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Accounting Profession in the United Kingdom, Second Edition Revised; Professional Accounting in Foreign Country Series

BDO Binder

Steven F. Moliterno

SECOND EDITION, REVISED

The Accounting Profession in the United Kingdom

PROFESSIONAL ACCOUNTING IN FOREIGN COUNTRIES SERIES

AICPA

American Institute of Certified Public Accountants

The Accounting Profession in the United Kingdom Second Edition, Revised
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NOTICE TO READERS

The Professional Accounting in Foreign Countries series is designed to be educational and used as reference material for the members of the Institute and others interested in the subject.

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Prepared by

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American Institute of Certified Public Accountants

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Preface

This booklet is one of a series on professional accounting in foreign countries. The material is current as of November 1993. Changes made after this date in the standards of either the United States or the United Kingdom may alter the comparisons and references detailed in this publication.

Included are descriptions of the accounting profession, auditing standards, and accounting principles in the United Kingdom. The booklet also presents brief descriptions of the various forms of business organizations, taxes, and requirements for stock exchange listings and securities offerings. Checklists comparing United Kingdom auditing standards and accounting principles with those generally accepted in the United States are included as appendixes to the text.

This booklet is not intended to be a comprehensive discussion of auditing standards and accounting principles in the United Kingdom but is designed instead to focus primarily on differences from those of the United States.

John F. Hudson
Vice President—Technical
Standards and Services

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The Accounting Profession

REQUIREMENTS FOR ENTRY INTO THE PROFESSION

Domestic Functions and Licensing Requirements

1. The accounting profession in the United Kingdom is regulated by six major professional bodies:

- The Institute of Chartered Accountants in England and Wales
- The Institute of Chartered Accountants of Scotland
- The Institute of Chartered Accountants in Ireland
- The Chartered Association of Certified Accountants
- The Chartered Institute of Management Accountants
- The Chartered Institute of Public Finance and Accountancy

2. These organizations control the admission, training, and professional conduct of their respective members and, although they are all independent bodies, they coordinate many of their policies through the Consultative Committee of Accounting Bodies (CCAB). The Institute of Chartered Accountants in England and Wales can be reached at the following address:

Chartered Accountants' Hall
Moorgate Place
P.O. Box 433
London, EC2P 2BJ

3. In the United Kingdom, the use of the terms *accountant* and *auditor* is not regulated; anyone can use them and offer accounting, auditing (except for certain entities such as limited companies or pension funds, as discussed in paragraph 5, where eligibility for appointment is legally defined), and tax services. However, the use of the title *Chartered Accountant* or *Certified Accountant* is restricted to members of the respective professional bodies.

4. The United Kingdom comprises Great Britain (consisting of England, Wales, and Scotland) and Northern Ireland. For all practical purposes, a single legal system operates throughout the United Kingdom, but in certain sectors, such as property law and law enforcement, the law applicable in Scotland is different from that applicable to the rest of the United Kingdom. Similarly, Northern Ireland has its own legislation, although, so far as company law is concerned, this replicates corresponding legislation in Great Britain. Consequently, throughout this book, references to legislation relate to that applicable in Great Britain.

5. All companies formed under the provisions of the Companies Act 1985 (as amended by the Companies Act 1989) (the Act) or its predecessors, with the exception of dormant companies, must appoint an auditor. The Act established for the first time a framework of recognized supervisory bodies (RSBs) and recognized qualifying bodies (RQBs) to regulate the authorization, training, and conduct of individuals involved in statutory audits to ensure that they are appropriately qualified and properly supervised. The RSBs must maintain a register (accessible to the public) of those individuals and firms that are eligible for appointment as company auditors and thereby entitled to use the description *Registered Auditor.*

6. The three Institutes of Chartered Accountants and the Chartered Association of Certified Accountants have been approved as RSBs by the Department of Trade and Industry, and the three Institutes of Chartered Accountants have formed a Joint Monitoring Unit to conduct visits to selected firms to check compliance with the RSBs' Audit Regulations. These require formalized and documented procedures for practice management, independence, professional conduct, training, and technical competence in the conduct of audits. The rules apply to all Registered Auditors whether they are

sole practitioners or firms. Since October 1991, only Registered Auditors are eligible for appointment as auditors of companies incorporated under the Companies Acts.

7. United Kingdom Chartered Accountants often engage in activities that are not customary for a certified public accountant (CPA) in the United States. For example, a Chartered Accountant may act as a liquidator, receiver, or administrator of a company in bankruptcy; as a registrar and transfer agent of its shares and debentures; or as a valuer of shares (especially of private companies) for inheritance tax, for sale, and for other purposes.

Foreign Reciprocity

8. Accountants who hold approved overseas qualifications and pass any extra examinations specified by the Secretary of State may, by first applying for *Affiliate* status with one of the RSBs, be permitted to audit United Kingdom companies. This does not confer membership in the RSB, but enables such accountants to apply for registration as a Registered Auditor. The English, Scottish, and Irish Institutes will offer reciprocal membership to each other's members in certain cases.

ROLES AND RESPONSIBILITIES OF STANDARD-SETTING BODIES

Professional Standards Promulgated by Each Body

9. In recent years there have been significant changes in the procedures and authority of the principal bodies that determine accounting and auditing standards in the United Kingdom. Since August 1990, the development and enforcement of accounting standards became the responsibility of the Financial Reporting Council (FRC), an independent body whose members are drawn from a wide spectrum of the financial community, including the profession, industry, and financial institutions. Development of accounting standards has been delegated to the Accounting Standards Board (ASB) and their enforcement to the Financial Reporting Review Panel (FRRP).

10. Accounting standards define standard practice on particular aspects of accounting and are usually preceded by consultation documents known as Discussion Drafts (DDs) and Financial Reporting Exposure Drafts (FREDs). The ASB has adopted all the Statements of Standard Accounting Practice (SSAPs) developed by its predecessor, the Accounting Standards Committee (ASC), which was a subcommittee of the CCAB.

11. The ASB has embarked on a comprehensive review program and new standards, termed Financial Reporting Standards (FRSs), are issued by the ASB. Under the Companies Act 1989, financial statements (except for those of small or medium-sized companies) must state that they comply with applicable accounting standards or give details of significant departures.

12. The ASB has appointed an Urgent Issues Task Force (UITF) to address emerging issues in case an accounting standard or legislation exists, but unsatisfactory or conflicting interpretations have developed. The UITF's conclusions, published as abstracts, have the status of accounting standards.

13. The ASB has discontinued the former practice of the ASC of producing Statements of Recommended Practice (SORPs), which were aimed at clarifying the practice concerning particular accounting problems in individual industry sectors. SORPs will, however, continue to be developed by any appropriate bodies recognized by the ASB as being representative of relevant industry sectors.

14. The purpose of the FRRP is to oversee the accounts of all public limited companies (PLCs), and it has the power to require directors to correct defective financial statements (that is, financial statements that fail to comply with the relevant legislation). The panel does not itself actively initiate searches of company accounts for possible errors, but acts on matters referred to it.

15. Development of auditing standards is now the responsibility of the Auditing Practices Board (APB), an organization modeled on the ASB but controlled by the CCAB, which in April 1991 replaced the Auditing Practices Committee of the CCAB.

16. The APB has adopted all the outstanding Auditing Standards and Guidelines developed by its predecessor. New standards, termed Statements of Auditing Standards (SAS), are automatically adopted by the members of CCAB. Apparent failures by auditors to comply with SASs will be investigated by the relevant accounting body and disciplinary or regulatory action may result.

17. In the United Kingdom, the general standards of care that auditors are expected to follow are defined by case law; the Companies Act 1985 specifies only particular points that the auditor must consider in forming an opinion on the financial statements, such as whether proper accounting records have been kept by the company and whether the company's individual accounts are in agreement with the accounting records. The law leaves the auditor to decide which procedures to adopt in conducting a particular audit.

Ethics Requirements

18. The English, Scottish, and Irish Institutes have coordinated their approach to ethical guidance through the Chartered Accountants Joint Ethics Committee. The Guide to Professional Ethics published in February 1992 sets out fundamental principles of—

- Integrity, objectivity, and independence.
- Competence.
- Diligence.
- Courtesy.

19. These are augmented by detailed guidance on a wide range of areas of risk, including—

- Conflicts of interest.
- Confidentiality.
- Consultancy.
- Agencies.
- Fees (for example, percentage and contingency fees are prohibited for audit work and reporting assignments).
- Rotation of audit partners.
- Obtaining professional work.

- Names of practicing firms.

In general, similar ethical rules apply in the United Kingdom as in the United States.

PROFESSIONAL PUBLIC ACCOUNTING ORGANIZATIONS

Requirements for Membership

20. The three Institutes of Chartered Accountants have similar membership requirements and similar organizational structures. Applicants for membership must pass institute examinations covering a wide range of subjects and complete a designated period (for example, three years for United Kingdom graduates) under a training contract with an authorized training office.

21. The Chartered Association of Certified Accountants and the Chartered Institute of Management Accountants are organizations of accountants mainly employed by industrial and commercial companies. Members of the Chartered Institute of Public Finance and Accountancy generally hold accounting and administrative positions in local government and nationalized industries. Applicants for membership in all three bodies must have certain basic educational qualifications, pass the examinations of the respective body, and obtain relevant experience.

Rights of Membership

22. Only Registered Auditors (who must be members of one of the RSBs and consequently be members or affiliates of the three Institutes of Chartered Accountants or of the Chartered Association) are eligible to undertake the audit of companies incorporated under the Companies Act or of other entities, such as pension plans, that define the eligibility of auditors in similar terms.

Number of Members

23. The number of members in each of the major public accounting organizations at the beginning of 1994 was as follows:

Professional Bodies	*Number of Members*
The Institute of Chartered Accountants in England & Wales	105,400
The Institute of Chartered Accountants of Scotland	13,500
The Institute of Chartered Accountants in Ireland	7,500
The Chartered Association of Certified Accountants	27,500
The Chartered Institute of Management Accountants	27,000
The Chartered Institute of Public Finance and Accountancy	12,100
	193,000

CPE Requirements

24. The three Institutes of Chartered Accountants require continuing professional education (CPE). Generally, a member in public practice must obtain annual minimum credit for CPE within a broad range of professional activities (such as audit, tax, and company law).

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Auditing Requirements

STATUTORY AUDITING AND REPORTING REQUIREMENTS

Purpose of the Statutory Audit

25. The purpose of an audit under the Companies Act 1985 (the Act) is to enable auditors to form an opinion on whether the financial statements have been properly prepared in accordance with the Act and, in the case of a company's individual financial statements, give a true and fair view of the company's state of affairs at the end of the year and the profit or loss for the year and, in the case of group financial statements, give a true and fair view of the state of affairs at the end of the year and the profit or loss for the financial year of the operations included in the consolidation. Auditors are required to consider whether the information in the directors' report is consistent with the financial statements and, if it is not, to state that fact in their report.

