commitments.....	828
5.2	Pension costs.....	828
5.3	Directors' emoluments.....	829
6	Comparison with IASC and US pronouncements.....	829
6.1	IASC.....	829
6.1.1	IAS 19.....	829
6.1.2	E32.....	829
6.2	US.....	830
6.2.1	Background.....	830
6.2.2	SFAS 87.....	830
6.2.3	SFAS 88.....	831
7	Conclusion.....	832

CHAPTER 18 TAXATION

835

1	General principles.....	835
1.1	The nature of taxation.....	835
1.2	Allocation between periods.....	836
1.2.1	Background.....	836
1.2.2	Permanent differences.....	836
1.2.3	Timing differences.....	837
1.2.4	The deferral method.....	839
1.2.5	The liability method (with full provision/comprehensive allocation).....	841
1.2.6	The liability method (with partial provision).....	843

1.2.7	The hybrid method	848
1.2.8	Discounting the liability	849
1.2.9	The net of tax method.....	849
1.3	Allocation within periods.....	850
2	The development of accounting for taxation in the UK	850
2.1	Accounting for tax payable	850
2.1.1	ED 12	850
2.1.2	SSAP 8.....	851
2.2	Accounting for deferred tax.....	851
2.2.1	ED 11	851
2.2.2	SSAP 11	851
2.2.3	ED 19	852
2.2.4	SSAP 15	852
2.2.5	ED 33	853
2.2.6	SSAP 15 (Revised)	854
2.3	Other ASC pronouncements	854
2.3.1	SSAP 5.....	854
2.3.2	ED 28	854
3	The requirements of the relevant accounting standards and company law	855
3.1	SSAP 8.....	855
3.1.1	Outgoing dividends and the related ACT	855
3.1.2	Recoverable ACT	855
3.1.3	Incoming dividends	857
3.1.4	Disclosure of the tax charge in the profit and loss account	857
3.2	SSAP 15.....	859
3.2.1	General approach	859
3.2.2	Definitions.....	860
3.2.3	Detailed accounting requirements.....	860
3.2.4	Disclosure.....	863
3.3	Companies Act 1985.....	868
4	Problem areas.....	869
4.1	Combining different categories of timing difference	869
4.2	Tax losses and deferred tax.....	872
4.2.1	Tax losses which have been incurred.....	872
4.2.2	Tax losses which have yet to be incurred.....	873
4.3	Tax losses and group relief.....	874
4.3.1	Background	874
4.3.2	The financial statements of the profitable company.....	874
4.3.3	The financial statements of the loss-making company	875
4.4	Tax in the financial statements of a group.....	875
4.4.1	Offsetting consolidated tax balances	875

4.4.2	Tax effects of consolidation adjustments.....	877
4.5	ACT.....	878
4.5.1	ACT carried forward as an asset.....	878
4.5.2	ACT set against the deferred tax liability.....	878
4.6	Deferred tax and government grants.....	883
4.7	Changes in tax rates and allowances.....	884
4.7.1	Changes in the rates of tax.....	884
4.7.2	Changes in tax allowances.....	885
4.8	Revaluations of fixed assets.....	887
4.9	Overseas earnings.....	888
4.10	Deferred tax on fair value adjustments.....	889
5	Comparison with US and IASC pronouncements.....	889
5.1	IASC.....	889
5.2	US.....	890
5.2.1	APB 11.....	890
5.2.2	SFAS 96.....	890
5.2.3	Main differences between US and UK requirements.....	891
6	Conclusion.....	893

CHAPTER 19 EXTRAORDINARY ITEMS AND PRIOR YEAR ADJUSTMENTS

897

1	The need for a standard.....	897
1.1	Income measurement.....	897
1.1.1	The all inclusive concept.....	898
1.1.2	The current operating performance concept.....	898
1.1.3	Which concept?.....	899
1.2	The development of UK standards.....	899
1.2.1	The original SSAP 6.....	900
1.2.2	The revision of SSAP 6.....	900
2	The requirements of SSAP 6 (Revised).....	902
2.1	Identification of extraordinary and exceptional items.....	902
2.1.1	Definitions.....	902
2.1.2	Examples of exceptional and extraordinary items.....	903
2.2	Terminated activities.....	904
2.2.1	Identification of a business segment.....	904
2.2.2	Items to be taken into account in evaluating the effect of discontinuing a business segment.....	904
2.2.3	Decision date and implementation date.....	905
2.3	Tax attributable to extraordinary items.....	907
2.4	Statement of movements on reserves.....	908