26. For most companies, the primary purpose of an audit is to comply with the Act and to attest to information provided to shareholders and creditors. For larger companies, an additional purpose is to satisfy London Stock Exchange (the Stock Exchange) requirements.

Entities Required to Be Audited

27. Every company registered in the United Kingdom (apart from certain dormant companies) is required to have an annual audit of its financial statements. The annual report to shareholders must include at least a directors' report, a balance sheet, a profit and

loss statement, and (from March 1992 on, but subject to some exemptions) a cash flow statement, as well as notes disclosing additional detailed information. The financial statements of certain other entities, such as pension plans and, beginning in 1995, charities with annual income in excess of £100,000, are also required to be audited.

Appointment and Qualifications of Auditors

28. The directors of a company may appoint auditors at any time before the first annual general meeting of the shareholders. If this is not done, the shareholders may appoint the auditors. Thereafter, an auditor must be appointed annually. The Act prohibits a director or employee of a company from accepting an appointment as auditor of the company.

29. When a firm of auditors is appointed, the Act makes it clear that the appointment is of the partnership rather than the partners, and the partnership must satisfy the requirements of the recognized supervisory responsibility (RSB) regarding eligibility. An individual is not permitted to perform an audit of a company under the Act in his or her own name unless he or she is a member of one of the Institutes of Chartered Accountants or of the Chartered Association of Certified Accountants and is individually registered with one of the RSBs.

Auditing and Reporting Responsibilities

30. It is the responsibility of the directors to ensure that a company keeps proper accounting records and to prepare annual financial statements that give a true and fair view of the company's state of affairs, profit or loss, and cash flow. The auditors' responsibility is to report to the shareholders about whether or not these obligations have been fulfilled. These duties are explicit with the advent of the standard form of audit report based on Statement of Auditing Standards (SAS) 600, *Auditors' Reports on Financial Statements.* The auditors' duties do not require them specifically to search for errors or other irregularities, but their responsibility is to plan, perform, and evaluate their audit work so as to have a reasonable expectation of detecting material misstatements in the financial statements, whether they are caused by fraud, other irregularities, or

errors. The auditors have the right of access to the books, records, and vouchers of the company and the right to obtain information from the company's officers and subsidiaries as necessary to carry out their statutory duties.

31. A company's annual report to shareholders may include additional financial information, such as five-year summaries, but such information is not required to be audited. The directors' report, which appears in the company's annual report, should contain various matters specified in the Act. The directors' report is not required to be audited, but the Act requires the auditors to comment if any information given in the directors' report is not consistent with the company's financial statements.

Filing of Reports

32. The statutory auditors' report is addressed to the shareholders and attached to the financial statements sent to each shareholder. A signed copy of the financial statements and audit report is filed with the government's Registrar of Companies. Public limited companies (plcs) are required to file their financial statements within seven months after the balance sheet date. Other (private) limited (Ltd) companies are required to file their financial statements within ten months after the balance sheet date. Companies with an overseas interest may apply for an extension of three months. Penalties are automatically imposed if financial statements are not filed within the prescribed time limits.

33. Small and medium-sized companies or groups may file *abbreviated accounts*, which must contain a prescribed minimum of information. An enterprise is *small* or *medium-sized* if, for at least two out of three years ending in the year under review, it satisfies two of the criteria shown in the following table:

Individual Companies

	Small (not more than)	*Medium-sized (not more than)*
Revenues (millions of pounds)	£ 2.8	£ 11.2
Balance sheet total (net assets) (millions of pounds)	£ 1.4	£ 5.6
Employees	50	250

34. The exemptions are not available if the company is or was at anytime during the year a public company, a banking or insurance company, a member of an ineligible group (meaning, a group that includes one of the foregoing companies), a parent company (unless the whole group qualifies as small or medium-sized).

	Groups	
	Small (not more than)	*Medium-sized (not more than)*
Revenues (millions of pounds)	Gross £3.36 Net £2.8	£ 13.44 £ 11.2
Balance sheet total (net assets) (millions of pounds)	Gross £1.68 Net £1.4	£ 6.72 £ 5.6
Employees	50	250

Net means with the offsets and other adjustments required by consolidated financial statements. *Gross* means without those adjustments. A company may choose either the net or the gross figures.

35. If, after the financial statements are approved, it is discovered that they are defective and fail to present a true and fair view, the board of directors has the obligation to inform shareholders immediately, either by issuing a statement concerning the defect or, if appropriate, by issuing revised financial statements. The statement or revised financial statements should be accompanied by a special audit report and copies filed with the Registrar of Companies.

SUMMARY OF SIGNIFICANT AUDITING STANDARDS AND COMPARISON WITH UNITED STATES GENERALLY ACCEPTED AUDITING STANDARDS

Standards Issued

36. Auditing standards in the United Kingdom are set out in pronouncements issued by the Auditing Practices Board (APB) and its predecessor, the Auditing Practices Committee. These address standards of fieldwork and reporting. Ethical standards are addressed in the *Guide to Professional Ethics* adopted by the three Institutes of Chartered Accountants.

General Standards

37. Auditing Standards and Guidelines prescribe the basic principles and practices to be followed when performing an audit. In addition, the Guidelines provide general guidance on audit procedures and techniques. Although the wording of auditing standards in the United Kingdom differs from that in the United States, the substance is generally similar. The major difference is that United Kingdom auditing standards are much less codified while procedures are more judgmental.

38. Significant differences in auditing procedures between the United Kingdom and the United States include the following:

- In the United Kingdom, the auditor is not expressly required to confirm receivables. However, Statement 901, *Verification of Debtor Balances: Confirmation by Direct Communication*, states that the auditor should consider direct communication with debtors, and such communication is the predominant practice for all significant debtors.
- In accordance with Auditing Guideline 404, *Representations by Management*, written representations by management are not strictly required in the United Kingdom if oral representations can be corroborated by the auditor through sources independent of the enterprise, but written representations are required if such evidence cannot be obtained. However, it is the predominant practice in the United Kingdom to obtain written representations from management in all circumstances.
- In the United Kingdom, there is no specific requirement to obtain legal representation letters. However, Statement 903, *The Ascertainment and Confirmation of Contingent Liabilities Arising from Pending Legal Matters*, states that "auditors may decide to obtain written confirmation from third parties." Auditors in the United Kingdom generally do obtain such written representations for all significant contingent liabilities.
- Although it is the predominant practice in the United Kingdom, there is currently no auditing guideline advising the auditor to perform procedures to identify and disclose related-party transactions. However, the Act requires disclosure of certain transactions with specific related parties (for example, subsidiaries, directors, and persons closely connected with directors, as defined by the Act).

- The principal auditor in the United Kingdom is fully responsible for an opinion on consolidated financial statements that include the statements of subsidiary or other components audited by another auditor. There can be no division of responsibility by referring to an examination by other auditors.

39. Matters similar to those discussed in the general standards in the United States are covered in the United Kingdom by the Auditing Guidelines, the *Guide to Professional Ethics*, and by the audit regulations and guidance as follows:

- Auditing Guideline 201, *Planning, Controlling and Recording*, directs that work is allocated to audit staff who have appropriate training, experience, and proficiency.
- Audit Regulation 3.14 requires formal procedures to ensure that all principals and employees involved in audit work are, and continue to be, competent.
- Audit Regulation 3.02 states that a registered auditor shall not accept appointment, or continue as auditor, if the firm has any interest likely to conflict with the proper conduct of the audit.
- The Guide to Professional Ethics 1.201, Section A, requires members in public practice to be, and appear to be, independent.

40. Although the auditing standards do not expressly require the exercise of due professional care in the exercise of an audit, the fundamental principles in the *Guide to Professional Ethics* require members to carry out their professional work with due skill, care, diligence, and expedition.

41. The explanatory notes included in the *Guide to Professional Ethics* state that a firm should not participate in the preparation of the accounts or accounting records of a public company audit client except in exceptional circumstances. The notes permit a practice unit to participate in the preparation of the accounting records of a private company audit client but require that particular care be taken to ensure that the client accepts full responsibility for the records and that objectivity is not impaired in carrying out the audit.

Standards of Fieldwork

42. United Kingdom Auditing Standard 101, *The Auditor's Operational Standard*, sets out the following standards of fieldwork that apply whenever an audit is performed:

- The auditor should adequately plan, control, and record his or her work.
- The auditor should review the enterprise's system of recording and processing transactions and assess its adequacy as a basis for the preparation of financial statements.
- The auditor should obtain relevant and reliable audit evidence sufficient to draw reasonable conclusions therefrom.
- If the auditor wishes to place reliance on any internal controls he or she should review or evaluate those controls and perform compliance tests on their operation.
- The auditor should carry out such a review of the financial statements as is sufficient, in conjunction with the conclusions drawn from the other audit evidence obtained, to give him or her a reasonable basis for an opinion on the financial statements.

43. The operational Auditing Guidelines stress the importance of staff supervision and also define the objective of the study and evaluation of internal controls and the nature and quality of audit evidence.

Standards of Reporting

44. Auditors are not required to refer in their report to departures with which they concur, provided that adequate disclosure has been made in the notes to the financial statements. In addition, the Act requires the audit report to state whether the accounts have been properly prepared in accordance with the Act. Elsewhere the Act prescribes conformity with the fundamental accounting principles of going concern, consistency, prudence, accruals, and separate valuation (for example, no netting), and also requires the accounts of large companies to state that they have been prepared in accordance with applicable accounting standards.

45. The Act also requires disclosure of corresponding amounts for the prior year for items shown in the balance sheet, profit and loss statement, and notes. Those amounts are to be adjusted if necessary to achieve comparability. Adjustments should be disclosed in accordance with the Companies Act 1985. The auditor need not refer to such a change if it is disclosed in the financial statements in accordance with Financial Reporting Standard (FRS) 3, *Reporting Financial Performance.*

Standard Form of Report

46. The standard audit report is modified when the opinion is qualified, when a disclaimer of opinion is issued, or when an adverse opinion is expressed. The audit report is also modified if the company has taken advantage of the exemptions available to banking or insurance companies and to small or medium-sized companies. In such a case, no opinion need be expressed on whether the financial statements give a true and fair view, and the auditor's opinion may be restricted to confirming the compliance of the financial statements with the applicable statutory provisions.

Qualifications in Audit Reports

47. If the auditor disagrees with the client on the accounting for a particular item that does not render the financial statements totally misleading, an *except for* opinion is given. If the disagreement renders the statements totally misleading, an overall adverse opinion is given.

48. If the audit report is qualified, the Act requires the auditor in addition to state, either in the auditor's report on the financial statements or in a separate report, whether the qualification is material in determining whether a dividend may be paid. A dividend may not lawfully be paid unless the auditor makes this statement.

Dating of Audit Reports

49. Statement of Standard Accounting Practice (SSAP) 17, *Accounting for Post Balance Sheet Events,* states that the date that a company's accounts are approved by the board of directors should be disclosed in the financial statements. In the United Kingdom, the auditor's report is usually signed and dated on the same date that, or immediately after, the accounts have been approved, which will be subsequent to the completion of fieldwork.

Other Auditors

50. In the United Kingdom the auditors of a parent company are held fully responsible for their opinion on a consolidated financial statement, and accordingly should not refer to the fact that

certain subsidiaries or associated companies have been audited by other auditors.

51. The concept of *joint auditors* is defined as when two auditors jointly audit a company's financial statements and jointly sign the opinion.

3

Accounting Principles and Practices

SOURCES OF ACCOUNTING PRINCIPLES

52. Accounting principles derive from both the Companies Act 1985 as amended by the Companies Act 1989 (the Act) and the series of Statements of Standard Accounting Practice (SSAPs) issued by the Accounting Standards Committee (ASC) and Financial Reporting Standards (FRSs) issued by its successor, the Accounting Standards Board (ASB), collectively known as accounting standards. Although the Act applies only to companies incorporated thereunder, accounting standards apply to all financial statements intended to give a true and fair view of a reporting entity's financial position and profit and loss. The Act specifically refers to the following fundamental principles: going concern; consistent application of accounting policies; prudence; the accruals concept; and the separate valuation of assets, liabilities, income, and expenditure. The Act requires large companies to state whether the financial statements have been prepared in accordance with applicable accounting standards and give particulars of, and reasons for, any departure.

FORM AND CONTENT OF FINANCIAL STATEMENTS

Presentation of Statements

53. The directors of a company are required by the Companies Act 1985 to submit a directors' report and audited financial state-

ments (accounts) to the shareholders for their approval at the annual general meeting. The directors are additionally required to file such statements (or abbreviated accounts in the case of small or medium-sized companies) with the Registrar of Companies within seven months of the company's year-end for a public company and within ten months for a private company. For a listed public company, the London Stock Exchange (the Stock Exchange) requires published annual accounts within six months of the company's year end, as well as interim (semiannual) unaudited statements within four months of the end of the interim period.

54. The directors' report contains the directors' view of the company's affairs, and the Act requires the following matters to be disclosed:

a. Principal activities of the company and its subsidiaries
b. Review of the development of the business of the company (and subsidiaries) during the year and its position at the year end
c. Particulars of important post-balance sheet events affecting the company or any subsidiary
d. Future developments in the business of the company (and subsidiaries)
e. Research and development activities
f. Recommended dividend
g. Proposed transfers to reserves
h. Details of significant changes in fixed assets and of significant differences between book amount and market value of land and buildings
i. Names of directors and their interests in shares, debentures, and options of the company or any subsidiary
j. – Company policy concerning the recruitment, training, and promotion of disabled employees
– Arrangements to inform and consult employees on matters affecting their interests
k. Political and charitable donations
l. Details of treasury shares acquired by the company
m. Details of insurance in effect for officers or auditors against liabilities in relation to the company

The Act requires the directors' report to be approved by the board of directors and signed by a director or the secretary.

55. Listed companies reporting after June 30, 1993, are required by the Stock Exchange to conform to the Code of Best Practice on Financial Aspects of Corporate Governance (generally known as the Cadbury Report) and include statements by the directors about—

- Their compliance with the code, with the identity and reasons for any areas of noncompliance.
- Their responsibility for preparing the financial statements.

56. The Act requires a company to select one of two alternative formats for the balance sheet and one of four formats for the profit and loss statement but, once adopted, these must be used consistently and may only be changed in special circumstances with appropriate disclosure of the change. The Act additionally requires comparative information for items in the balance sheet, profit and loss statement, and notes to the financial statements (but not for changes in reserves or fixed assets).

57. The Act does not require a statement of changes in financial position. However, Financial Reporting Standard (FRS) 1, *Cash Flow Statements*, requires companies to present a cash flow statement. Excluded from this requirement are—

- *Small companies*, as defined in paragraph 33.
- Wholly-owned subsidiaries of companies incorporated in a member state of the European Community provided that company publishes, in English, consolidated financial statements (including a cash flow statement) that include the subsidiary concerned.
- Buildings societies (residential mortgage companies).
- Mutual life assurance companies.

Types of Statements

58. The annual financial statements presented to the shareholders must comply with the Companies Act 1985 and with accounting standards. However, certain small and medium-sized companies may file *abbreviated accounts* with the Registrar of Companies. The abbreviated accounts for a qualifying small company consist of a balance sheet, abridged notes, a special declaration by

the directors, and a special audit report—but no profit and loss statement, cash flow statement, or directors' report. A qualifying medium-sized company may present a profit and loss statement beginning with gross profit (thereby omitting sales and cost of sales), so long as it indicates that the accounts are abbreviated and presents all other information required of other companies.

59. A company with subsidiary operations is required by the Act to file consolidated statements. The Act requires the parent company's balance sheet to be presented with the consolidated statements, but a separate profit and loss statement for the parent company is not required, provided this omission is disclosed in the notes to the statements and the notes also indicate the amount of the consolidated profit or loss for the financial year attributable to the parent.

60. The Act grants exemption from preparing consolidated statements to groups that qualify as medium-sized or small groups. The Act also exempts a United Kingdom intermediate holding company that is wholly owned (or majority owned, subject to conditions) by another company incorporated within a member state of the European Community from the obligation to prepare group statements.

61. FRS 2, *Accounting for Subsidiary Undertakings*, imposes more stringent conditions than the Act and, apart from the exemptions mentioned above, requires all subsidiary operations to be consolidated, except where one of the following applies:

- Severe long-term restrictions substantially hinder the exercise of the parent's rights over the subsidiary.
- Control is intended to be temporary and the subsidiary has not previously been consolidated.
- The subsidiary's activities are so different from the rest of the group that its inclusion would be incompatible with the obligation to give a true and fair view.

62. The main thrust of both the Act and FRS 2 is that a parent-subsidiary relationship exists where the parent has control; in other words, it is capable of directing the financial and operating activities of the subsidiary with a view to gaining economic benefits from its activities. Control exists where a parent meets one of the following criteria:

- It holds a majority of the voting rights in the subsidiary
- It is a shareholder of the subsidiary and has the right to appoint or remove the majority of its Board of Directors
- It has the right to exercise a dominant influence over the subsidiary
- It is a shareholder of the subsidiary and controls alone, pursuant to an agreement with other shareholders or members, a majority of the voting rights in the subsidiary
- It has a participating interest in the subsidiary and—
  - Actually exercises a dominant influence over that subsidiary.
  - It and the subsidiary are managed on a unified basis.

63. When a subsidiary is not included in a company's consolidated statements, disclosure is required of the name of the subsidiary, its country of incorporation, the reason why the company is not consolidated, details of the parent company's shareholdings in the subsidiary, and details of the subsidiary's profit or loss for the year and the aggregate amount of its capital and reserves. In addition, disclosure is required of the aggregate investment in the subsidiary under the equity method of accounting and any material qualifications in the audit report on the subsidiary's financial statements. If any of this information is not available, that fact must be disclosed. Subsidiaries must disclose details of the ultimate holding company and also of the largest and smallest group in which its results are consolidated.

64. FRS 3, *Reporting Financial Performance*, provides a true and fair view of a reporting entity's financial position and profit or loss for a period (including not-for-profit organizations). The key features of the standard are—

- Changes in the presentation of the profit and loss statement to a new layered format to highlight—
  - Results of continuing operations, showing separately the results of acquisitions.
  - Results of discontinued operations.
  - Profits or losses on sale or termination of an operation, costs of a fundamental reorganization or restructuring, and profits or losses on the disposal of fixed assets.
  - Extraordinary items.
- A new primary statement giving the total of all gains and losses recognized in the year.

- Earnings per share to be calculated on profit attributable to equity shareholders, after extraordinary items, minority interests, preference dividends, etc.
- Profits or losses on disposal of fixed assets calculated by reference to net carrying value.
- A memorandum note of historical cost profit or loss to show the effect, if material, on the reported profit or losses of previous revaluations of disposed assets.

65. The standard also changes the way in which entities account for decisions to sell or terminate an operation. If, at the balance sheet date, there is no binding agreement to sell or terminate an operation, no provision can be made for any associated direct costs or for ongoing operating losses up to the eventual date of disposal or closing.

66. The new primary statement of total recognized gains and losses highlights those gains and losses attributable to shareholders that are recognized in the period. It will effectively show the change in net assets, excluding any capital raised from or repaid to shareholders in the period. A reconciliation of the opening and closing totals in shareholders' funds for the period must be given in the notes to the financial statements.

67. Comparative figures are required for all items in the primary statements and in the notes.

SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES AND COMPARISON WITH UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

Historical Cost Accounting Rules

68. The Companies Act requires assets to be recorded according to specified historical cost principles or alternative accounting rules (which are based on valuations). A company may choose—

a. To record all assets on the historical cost basis.

b. To record some on the historical cost basis and some on a valuation basis.

c. To record all assets on a valuation basis.

United Kingdom companies commonly adopt the second alternative.

69. The Act defines a fixed asset as one intended for use on a continuing basis in the company's activities. Any asset that is not a fixed asset is a current asset. A classification as current does not necessarily imply that the asset will be realized within the operating cycle of the business but, in the case of receivables, amounts falling due after one year must be disclosed.

70. The historical cost rules require all fixed assets with a limited useful economic life to be carried at purchase price or production cost, less provisions for any permanent diminution in value, and to be systematically depreciated over their useful economic life. Any fixed asset must be written down if a permanent diminution in value has occurred, regardless of whether or not its useful economic life is limited.

71. Current assets must be valued under the historical cost rules at production cost or purchase price, or net realizable value if this is lower. Loss provisions (reserves) no longer required must be reversed.

Alternative Accounting Rules

72. The alternative accounting rules permit inventories, investments, tangible fixed assets, and intangible fixed assets (other than goodwill) to be stated at values in excess of cost as follows:

- *Current cost*—Intangible fixed assets (other than goodwill), tangible fixed assets, inventories, and investments classified as current assets may be valued at current cost.
- *Market value*—Tangible fixed assets and investments classified as fixed assets may be stated at market value. The amount to be used is the value as of the date of the last valuation.
- *Equity method*—Investments in or by subsidiaries or in associated companies may be valued under the equity method. Under this method, the investment is shown in the group balance sheet at cost plus the attributable share of post acquisition changes in capital and reserves, less any amounts written off. Group profit and loss statements are credited (or debited) with the appropriate proportion of profit or loss as well as the same proportion of taxation and extraordinary items.
- *Other*—Investments classified as fixed assets may be valued on any other basis that appears to the directors to be appropriate to the

company's circumstances, provided that the method and reasons for choosing it are disclosed.