2.5	Prior year adjustments	908
2.5.1	Definition	908
2.5.2	Identification of prior year adjustments	908
2.5.3	Changes in accounting policy	909
2.5.4	Correction of fundamental errors	909
2.5.5	Accounting treatment	910
2.6	Historical summaries, half-yearly reports and preliminary profit statements	913
2.7	Exceptions from SSAP 6	913
2.7.1	Reserve movements permitted or required by other accounting standards	913
2.7.2	Reserve movements permitted or required by law	914
2.7.3	Value based companies	914
3	Disclosure requirements	915
3.1	Profit and loss account format	915
3.2	Extraordinary items	916
3.3	Exceptional items	917
3.4	Prior year adjustments	919
3.5	Statement of movements on reserves	920
4	Problem areas	922
4.1	Definition of extraordinary items	922
4.2	Terminated activities	924
4.2.1	Definition of business segment	924
4.2.2	Identification of decision date and implementation date	926
4.3	Disclosure requirements relating to exceptional and extraordinary items	928
4.4	Historical summaries, half-yearly reports and preliminary profits statements	929
5	Comparison with US, IASC and Canadian pronouncements	929
5.1	US	929
5.1.1	Extraordinary items	929
5.1.2	Terminated activities (discontinued operations)	931
5.1.3	Prior year adjustments	931
5.2	IASC	932
5.3	Canada	933
5.3.1	Infrequency of occurrence	933
5.3.2	Normal business activities	934
5.3.3	Decisions by management	934
6	Conclusion	934

CHAPTER 20 EARNINGS PER SHARE

939

1	Introduction.....	939
2	Scope of SSAP 3	940
3	The basic EPS.....	940
3.1	Definition of EPS.....	940
3.2	Disclosure	941
4	Changes in equity share capital.....	942
4.1	Issue for cash at full market price.....	942
4.2	Bonus issue and share split.....	942
4.3	Rights issue.....	943
4.4	Options exercised during the year.....	946
4.5	Issue for cash at less than full market price.....	946
4.6	Purchase and redemption of own shares.....	946
4.7	Post-balance sheet changes in capital.....	946
4.8	Issue to acquire another business	947
4.9	Group reconstructions	948
4.10	Adjustments to EPS in five year summaries.....	949
5	Matters affecting the EPS calculation.....	949
5.1	Earnings.....	949
5.2	Preference dividends	949
5.3	Losses	950
5.4	Prior year adjustments	950
5.5	Different classes of equity shares	950
5.6	'Net' and 'nil' bases.....	951
5.6.1	Should EPS be calculated net or nil ?	952
5.6.2	Calculation of nil basis EPS.....	953
5.7	Other bases	955
6	Fully diluted earnings per share.....	958
6.1	The need for fully diluted EPS.....	958
6.2	Disclosure of fully diluted EPS.....	959
6.3	Calculation of fully diluted EPS.....	960
6.3.1	Equity shares with future dividend entitlement	960
6.3.2	Convertible securities.....	961
6.3.3	Options or warrants to subscribe for equity shares.....	964
6.3.4	Fully diluted EPS calculations involving more than one type of potentially dilutive security	965
6.3.5	Deferred consideration agreements.....	966

7	Comparison with US pronouncements.....	968
7.1	The primary EPS.....	968
7.2	Fully diluted EPS.....	969
7.3	Disclosure	969

CHAPTER 21 POST BALANCE SHEET EVENTS

973

1	The development of accounting for post balance sheet events.....	973
1.1	Introduction	973
1.2	Companies Act 1948.....	974
1.3	ICAEW Recommendation N17.....	974
1.4	ED 22.....	974
1.5	SSAP 17.....	975
2	Requirements of SSAP 17.....	975
2.1	Definitions	975
2.2	Events requiring adjustment.....	977
2.3	Events not requiring adjustment but requiring disclosure.....	977
2.4	Disclosure requirements.....	980
3	Problem areas.....	982
3.1	Reclassification of a non-adjusting event as adjusting in exceptional circumstances.....	982
3.2	The valuation of stock realised after the balance sheet date.....	983
3.3	Long-term contracts.....	984
3.4	Acquisitions and disposals of fixed assets	984
3.5	Window dressing.....	986
3.6	Valuations of property.....	987
3.7	Insolvency of a debtor.....	987
4	Comparison with US and IASC pronouncements	987
4.1	US.....	987
4.2	IASC.....	988
5	Conclusion.....	988