73. The effect of the alternative accounting rules is to allow companies to continue the existing practice of incorporating intermittent piecemeal revaluations (primarily of fixed assets such as property) in historical cost accounts. Any deficit or surplus arising on a revaluation must be accounted for through the *revaluation reserve*. Once fixed assets have been revalued, the Act requires depreciation to be based on the revalued amount. The Act also requires disclosure of the items valued by the alternative accounting rules, the valuation method used and, except in the case of inventories, the cost and accumulated depreciation that would be reported for the items under the historical cost rules.

Inventory

74. When inventory (referred to as *stocks*) is stated on the statutory historical cost basis, it is valued at the lower of cost or net realizable value on a first-in, first-out (FIFO) basis or average cost basis. The last-in, first-out (LIFO) method of pricing inventories is generally not used, because it is not permitted for tax purposes or by SSAP 9, *Stocks and Long-term Contracts.*

Investment Properties

75. SSAP 19, *Accounting for Investment Properties*, defines investment property as an interest in land or buildings held for investment purposes where construction and development are substantially complete. Property owned and occupied by a company for its own use or rental to another of the same group is not treated as an investment property. It is assumed that any rental income is negotiated at arm's length. The SSAP provides that investment properties be carried at market value and not depreciated, except for properties with short leases. Changes in value should be disclosed as changes in the revaluation reserve; however, if a decrease in value of investment properties exceeds the total in the investment revaluation reserve, the excess should be charged in the profit and loss statement.

Investments

76. The Companies Act requires investments to be treated as either fixed or current assets. Those treated as fixed assets generally

include subsidiaries, associated companies, and other investments held long term. An associated company is a business that is not a subsidiary of the investor company, the investor has a participating interest and in which it exercises significant influence over its operating and financial policy. When a company holds 20 percent or more of the voting rights in another company, it is presumed to exercise such an influence unless the contrary can be shown.

77. Investments classified as fixed assets are permitted by the Act to be valued according to either the historical cost rules or the alternative valuation rules. In the United Kingdom, investments in subsidiaries and associated companies are generally carried in the investor company's own financial statements at cost less any allowance required for any permanent impairment in value.

Receivables

78. The valuation rules for current assets apply to receivables (referred to as *debtors*). There is no requirement to disclose the amount of provisions for discounts, allowances, or doubtful debts unless the amounts are of special significance. To the extent that a provision for bad debts is not for specific doubtful items, it will not be deductible for tax purposes. There is no explicit requirement to impute interest on receivables and it is not customary to do so.

79. With certain exceptions, the Act prohibits a company from providing its directors with loans or other forms of credit. Credit may be extended to employees in certain cases. Detailed disclosure is generally required in the notes to the financial statements.

Acquisitions and Mergers

80. The Companies Act 1985 as amended by the Companies Act 1989 requires that all acquisitions of subsidiary operations are to be accounted for by the acquisition (purchase) method unless the conditions for using the merger (pooling of interests) method are met. The merger conditions are:

a. At least 90 percent of the nominal value of the relevant shares in the company acquired is held by or on behalf of the parent company and its subsidiaries (for this purpose, *relevant shares* means shares carrying unrestricted rights to participate both in distributions and in the assets of the company upon liquidation).

b. The parent company's proportion of the nominal value of the relevant shares in the company acquired was attained as a result of an arrangement providing for the issue of equity shares by the parent company or one or more of its subsidiaries.

c. The fair value of any consideration other than the issue of equity shares given under that arrangement did not exceed 10 percent of the nominal value of the equity shares issued.

81. The acquisition method of accounting requires that the identifiable assets and liabilities of the company acquired be included in the consolidated balance sheet at their fair values as of the date of acquisition. For this purpose, identifiable assets and liabilities are those that can be disposed of separately without disposing of the company. Results of operations of a company acquired are included in the group accounts only from the date of acquisition. The acquisition cost of the shares of the acquired company held by the parent is matched against the capital and reserves of the company acquired (as adjusted for fair values) and the difference treated as goodwill.

82. Where the conditions for pooling of interests accounting are met, the acquirer need not record the shares issued at their fair value or record any premium on those shares in a share premium account.

83. SSAP 23, *Accounting for Acquisitions and Mergers*, which applies only to consolidated statements, is in certain respects more restrictive than the legal criteria and states that pooling of interests may be adopted only under the following circumstances:

a. The combination results from an offer to the holders of all equity and voting shares.

b. The offer results in at least a 90 percent holding in the offerees' equity and voting shares.

c. At least 90 percent of the fair value of the total consideration given for the equity capital is in the form of the offeror's equity.

d. Prior to the offer, the offeror did not hold more than 20 percent of the offerees' equity and voting shares.

84. Pooling of interests accounting requires that the assets and liabilities of the subsidiary need not be adjusted to fair value either in its own books or in consolidation (although appropriate adjust-

ments should be made to achieve uniformity of accounting policies between the combining companies). The subsidiary's assets and liabilities are to be included in the consolidated balance sheet at their carrying value, and the profits or losses of a subsidiary are brought into the group accounts for the entire accounting period during which the merger occurred without any adjustment for the period prior to the merger. Corresponding figures are restated by including the results of the subsidiary for the previous period and its balance sheet for the previous balance sheet date.

85. If the SSAP 23 criteria are not met, pooling of interests accounting should not be adopted. If the criteria are met, pooling of interest accounting is permitted, but not required. A company may use both pooling of interests accounting and acquisition accounting for different acquisitions in the same period.

Goodwill

86. The alternative accounting treatment permitted for intangible fixed assets in the United Kingdom, for example, revaluation, does not apply to goodwill. SSAP 22, *Accounting for Goodwill*, provides that purchased goodwill be valued as the difference between the fair value of the consideration given and the aggregate of the fair values of the separable net assets (including separable intangibles) acquired. Purchased goodwill should not be carried in the balance sheet as a permanent item but should normally be eliminated immediately on acquisition against equity (*immediate write-off*). Any excess of the aggregate of the fair values of the separable net assets acquired over the fair value of the consideration given (negative goodwill) should be credited directly to equity.

87. Alternatively, SSAP 22 states that purchased goodwill (other than negative goodwill) may be capitalized and amortized through the profit and loss accounts over its useful economic life. If goodwill is capitalized, it should not be revalued. The useful economic life should be estimated at the time of acquisition and the estimate may be subsequently shortened but not increased. A company may use both the immediate write-off and the capitalization methods for goodwill arising in different acquisitions.

88. Urgent Issues Task Force (UITF) Abstract 3, *Treatment of Goodwill on Disposal of a Business*, requires that, on the disposal of

a previously acquired business, any material amounts of purchased goodwill attributable to that business that have not impacted the profit and loss account (in other words, goodwill that was debited or credited directly to reserves) be reinstated and taken into account in arriving at the profit or loss on disposal to be shown in the consolidated profit and loss statement.

Research and Development Costs

89. The Act prohibits capitalization of research costs but permits capitalization of development costs in *special cases* (which the Act does not define), provided that a note explains the write-off period and the reasons for capitalization. The Act further provides that, in calculating the amount of the distributable profit, capitalized development costs be treated as a charge against distributable profits, unless the directors consider that special circumstances exist making this inappropriate, and disclose and justify the accounting treatment adopted. Compliance with SSAP 13, *Accounting for Research and Development*, would normally be an adequate justification.

90. SSAP 13 requires the cost of fixed assets, acquired or constructed to provide facilities for research and development activities over a number of accounting periods, to be capitalized and written off over their useful lives. Research expenses should be written off in the year of expenditure. Development expenses should be written off in the year of expenditure except in the following circumstances, when they may be deferred if recovery of costs is reasonably ensured:

a. A clearly defined project exists.
b. The related expenditure is clearly identifiable.
c. The technical feasibility and commercial viability are reasonably certain.
d. Further development costs on the same project (and related costs) are reasonably expected to be covered by related future revenue.
e. Adequate working capital exists to enable completion of the project.

91. If development costs are deferred to future periods, they should be disclosed separately and amortized systematically, commencing with the commercial production of the project or process. SSAP 13 states that deferred development expenses should be reviewed at the end of each accounting period. If the circumstances

that have justified the deferral of the expenditure no longer apply, or are considered doubtful, the expenditure should be written off immediately to the extent that it is not considered to be recoverable.

Leases

92. The Companies Act 1985 does not specifically refer to leases other than in the context of disclosure concerning leasehold property. SSAP 21, *Accounting for Leases and Hire Purchase Contracts,* divides leases into two categories—finance leases and operating leases—and specifies the accounting and disclosure requirements for each.

93. SSAP 21 defines finance leases as those that transfer substantially all the risks and rewards of ownership to the lessee. All other leases are operating leases. Because most leases in the United Kingdom covering land and buildings have regular rent reviews that provide for the adjustment of rentals to market values, they are not, in substance, financing transactions and are treated as operating leases.

94. Assets acquired under a finance lease should be shown in the lessee's accounts as a separate subdivision of fixed assets and depreciated over the shorter of the lease term—which includes all periods for which the lessee has the option to renew the lease when it is reasonably certain at the inception of the lease that the lessee will renew—or their useful life. The obligation to pay future rentals to the lessor should be shown as a liability. At the start of the lease, the amount of the asset and the liability will normally be the fair value of the asset or the present value of the minimum lease payments, discounted at the interest rate implicit in the lease. Rental payments should be apportioned between interest and principal repayments. The interest on the liability should be calculated in order to produce an approximately consistent rate of interest on the balance owed to the lessor.

95. The rentals under an operating lease should be charged in the profit and loss statement on a straight line basis over the lease term, even if the payments are not made on such a basis, unless another systematic and rational method is more appropriate.

96. Finance leases should be treated in the lessor's accounts as a receivable from the lessee at the net investment in the lease, less provisions for bad debts. The net investment is the gross investment in

the lease (the total of the minimum lease payments and any unguaranteed residual value accruing to the lessor) less gross earnings allocated to future periods. The interest on the receivable should be disclosed separately in the profit and loss statement.

97. A lessor should show operating lease assets as fixed assets and should depreciate them over their useful lives. Rental income from operating leases, excluding charges for services such as insurance and maintenance, should be recognized on a straight line basis over the period of the lease and be shown separately in the profit and loss statement or notes.

98. Lessees should disclose the following:

- Gross amounts of assets held under finance leases (and accumulated depreciation) by each major class of asset
- Obligations related to finance leases (net of finance charges allocated to future periods) separately identified
- Finance lease obligations payable in the next year, in years two to five, and aggregate thereafter
- Aggregate finance charges allocated for finance leases
- Total operating lease rentals charged in period
- Commitments under operating leases due within the next year, in years two to five, and thereafter (showing commitments of land and building leases separate from other operating leases)
- Accounting policies adopted for finance and operating leases

99. Lessors should disclose the following:

- The net investment in finance leases and hire purchase contracts at each balance sheet date
- The gross amounts of assets held for use in operating leases and the related accumulated depreciation
- The accounting policies adopted for operating and finance leases
- The aggregate rentals receivable for finance and operating leases

Taxation

100. Corporation tax is charged at a single rate on a company's income whether distributed or not and, in the absence of a dividend, the entire tax is payable on a date that may be nine months or more after the end of the relevant accounting period. When a company

makes a distribution to shareholders in an accounting period, it is required to make an advanced payment of corporation tax. This Advance Corporation Tax (ACT) will normally be offset against the company's total liability for corporation tax on its income of the same accounting period. The resultant net liability is known as the mainstream corporation tax. The charge for corporation tax therefore comprises the mainstream corporation tax and the ACT.

101. SSAP 8, *The Treatment of Taxation under the Imputation System in the Accounts of Companies*, requires the following items to be included in the taxation charge in the profit and loss statement and, if material, to be separately disclosed:

a. The amount of United Kingdom corporation tax specifying—
   - The charge for corporation tax on the income for the year
   - Transfers between the deferred taxation account and the profit and loss statement
   - The relief for overseas taxation

b. The total overseas taxation

c. Tax attributable to franked investment income (excess of dividends received from United Kingdom companies over dividends paid)

102. SSAP 8 defines recoverable ACT as that amount of the ACT paid or payable on dividends paid or proposed that can either be offset against the corporation tax liability on the profits of current or prior periods or against a credit balance in the deferred tax account, or that is expected to be recoverable taking into account expected profits and dividends (normally for the next period only). Unrecoverable ACT is the ACT paid or payable on paid or proposed dividends that do not meet the definition of recoverable ACT.

103. SSAP 15, *Accounting for Deferred Tax*, states that deferred tax should be calculated under the liability method only to the extent that it is probable that a tax asset or liability will materialize. The assessment of whether a tax asset or liability will materialize should be based on reasonable assumptions that take into account relevant information up to the date on which the financial statements are approved by the Board of Directors, as well as the intentions of management. A prudent view should be taken. SSAP 15 also states that deferred tax liabilities should be reduced by any deferred tax

debit balances arising from timing differences or ACT that are available for offset against those liabilities. Generally, deferred tax debit balances may not be carried forward as assets.

104. Deferred tax on the ordinary activities of a company is shown as a separate component of the tax provision on the profit from ordinary activities. The amount of any unprovided deferred tax is disclosed in a note.

105. The Companies Act 1985 requires disclosure of the following:

- The basis of computing United Kingdom income and corporation tax
- The amount of United Kingdom corporation tax, related double tax relief (foreign tax credits), and foreign tax
- Separate details of the foregoing that relate to extraordinary items
- Provisions for tax other than deferred tax
- The amount of unprovided deferred taxation and the tax treatment of items credited or debited to the revaluation reserve

Dividends

106. A dividend for a year that has been proposed but not yet approved is reported as a current liability at the end of that year, even if the dividend was proposed subsequent to the year end. Stock dividends (bonus issues) are reported by transferring to share capital an amount equal to the par value of the shares distributed. The amount can be transferred from the share premium account, the revaluation reserve, the capital redemption reserve, or retained profits.

Pension Costs

107. Although the Companies Act 1985 requires disclosure of pension costs in financial statements, it does not specify the accounting treatment. This is addressed by SSAP 24, *Accounting for Pension Costs.* SSAP 24 applies to all pension plans whether contractual or arising out of customary practice, whether funded or unfunded, and whether defined contribution or defined benefit. The accounting objective is that the employer should recognize the

expected cost of providing pensions on a systematic and rational basis over the period during which it derives benefit from the employees' services.

108. The following disclosures should be made with respect to a defined contribution plan:

a. The nature of the plan (that is, defined contribution)
b. The accounting policy
c. The pension cost charge for the period
d. Any outstanding or prepaid contributions at the balance sheet date

109. The following disclosures should be made with respect to a defined benefit plan:

a. The nature of the plan (that is, defined benefit)
b. Whether it is funded or unfunded
c. The accounting policy and, if different, the funding policy
d. Whether the pension cost and provision (or assets) are assessed in accordance with the advice of a professionally qualified actuary and, if so, the date of the most recent formal actuarial valuation or later formal review used for this purpose; if the actuary is an employee or officer of the reporting company, or of the group of which it is a member, this fact should be disclosed
e. The pension cost charged for the period and explanations of significant changes in the charge compared with the previous period
f. Any provisions or prepayments in the balance sheet resulting from a difference between the amounts recognized as cost and the amounts funded or paid directly
g. The amount of any deficiency on a current funding level basis, indicating the action being taken to address it in the current and future accounting periods
h. An outline of the results of the most recent formal actuarial valuation or later formal review of the plan on an ongoing basis; this should include disclosure of the actuarial method used and a brief description of the main actuarial assumptions, the market value of plan assets on the date of their valuation or review, the level of funding expressed in percentage terms, and comments on

any material actuarial surplus or deficiency or any commitment to make additional payments over a limited number of years

i. The accounting treatment adopted for any refund made to the employer

j. Details of the expected effects on future costs of any material changes in the group's and/or company's pension arrangements

110. When a company or group has more than one pension plan, disclosure should be on a combined basis unless disclosure of information about individual plans is necessary for a proper understanding of the statements.

Accounting Changes

111. FRS 3, *Reporting Financial Performance*, requires items representing corrections and adjustments of accounting estimates in prior years to be included in the profit and loss statement of the period in which they are identified.

112. Prior-period adjustments are restricted to material items involving—

- Correction of fundamental errors in the financial statements of prior periods.
- Changes in accounting policies.

Prior-period adjustments are accounted for by restating prior periods, with the result that the opening balance of retained earnings will be adjusted accordingly and highlighted in the reconciliation of changes in shareholders' equity and also noted in the statement of recognized gains and losses.

113. SSAP 12, *Accounting for Depreciation*, specifies the treatment when a company changes from one method of depreciation to another. It states that unamortized costs of the asset should be depreciated over the remaining useful life on the new basis, commencing with the period in which the change is made.

Related-Party Transactions

114. *Related parties* is not a defined term in the United Kingdom. The Act distinguishes holding, subsidiary, and associated companies and requires subsidiaries to be identified. The Act also requires year-end balances with all these companies to be disclosed, but not

details of transactions during the year unless they concern security given or other financial commitments. It requires disclosure of ultimate holding companies but no details of transactions with them. The Act identifies directors, persons connected with them, and nondirector officers, and prescribes various disclosures of either year-end balances or transactions during the year or both. The London Stock Exchange defines and requires disclosure of certain transactions with substantial corporate shareholders. The Companies Act requires shareholders whose holdings exceed 3 percent to be identified, but not transactions with them.

Inflation Accounting

115. There is no statutory requirement to indicate the impact of inflation on a company's financial performance. The Accounting Standards Committee produced a number of proposals embracing both the current purchasing power method and current cost accounting (CCA). Both proved unpopular in practice and have been withdrawn. However, certain companies, such as gas, electricity, and water companies, continue to publish statements on a CCA basis as supplementary information accompanying their annual historical cost financial statements.

116. Where a subsidiary operates in a hyperinflationary economy (defined as approaching or exceeding 100 percent over three years) and those operations are material in the context of group results or net assets, SSAP 20, *Foreign Currency Translation*, requires adjustments to be made to eliminate any distortion caused by hyperinflation and disclosure of the accounting policy adopted.

Foreign Currency Translation

117. SSAP 20 requires individual companies to record transactions at one of the following:

a. Actual (or average) rates of exchange
b. The contracted rates of exchange at which the transactions are to be settled
c. The rates of exchange specified in matching forward contracts

118. The carrying amount of nonmonetary assets acquired in foreign currency transactions should not normally be adjusted to reflect the current exchange rate at the balance sheet date. Monetary

items denominated in a foreign currency should be adjusted to reflect the current exchange rate at the balance sheet date or, if appropriate, should be translated at the rates specified in the relevant contract.

119. All exchange differences should be included as part of the profit or loss for the period from ordinary activities, unless they arise as a result of events that are themselves treated as extraordinary, in which case they should be included as part of such items. This treatment should be adopted for all monetary items irrespective of whether they are short term or long term or whether the exchange differences are gains or losses. Exchange gains or losses on balances resulting from intragroup transactions should be treated in the same way as third-party transactions.

120. When foreign and equity investments have been financed by foreign currency borrowings or when borrowings have been taken out to hedge the exchange risks associated with existing equity investments, companies should (subject to certain conditions) offset translation gains or losses within shareholders' equity.

121. In translating foreign currency financial statements, in most circumstances the *closing rate/net investment method* should be used, in which—

a. Amounts in the subsidiary's balance sheet are translated at the current exchange rate on the balance sheet date, and any difference between the parent's net investment in its subsidiary translated at the current exchange rates at the beginning and end of the year is transferred to (or from) shareholders' equity.

b. The subsidiary's profits or losses are translated at an average rate for the period or the current exchange rate on the balance sheet date. If an average rate is used, any difference between the average and the closing rate is transferred to shareholders' equity.

c. Subject to certain limitations, exchange gains or losses on foreign currency borrowings used to finance or hedge an investment in a foreign enterprise may be offset in shareholders' equity against the exchange differences on the net investment.

122. The Companies Act 1985 and SSAP 20 require the methods used in the translation of foreign enterprises and the treatment

accorded to exchange differences to be disclosed in the accounts. Disclosure of foreign currency restrictions is also required.

Capitalization of Interest

123. The Act permits the production costs of both fixed and current assets to include interest on capital borrowed to finance the production of the asset concerned (provided certain disclosures are made).

Accounting for Contracts

124. Under SSAP 9, *Stocks and Long-Term Contracts,* profit is recognized as work progresses (the percentage of completion method) for long-term contracts. For short-term contracts, profit is recognized at the end of the contract (the completed contract method).

Earnings per Share

125. The basic earnings per share under SSAP 3, *Earnings Per Share,* do not include potentially dilutive securities that are, in substance, equivalent to common stock, and that are required to be included in primary earnings per share in the United States. However, where there is a significant level of potentially dilutive securities, a fully diluted earnings per share figure must be given.