CHAPTER 22 CONTINGENCIES

991

1	The development of accounting for contingencies	991
1.1	Introduction	991
1.2	The historical background.....	991
2	Requirements of SSAP 18.....	992
2.1	Definition of contingency.....	992

2.2	Contingent gains.....	992
2.3	Contingent losses.....	993
2.4	Offsets.....	994
2.5	Groupings.....	994
2.6	Disclosure requirements.....	995
3	Problem areas.....	995
3.1	Probable, possible or remote.....	995
3.2	Estimating the amount of a contingency.....	996
3.3	Disclosure of the financial effect of a contingency.....	997
3.4	Litigation and disclosure of potentially prejudicial information.....	998
3.5	Disclosure of remote contingencies.....	999
3.6	Other problem areas.....	1000
3.6.1	Guarantees — year-end or maximum liability.....	1000
3.6.2	Discounted bills of exchange.....	1001
3.6.3	VAT groups.....	1001
3.6.4	Performance bonds.....	1002
4	Comparison with US and IASC pronouncements.....	1003
4.1	US.....	1003
4.2	IASC.....	1004

CHAPTER 23 STATEMENTS OF CASH AND FUNDS FLOW

1007

1	Introduction.....	1007
1.1	What is a funds statement?.....	1007
1.2	The form and content of the funds statement.....	1008
1.3	The objectives of the funds statement.....	1009
1.3.1	The funds statement and cash flows.....	1009
1.3.2	SSAP 10 and the objectives of the funds statement.....	1010
2	The requirements of SSAP 10.....	1011
3	The meaning of 'funds'.....	1012
3.1	Net liquid funds.....	1013
3.2	Working capital.....	1015
3.3	Net borrowings.....	1016
3.4	Total external financing.....	1018
3.5	Other formats.....	1020
4	Problem areas.....	1020
4.1	The starting point — before or after taxation?.....	1020
4.2	Funds absorbed by operations.....	1023
4.3	Extraordinary items.....	1024
4.4	Netting off of transactions.....	1025

4.5	Prior year adjustments	1025
4.6	Foreign currency differences	1025
4.6.1	Exchange differences in individual companies	1025
4.6.2	Exchange differences on consolidation	1026
4.6.3	Cover method	1028
4.7	Group financial statements	1028
4.7.1	Minority interests	1028
4.7.2	Investments in associated undertakings	1029
4.7.3	Acquisitions and disposals of subsidiaries	1030
5	Comparison with US and IASC requirements	1032
5.1	US	1032
5.1.1	Introduction	1032
5.1.2	Focus of SFAS 95	1033
5.1.3	Cash equivalents	1033
5.1.4	Form and content of the statement of cash flows	1034
5.1.5	Investing activities	1034
5.1.6	Financing activities	1035
5.1.7	Operating activities	1035
5.1.8	Receipts and payments are presented gross	1036
5.1.9	Non-cash activities are disclosed separately	1036
5.1.10	Choice of using the direct or indirect methods	1037
5.1.11	Illustrative examples	1037
5.2	IASC	1041
6	Proposed replacement of SSAP 10: ED 54	1042
6.1	Introduction	1042
6.2	Classes and elements of cash flows	1043
6.2.1	Dividends and interest paid	1043
6.2.2	Taxation	1043
6.2.3	Foreign currency differences	1044
6.3	The direct or the indirect method?	1044

CHAPTER 24 RELATED PARTIES

1049

1	Introduction	1049
1.1	The related party issue	1049
1.2	Possible solutions	1050
1.2.1	Remeasurement of transactions at fair values	1050
1.2.2	Disclosure of transactions	1050
1.3	Position in the UK	1050

2	ED 46.....	1051
2.1	Introduction	1051
2.2	Identification of related parties	1051
2.3	Types of transactions and arrangements.....	1052
2.4	Information to be disclosed	1053
2.4.1	Abnormal transactions	1053
2.4.2	Controlling relationship.....	1054
2.4.3	Economic dependence	1054
2.4.4	Specific exemptions from disclosure	1054
2.4.5	Disclosure in practice.....	1055
3	Problem areas.....	1056
3.1	Identification of related parties	1056
3.1.1	Control or significant influence.....	1056
3.1.2	Controlled or significantly influenced parties.....	1056
3.1.3	Controlling or significantly influencing parties	1057
3.1.4	Enterprises under common control or significant influence	1060
3.1.5	Economic dependence	1061
3.1.6	Conclusion	1062
3.2	Types of transactions and arrangements.....	1062
3.2.1	Introduction.....	1062
3.2.2	Normal/abnormal transactions.....	1063
4	Other requirements in the UK.....	1064
4.1	Legislative requirements	1064
4.1.1	Directors.....	1064
4.1.2	Non-director officers.....	1065
4.1.3	Related undertakings.....	1065
4.2	UK accounting standards	1069
4.3	Stock Exchange requirements.....	1070
4.3.1	Directors.....	1070
4.3.2	Shareholders.....	1071
5	Comparison with US and IASC pronouncements	1072
5.1	IASC.....	1072
5.1.1	IAS 24	1072
5.2	US.....	1073
5.2.1	SFAS 57	1073