Segmental Reporting

126. The Companies Act 1985 requires companies to provide a geographical analysis of sales by market, together with an analysis of sales and profit before tax by class of business. This information need not be disclosed if the directors consider that it would be seriously prejudicial to the interest of the company.

127. SSAP 25, *Segmental Reporting,* requires public limited companies, banking and insurance companies, and private companies that exceed ten times the criteria for medium-sized companies to disclose the following for each class of business and geographical segment:

a. Sales.

b. Operating results before taxation.

c. Net assets.

128. All companies should also disclose a geographical analysis of sales by origin and sales to third parties by destination. Where the reporting company has associated companies that account for more than 20 percent of its total profit or 20 percent of its total net assets the following segmental information should also be disclosed:

a. Aggregate share of results of associated companies before taxation, minority interests, and extraordinary items

b. Aggregate share of net assets of associated companies

Such information need not be disclosed if it is unobtainable or prejudicial to the business of the associate, but the reason for non-disclosure should be stated.

4

Business Environment

FORMS OF BUSINESS ORGANIZATION

Entities With Corporate Attributes

129. The forms of business organization that exist in the United States are also found in the United Kingdom. Although there are certain differences, the sole proprietorship, the partnership, and the limited liability company (or corporation) are generally similar.

130. With the exception of certain special types of company—such as those incorporated by Royal Charter—the formation and dissolution of all companies incorporated in the United Kingdom are controlled by the provisions of the Companies Act 1985 (the Act) and the Insolvency Act 1986.

131. Companies may be incorporated in the following ways:

- A company limited by shares, in which the liability of the shareholder (member) is limited to the amount, if any, unpaid on those shares
- A company limited by guarantee, in which the liability of a shareholder is limited to the amount the shareholder has undertaken to contribute in the event that the company goes out of business
- An unlimited company, in which the liability of a shareholder is unlimited

132. The Act distinguishes between private and public companies limited by shares. The principal restriction on a private company is a prohibition against offering shares for public subscription. A public company is not necessarily listed on the London Stock

Exchange (the Stock Exchange) and many are not, but any company with listed ordinary shares, listed preference (nonequity) shares, or listed debentures (loan stock) will always be a public company. A public company must have the words *public limited company* or the abbreviation *plc* added to the end of its name.

133. A company can become public only if it satisfies certain criteria, the most significant of which is that its share capital (par value) must be at least £50,000 (cash must be paid for at least 25 percent of par value, as well as the full amount of any share premium). Public companies are also subject to stricter requirements than private companies in the following areas:

- Payment and maintenance of capital
- Distributions
- Loans to directors
- Appointment of company secretaries
- Publication of statements
- Purchase and redemption of treasury shares
- Granting of financial assistance to third parties for the acquisition of their shares

134. A limited company normally must hold a general meeting of shareholders at least once each calendar year, but this procedure can be dispensed with if the shareholders approve (an elective resolution). The approval of the shareholders must be sought before the company can proceed with certain matters, including an increase in the authorized share capital, a change in the company's name, or alterations to the memorandum or articles of association.

135. Although a shareholder of a limited company is only liable to contribute any amount unpaid on his or her shares, a director is liable for prescribed penalties if the company is in default of its obligations under the Act. These obligations include: the preparation of financial statements giving a true and fair view of the company's (or group's) affairs, the presentation of audited financial statements and a directors' report to the shareholders at the general meeting, and the subsequent timely filing of the financial statements and directors' report with the Registrar of Companies. Directors may incur unlimited liability if the company, to their knowledge, has traded unlawfully or with intent to defraud creditors.

136. A company is required by law to establish the following:

- A share premium account (if shares are issued at a premium)
- A capital redemption reserve (if shares are purchased or redeemed out of profits)
- A reserve for its own (treasury) shares (if a public company acquires its own shares other than by purchase or redemption)
- A revaluation reserve (if assets are revalued)

These reserves are not available for distribution as dividends other than stock dividends. In addition, a company's Memorandum and Articles (charter and bylaws) may specify that profits arising in certain circumstances are not available for distribution.

Branch of a Foreign Company

137. A foreign company wishing to establish a presence in Great Britain (meaning, England, Wales, and Scotland) must first register with the Registrar of Companies as an overseas company under either the *place of business* regime or the *branch* regime, depending on the scale of the operation. There is no definition of a place of business, but it is some physical or visible evidence that an overseas company has a connection with a particular premises recognizable as the company's place of business, although transactions would be transmitted to the parent organization for processing. A branch will be organized so as to conduct business on behalf of a limited company such that a person residing in Great Britain would be able to deal directly with the branch instead of with the company in its home country.

Place of Business Regime

138. Within one month of setting up in Great Britain, the overseas company must file with the Registrar of Companies—

- A certified copy of the company's charter and bylaws (in the English language)
- A return in the prescribed form, detailing—
  - Particulars of the directors and secretary of the company.
  - The name and address of the person residing in the United Kingdom on whom legal process against the company may be served.

  – A statutory declaration by a director stating the date on which the company's place of business was established.
- The corporate name of the company.

The overseas company must notify the Registrar of any changes to the above information.

139. Overseas companies must submit copies of their annual report to the Registrar of Companies, including consolidated statements where applicable, within 13 months of their financial year end; United Kingdom branch statements only are not acceptable. The general requirement is that the statements submitted must comply with the provisions of the Companies Act 1985 applicable to United Kingdom companies subject to certain exemptions. Overseas companies are not required to publish the auditors' report; the directors' report; sales; details of United Kingdom taxation charges; details of parent, subsidiary, and associated companies; compensation paid to directors and senior employees; and loans and other transactions with directors and officers.

140. An overseas company is required to display in each place of business in the United Kingdom its name, the country under whose laws it was organized, and the fact that it is incorporated with limited liability, if that is indeed the case. The same information must also be clearly stated on all invoices and letterheads and in all notices, advertisements, and other publications of the company.

Branch Regime

141. Within one month of setting up a branch in Great Britain, an overseas company is required to file with the Registrar of Companies the following information:

- Corporate name of the company
- Its country of incorporation and, if registration is required there, its registration number and the identity of the register
- Its legal form (such as whether it is a public or private company)
- A list of the directors and secretary
- The extent of the authority of the directors to represent the company in dealings with third parties and in legal proceedings, together with a statement as to whether they may act alone or jointly and, if jointly, the name of any other person concerned

142. The company must also give the following information about the branch:

- The address
- The date it was opened
- The business activity
- The name in which the business is conducted, if different from the name of the company

Partnership Entities

143. There are two types of partnership—the ordinary partnership governed by the Partnership Act 1890 and the Limited Partnership governed by the Limited Partnership Act 1907. No partnership may have more than twenty partners unless it is either a professional partnership (such as solicitors, accountants, or stockbrokers) or is registered under the Companies Act 1989.

144. General and limited partnerships in the United Kingdom exist on bases similar to those in the United States. In a general partnership, all partners have unlimited liability and there are no capital requirements. There are no nationality requirements for partners, who may be individuals or commercial entities. No partner can limit or avoid joint and several liability for partnership debts. There are no specific accounting, auditing, or disclosure requirements, and these partnerships are not required to publish their financial statements or make them available for public inspection. The Partnership Act 1890 only requires disclosure of partnership information to the partners themselves.

145. Limited partnerships are similar to general partnerships except that in addition to general partners they include limited partners, who are liable only to the extent of their respective capital contributions provided that they take no active part in the management of the partnership business. If this condition is not met, the partner will be regarded as a general partner and his or her liability will become unlimited. There must be at least one active or general partner whose liability is unlimited.

146. Joint ventures are not regarded as separate entities. In the United Kingdom a joint venture is usually organized as a partnership or through a jointly owned company.

Other Forms of Business Organization

147. A sole proprietor (referred to in the United Kingdom as a sole trader) is an individual engaged in a business or profession on a personal account. A sole proprietor is subject to the registration requirements common to all forms of business organization, notably for value-added tax purposes. This requires certain minimum records to be maintained, but otherwise there are no requirements regarding the audit or filing of annual accounts.

REQUIREMENTS FOR PUBLIC SALES OF SECURITIES AND REQUIREMENTS FOR LISTING SECURITIES ON THE STOCK EXCHANGE

Registration Requirements for Public Sale

148. An offer to sell new securities, other than when a listing on the main market of the Stock Exchange is sought, must be accompanied by a prospectus complying with Schedule 3 of the Companies Act 1985. A prospectus must include a report by a reporting accountant on the last five years' financial statements, and the prospectus must be filed with the Registrar of Companies. The secondary market of the Stock Exchange is the Unlisted Securities Market (USM). The regulations of the USM are less onerous than those of the main market. The USM will close at the end of 1996, with no new entrants allowed after 1994.

Requirements for Listing Securities on the Stock Exchange

149. The requirements governing the listing of securities on the main market (Official List) of the Stock Exchange are detailed in the Stock Exchange's *Admission of Securities to Listing*, generally known as the Yellow Book. These rules comply with European Community Directives to harmonize the minimum requirements for listing throughout the EC.

150. An application for listing must be accompanied by a prospectus (known as Listing Particulars, which must be approved by the Stock Exchange) and include the following:

a. General information about the issue, including its history, management, and business activities
b. Financial information, including a three-year summary of the profit and loss account, balance sheet, and cash flow statements
c. Recent developments and prospects of the company (a profit forecast can, but need not, be made)
d. A statement concerning adequacy of working capital
e. A statement regarding the company's current indebtedness

151. Once a company is listed it is under a continuing obligation to publish regular information about its activities, including annual audited statements, unaudited interim statements, and unaudited preliminary announcements, as well as details of major transactions such as acquisitions or disposals of assets. The Stock Exchange has the right to suspend the listing if it considers the information inadequate or if there is a possibility of a false market developing.

152. Auditing Guideline 412, *Prospectuses and the Reporting Accountant*, provides guidance for accountants' reports prepared for inclusion in prospectuses, listing particulars, circulars, and similar documents, as well as guidance on comfort letters which the reporting accountant may be required to prepare.

SELECTED ECONOMIC DATA

153. Key demographic and social factors based on 1992 United Kingdom census data are as follows:

Area (square kilometers)	240,939
Population (in millions)	58.0
Annual population increase	0.69%
Percentage of population under age 20	25.5%
Percentage of population aged 65 and over	16%
Labor force (in millions)	27.8
Percentage of women in labor force	43.3%
Unemployed (in millions)	2.9
Number of students in universities (in thousands)	817

154. United Kingdom trading partners as of 1992 were as follows:

	Exports (£ millions)	*Imports (£ millions)*
Germany	15,213	19,034
Belgium and the Netherlands	14,218	15,649
France	11,485	12,223
Other EC countries	19,786	18,703
United States	12,387	13,822
Japan	2,231	7,442
Canada	1,584	1,897
Australia	1,377	1,014
New Zealand	265	429
Other	29,961	35,654
	108,507	125,867

155. United Kingdom export and import products as of 1992 as a percentage of total exports and imports are as follows:

	Percentage of Exports	*Percentage of Imports*
Machines and transportation	41%	37%
Manufacturing	27	32
Chemicals	14	9
Food and livestock	8	11
Energy related products	6	6
Nonconsumable raw materials	2	4
Other	2	1
	100%	100%

TAXES

Principal Types

156. The principal taxes in the United Kingdom are corporation tax, capital gains tax, value-added tax, income tax, and inheritance tax. Other taxes include the business rate (real property

tax on business premises), petroleum revenue tax, social security contributions, and the council tax.

Corporation Tax

157. Corporation tax is assessed on resident companies based on total profits (that is, income and capital gains) and on nonresident companies based on profits from sources within the United Kingdom. Resident companies include all companies incorporated in the United Kingdom.

158. The tax rate is established at the beginning of each tax year, which ends on March 31. The rate was 33 percent for the years ended March 31, 1994 and 1995.

159. A reduced rate (the small companies rate) applies to annual profits not exceeding £250,000 and £300,000 for years ended March 31, 1994 and 1995. The full rate applies to annual profits exceeding £1,250,000 and £1,500,000 for those periods. A marginal rate of 35% applies to profits between these parameters for both periods.

160. Profits subject to corporation tax are computed under three headings—trading income, investment income, and capital gains. Dividends received from United Kingdom companies carry a tax credit (representing advance corporation tax paid by the paying company). This income, termed *franked investment income* (FII), is not subject to corporation tax in the hands of the recipient company.

161. Business income is calculated for tax purposes using commercial accounting principles. It is based on company profits subject to any modifications required by law. In order to be deducted in calculations of trading income, expenditures must have been incurred wholly and exclusively for trading purposes.

162. Depreciation is not an allowable deduction in calculating taxable profits, but is replaced by tax depreciation allowances (capital allowances) at rates fixed by law. These allowances are available for capital expenditures such as industrial buildings, machinery and equipment, scientific research assets, mines and oil wells, minerals and mineral rights, agricultural or forestry buildings, and patents. Capital allowances are not normally available for nonindustrial buildings such as offices, showrooms, and retail shops, except in

certain government-designated Enterprise Zones. Allowances are not available for expenditures for goodwill, trademarks, or land.

163. The disposal of assets qualifying for capital allowances may result in an adjustment to recapture capital allowances previously claimed. If certain assets (such as land and buildings, fixed plant, or machinery) are sold at a capital gain (that is, the sale proceeds exceed the original cost as indexed to reflect inflation) and the proceeds are reinvested in replacement business assets, the gain may be deferred at the taxpayer's option by reducing the tax base cost of the new assets. If deferral is not utilized, a gain or loss on disposal of assets is treated as a capital gain or loss for corporation tax purposes.

164. Although capital losses may not be offset against taxable income or carried back, they may be carried forward indefinitely to offset future capital gains.

Advance Corporation Tax

165. A company paying a dividend must pay Advance Corporation Tax (ACT) to the Inland Revenue (the taxing authority in the United Kingdom). For the year ended April 5, 1994, the rate was 29 percent of the net payment to the shareholder. This was reduced to 25 percent for the year ending April 5, 1995. When a company both receives and pays dividends in the same financial period, ACT is payable only on the excess of dividends paid over dividends received.

Taxation of Capital Gains

166. Companies pay corporation tax on their net capital gains at the marginal corporation tax rate. Individuals pay capital gains tax on net capital gains at the individual's highest rate of tax. For individuals, the first £5,800 of capital gains per annum are exempt from taxation.

Value-Added Tax

167. The Value-Added Tax (VAT) is levied at a standard rate of 17.5 percent on all supplies of goods and services in the United Kingdom, except for zero-rated and exempt supplies. A person selling zero-rated supplies may reclaim the tax charged by suppliers.

Regardless of the nature of the supply, only registered traders may charge or reclaim VAT. A trader must register if annual taxable revenue is greater than £45,000, although there are provisions for voluntary registration.

Income Tax

168. Income tax is assessed on the total income, including capital gains, of resident individuals subject to deduction of certain personal allowances. For the year ended April 5, 1994, the first £2,500 of taxable income was taxed at 20 percent and the next £21,200 at 25 percent. All taxable income in excess of £23,700 was taxed at 40 percent. The same rates apply for the year ending April 5, 1995, except that the 20 percent band is increased to £3,000 and the 25 percent band was reduced to £20,700.

Inheritance Tax

169. Inheritance tax is charged on a United Kingdom domiciled individual's estate on death and on gifts made within seven years of death. For non-United Kingdom domiciled individuals, the tax applies to United Kingdom property only. Tax is charged at the rate of 40 percent on cumulative transfers in the last seven years in excess of £150,000. Gifts made within seven years of death are taxed at a reduced rate. Certain other lifetime gifts (for example, gifts to discretionary trusts) are also taxable. However, there is substantial relief for gifts of business assets made on or after March 10, 1992. A relief rate of 100 percent applies to interests in unincorporated businesses; holdings above 25 percent in unquoted trading companies, owner-occupied farmland; and farm tenancies. A 50-percent relief rate applies to holdings of 25 percent or less in trading companies; controlling holdings in fully quoted companies; and land or business assets owned by partners and used in their partnership or owned by controlling shareholders and used in their company.

Other Taxes

170. Business rates are levied by local authorities on the imputed annual rental value of land and buildings occupied for business purposes. Since April 1993, a Council Tax has been levied on individuals by local authorities on the imputed value of residential

property. Social Security contributions (National Insurance) are payable by both employer and employee and are calculated as a percentage of earnings up to a maximum for employees' contributions but without limit for employers' contributions. Self-employed persons also pay national insurance at a flat rate and on an earnings-related basis.

Tax Returns

171. A new system for the collection and assessment of Corporation Tax, "Pay and File," is used for accounting periods ending on or after October 1, 1993. This requires each company to pay its estimated liability nine months after the end of its accounting period. Any tax paid later will be charged interest and overpayments will be repaid with interest. Corporation tax returns will normally be required twelve months after the end of the company's accounting period, and there are automatic penalties for failure to meet the filing deadline.

172. Returns for Advance Corporation Tax (known as CT61s) are filed quarterly for March 31, June 30, September 30, and December 31. A return is also filed if the company's year end is different from the filing period. Any ACT due must be paid when the return is filed, which is due fourteen days from the end of the quarter.

173. Individuals liable for United Kingdom income tax are usually required to submit an annual return showing income for the year within thirty days after the tax form is issued by the Inland Revenue, although additional time is normally allowed. Annual returns may not be required from individuals whose only income is from employment.

APPENDIX A

Outstanding Auditing Pronouncements

Auditing Pronouncements as of November 1993 are as follows:

SAS 600 *Auditors' Report on Financial Statements*

The Auditing Practices Board also issues Practice Notes, which provide nonmandatory guidance or background information on specific topics. Two have been issued to date:

1. *Investment Businesses*
2. *The Lloyds Market*

The following Auditing Standard and Guidelines have been approved by the Auditing Practices Committee of the CCAB (the former standard setting body) and adopted by the Auditing Practices Board.

Auditing Standard

No.	Title
101	*The Auditor's Operational Standard*

Auditing Guidelines—Operational

No.	Title
201	*Planning, Controlling and Recording*
202	*Accounting Systems*
203	*Audit Evidence*
204	*Internal Controls*
205	*Review of Financial Statements*

Auditing Guidelines—Industries

No.	Title
301	*Charities*
302	*Building Societies in the United Kingdom* (revised March 1989)
303	*Trade Unions and Employers' Associations*
304	*Housing Associations*
305	*The Impact of Regulations on Public Sector Audits*
306	*Pension Schemes in the United Kingdom*
307	*Banks in the United Kingdom*
308	*Guidance for Internal Auditors*
309	*Communications between Auditors and Regulators under the Financial Services Act 1986*
310	*General Business Insurers in the United Kingdom*
311	*Life Insurers in the United Kingdom*

Auditing Guidelines—Detailed Operational

No.	Title
401	*Bank Reports for Audit Purposes*
402	*Events after the Balance-Sheet Date*
403	*Amounts Derived from the Preceding Financial Statements*
404	*Representations by Management*
405	*Attendance at Stocktaking*
406	*Engagement Letters*
407	*Auditing in a Computer Environment*
408	*Reliance on Internal Audit*
409	*Quality Control*
410	*The Auditor's Considerations in Respect of Going-Concern*
411	*Financial Information Issued with Audited Financial Statements*
412	*Prospectuses and the Reporting Accountant*
413	*Reliance on Other Specialists*
414	*Reports to Management*
415	*Group Financial Statements—Reliance on the Work of Other Auditors*
416	*Applicability to the Public Sector of Auditing Standards and Guidelines*
417	*Analytical Review*
418	*The Auditor's Responsibility in Relation to Fraud, Other Irregularities and Errors*

Auditing Guidelines—Audit Reports

No.	Title
503	*Reports by Auditors Under Company Legislation in the United Kingdom*
504	*Reports by Auditors Under Company Legislation in the Republic of Ireland*
505	*Audit Reports and Information on the Effects of Changing Prices*
506	*The Auditor's Statement on the Summary Financial Statement*

The Auditing Practices Committee has also issued the following Practice Note:

Reliance by Banks on Audited Financial Statements

The statements issued by the Institute of Chartered Accountants in England and Wales before 1981 have, until they are superseded and withdrawn, the same status as Auditing Guidelines. The following statements are still outstanding.