CHAPTER 25 DIRECTORS' AND OFFICERS' LOANS AND TRANSACTIONS

1077

1	Introduction.....	1077
1.1	Outline of historical development in the UK	1077
2	Definitions.....	1077
2.1	Director.....	1077
2.2	Shadow director.....	1078
2.3	Alternate director.....	1078
2.4	Connected person	1078
2.5	Officer	1080
2.6	Loan.....	1080
2.7	Quasi-loan.....	1080
2.8	Credit transaction	1081
3	Disclosure requirements.....	1082
3.1	Introduction	1082
3.2	Scope	1082
3.3	Transactions requiring disclosure.....	1083
3.4	Section 330 transactions	1084
3.4.1	Introduction.....	1084
3.4.2	Disclosure requirements	1085
3.5	Material interest transactions.....	1088
3.5.1	Introduction.....	1088
3.5.2	Definition of material interest.....	1088
3.5.3	Disclosure requirements	1089
3.6	Exemptions from disclosure.....	1091
3.6.1	General.....	1091
3.6.2	Section 330 transactions.....	1091
3.6.3	Material interest transactions.....	1092
4	Banking companies under the Banking Act 1987.....	1093
4.1	Disclosure of transactions by banking companies.....	1093
5	Requirements of The Stock Exchange	1094
5.1	Listed companies.....	1094
5.2	USM companies	1095
6	Transactions involving officers	1095
6.1	Introduction	1095
6.2	Disclosure requirements.....	1095
6.3	Banking companies under the Banking Act 1987.....	1096
7	Conclusion.....	1096

APPENDIX: LEGAL REQUIREMENTS.....	1098
A Introduction.....	1098
B Prohibited transactions.....	1098
B.1 Loans.....	1098
B.2 Quasi-loans and credit transactions.....	1098
B.3 Assignment/assumption of rights, obligations or liabilities.....	1098
B.4 Arrangements.....	1099
C Exempted transactions.....	1099
C.1 Loans of small amounts.....	1099
C.2 Short-term quasi-loans.....	1099
C.3 Minor or business credit transactions.....	1099
C.4 Inter-company transactions.....	1099
C.5 Directors' business expenditure.....	1100
C.6 Money-lending companies.....	1100
C.7 Companies registered overseas.....	1101
D Sanctions.....	1101
D.1 Civil remedies.....	1101
D.2 Criminal penalties.....	1101
E Interests in contracts.....	1102
F Substantial property transactions.....	1102
G Transactions involving officers.....	1103

CHAPTER 26 DIRECTORS' REMUNERATION 1109

1 Introduction.....	1109
1.1 Remuneration.....	1109
1.2 Pensions.....	1109
1.3 Compensation for loss of office.....	1110
1.4 Service contracts.....	1110
2 Disclosure of remuneration.....	1111
2.1 Introduction.....	1111
2.2 Disclosure of aggregate emoluments.....	1111
2.2.1 Legal requirements.....	1111
2.2.2 Problem areas.....	1113
2.3 Definition of emoluments.....	1114
2.3.1 Legal requirements.....	1114
2.3.2 Problem areas.....	1114

2.4	Computing aggregate emoluments.....	1118
2.4.1	Legal requirements.....	1118
2.4.2	Problem areas	1120
2.5	Bandings	1122
2.6	Emoluments waived.....	1125
2.7	Pensions of directors and past directors.....	1125
2.8	Compensation for loss of office	1127
2.8.1	Legal requirements.....	1127
2.8.2	Problem areas	1128
2.9	Payments to third parties.....	1129
3	Employee disclosures.....	1129
3.1	Director as an employee	1129

APPENDIX	SPECIMEN FINANCIAL STATEMENTS	1133
----------	-------------------------------	------

INDEX OF EXTRACTS FROM ACCOUNTS	1195
---------------------------------	------

INDEX	1199
-------	------