No.	Title
901	*Verification of Debtor Balances: Confirmation by Direct Communication*
902	*Stock in Trade and Work in Progress*
903	*The Ascertainment and Confirmation of Contingent Liabilities Arising From Pending Legal Matters*
904	*Guidance for Auditors on the Implications of Goods Sold Subject to Reservation of Title*
905	*Auditors' Reports—Registered Societies and Industrial and Provident Societies*
906	*Special Reports of Accountants*
907	*Reports on Accounts of Sole Traders and Partnerships*
908	*Accountants' Reports on Profit Forecasts*
910	*Auditors' Reports on Insurance Companies' Returns to the Department of Trade and Industry*
911	*Auditors' Relationships with Actuaries Concerning Actuarial Valuations of Long-term Business Funds of Insurance Companies.*
912	*Auditors' Responsibilities under the Insurance Companies (Accounts and Statements) Regulations 1980*

APPENDIX B

Outstanding Accounting Pronouncements

Accounting Pronouncements as of November 1993 are as follows:

Statements of Standard Accounting Practice (SSAPs)*

No.	Title	For Accounting Periods Beginning on or After
1	*Accounting for Associated Companies* (revised 1982)	January 1, 1971
2	*Disclosure of Accounting Policies*	January 1, 1972
3	*Earnings Per Share* (revised 1974 and 1992)	January 1, 1972
4	*Accounting for Government Grants* (revised 1990)	January 1, 1974
5	*Accounting for Value Added Tax*	January 1, 1974
8	*The Treatment of Taxation under the Imputation System in the Accounts of Companies* (amended 1977)	January 1, 1975
9	*Stocks and Long-term Contracts* (revised 1988)	January 1, 1976
12	*Accounting for Depreciation* (revised 1987)	January 1, 1978
13	*Accounting for Research and Development* (revised 1989)	January 1, 1978
15	*Accounting for Deferred Tax* (revised 1985 and amended 1992)	January 1, 1979
17	*Accounting for Post Balance Sheet Events*	September 1, 1980
18	*Accounting for Contingencies*	September 1, 1980
19	*Accounting for Investment Properties*	July 1, 1980
20	*Foreign Currency Translation*	April 1, 1983
21	*Accounting for Leases and Hire Purchase Contracts*	July 1, 1984

* Some SSAPs have been superseded and withdrawn.

No.	Title	For Accounting Periods Beginning on or After
22	*Accounting for Goodwill* (revised 1989)	January 1, 1985
23	*Accounting for Acquisitions and Mergers*	April 1, 1985
24	*Accounting for Pension Costs*	July 1, 1988
25	*Segmental Reporting*	July 1, 1990

Statements of Recommended Practice (SORPs)

No.	Title	For Accounting Periods Beginning on or After
1	*Pension Scheme Accounts*	May 1, 1986
2	*Accounting by Charities*	May 1, 1988

Financial Reporting Standards (FRSs)

No.	Title	For Accounting Periods Beginning on or After
1	*Cash Flow Statements*	March 23, 1992
2	*Accounting for Subsidiary Undertakings*	December 23, 1992
3	*Reporting Financial Performance*	June 22, 1993

UITF Consensus Pronouncements

No.	Abstract	Date of Issue
1	*Convertible Bonds—Supplemental Interest/Premium*	July 24, 1991
2	*Restructuring Costs*	October 31, 1991
3	*Treatment of Goodwill on Disposal of a Business*	December 19, 1991
4	*Presentation of Long-Term Debtors in Current Assets*	July 22, 1992
5	*Transfers from Current Assets to Fixed Assets*	July 22, 1992
6	*Accounting for Post-Retirement Benefits Other Than Pensions*	November 9, 1992
7	*True and Fair View Override Disclosures*	December 17, 1992
8	*Repurchase of Own Debt*	March 19, 1993
9	*Accounting for Operations in Hyperinflationary Economies*	June 9, 1993

APPENDIX C

Illustrative Auditor's Report and Financial Statements

The following financial statements are intended for illustrative purposes. The statements are not intended to include all information that United Kingdom law requires (such as the director's report).

To the Members of ABC Group PLC

We have audited the financial statements on pages [______] to [______] in accordance with Auditing Standards.

In our opinion, the financial statements give a true and fair view of the state of affairs of the company and the group at 31 March 1993 and of the profit and cash flows of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

BDO Binder
Chartered Accountants
Registered Auditor
London

26 May 1993

Accounting Policies

Basis of Accounting

The accounts have been prepared under the historical cost convention and in accordance with applicable United Kingdom Accounting Standards.

The presentation of financial information has changed compared with the 1992 annual report as a result of the adoption of accounting standards and other pronouncements in the past year, including early adoption of Financial Reporting Standard No. 3, *Reporting Financial Performance.* Prior year's figures have been restated on a comparable basis.

Basis of Consolidation

The group accounts include the accounts of the company and all of its subsidiary undertakings up to 31 March.

The group accounts include the appropriate share of associated undertakings' results and net assets based on the latest available accounts. Associated undertakings are those in which the group has a long-term investment in the voting equity and over which it exerts significant influence.

When the fair value of the consideration for an acquired company exceeds the fair value of its separable net assets, the difference is treated as goodwill on acquisition and is written off to reserves. When the fair value of the separable net assets exceeds the fair value of the consideration the difference is treated as a reserve arising in consolidation.

Tangible Fixed Assets

Tangible fixed assets are stated at cost less depreciation. Depreciation is provided on a straight line basis to write off the cost or valuation of fixed assets over their estimated useful lives at the following annual rates:

Freehold land	Nil
Freehold buildings	2.0 to 10.0 percent
Short leasehold property	Over period of lease
Plant and machinery—heavy production	6.6 percent
—other	10.0 percent
Motor vehicles	20.0 to 33.3 percent

Leases

Assets acquired under finance lease are capitalized. The interest element is charged against profits so as to produce a constant periodic rate of charge on the outstanding obligations. Depreciation is calculated to write the assets off over their expected useful lives, or over the lease terms where these are shorter. Rentals under operating leases are charged to profit and loss account as incurred.

Investments

Fixed asset investments are stated at cost less provision for permanent diminution in value.

Stocks and Work in Progress

Stocks are valued at the lower of cost or net realizable value. In the case of finished goods and work in progress, cost comprises direct materials and labor and an appropriate proportion of overhead.

Long-term contract balances are valued at costs incurred, less amounts transferred to cost of sales, and after deducting attributable payments on account and providing for foreseeable losses.

Research and Development

Development expenditure on clearly defined projects whose outcome can be assessed with reasonable certainty is capitalized and amortized over the shorter of the project life or three years. Any other research and development expenditure is written off in the period in which it is incurred.

Deferred Taxation

Provision is made for deferred taxation using the liability method on all timing differences, including those arising in relation to pension costs, to the extent that it is probable that a liability or asset will crystallize in the foreseeable future. No provision is made for any tax arising in the event of the distribution of profits retained by overseas subsidiaries and associates.

Foreign Currencies

Transactions denominated in foreign currencies are translated at the rate of exchange ruling on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the year-end exchange rates.

Exchange gains and losses arising on foreign currency borrowings used to finance subsidiary undertakings are taken to reserves to the extent that they can be offset against the exchange differences arising on the equity investment. Except as disclosed below, assets and liabilities of foreign subsidiary undertakings are translated in consolidation at the rate of exchange at the balance-sheet date and the results are translated using the average exchange rate for the period.

When it is considered that an overseas undertaking is more dependent on sterling than its own reporting currency, the financial statements of the undertaking are consolidated using the temporal method, thereby assuming that all transactions had been entered into by the undertaking itself in sterling.

Turnover

In respect of long-term contracts, turnover represents amounts transferred to cost of sales during the period plus attributed profit. Other turnover comprises the invoiced value of goods and services supplied by the group. Turnover excludes sales taxes and intragroup transactions.

Pension Costs

The group operates various pension schemes established in accordance with local conditions and practices in the countries concerned. Contributions are based on periodic actuarial calculations and are charged so as to spread the cost of pensions over the expected service lives of the employees who are members of the schemes.

GROUP PROFIT AND LOSS ACCOUNT
For the Year Ended 31 March 1993

	Notes	1993 £'000	1992 £'000
Turnover	1	748,052	830,223
Cost of sales		(617,456)	(710,206)
Gross profit		130,596	120,017
Net operating expenses	2	(98,346)	(76,411)
Operating profit		32,250	43,606
Provisions for fundamental restructuring	3	(13,000)	–
Release of provision relating to litigation in respect of former group business	3	–	5,960
Profit on ordinary activities before interest		19,250	49,566
Net interest and similar charges	4	1,802	6,456
Profit on ordinary activities before taxation		21,052	56,022
Tax on profit on ordinary activities	8	(10,884)	(14,470)
Profit on ordinary activities after taxation		10,168	41,552
Minority interests		(902)	(2,405)
Profit for the financial year		9,266	39,147
Dividends paid and proposed		(11,290)	(16,107)
Retained (loss)/profit for the financial year		(2,024)	23,040
Earnings per share—net basis	9	1.72p	8.19p
—nil basis	9	2.64p	7.50p

STATEMENT OF TOTAL RECOGNIZED GAINS AND LOSSES

	1993 *£'000*	*1992* *£'000*
Profit for the financial year	9,266	39,147
Currency translation differences on foreign currency net investments and related loans	1,176	(361)
Expenses arising on share issue	–	(1,126)
Total recognized gains and losses relating to the year	10,442	37,660

The results for 1992 have been restated as disclosed in the accounting policies.

GROUP BALANCE SHEET
As at 31 March 1993

	Notes	1993 £'000	1992 £'000
Fixed Assets			
Tangible assets	10	99,021	99,868
Investments	11	5,715	4,624
		104,736	104,492
Current Assets			
Stocks	12	36,054	31,569
Debtors—due within one year	13	158,324	148,807
—due after more than one year	13	54,114	47,443
Cash and bank balances	14	64,507	137,369
		312,999	365,188
Creditors:			
Amounts due within one year	15	(279,399)	(312,203)
Net current assets		33,600	52,985
Total assets less current liabilities		138,336	157,477
Creditors:			
Amounts due after more than one year	16	(14,018)	(18,482)
Provision for liabilities and charges		(31,437)	(36,165)
Net assets		92,881	102,830
Capital and reserves			
Called up share capital	20	53,764	53,764
Share premium account		19,262	19,262
Profit and loss account		17,735	25,709
Shareholders' funds		90,761	98,735
Minority interests		2,120	4,095
		92,881	102,830

COMPANY BALANCE SHEET
As at 31 March 1993

	Notes	1993 £'000	1992 £'000
Fixed Assets			
Investment in subsidiary undertakings		122,834	122,749
Current Assets			
Debtors — due within one year	13	41,384	23,458
— due after more than one year	13	1,717	3,405
Cash and bank balances		10	61
		43,111	26,924
Creditors:			
Amounts falling due within one year	15	(59,170)	(63,584)
Net current liabilities		(16,059)	(36,660)
Net assets		106,775	86,089
Capital and reserves			
Called up share capital	20	53,764	53,764
Share premium account		19,262	19,262
Profit and loss account		33,749	13,063
		106,775	86,089

The accounts on pages [______] to [______] were approved by the board on 26 May 1993 and signed on its behalf by:

J. White
Director

E. Potter
Director

GROUP CASH FLOW STATEMENT
For the Year Ended 31 March 1993

	Notes	1993 £'000	1993 £'000	1992 £'000	1992 £'000
Net cash flow from operating activities			(1,651)		72,613
Returns on investments and servicing of finance					
Net interest and similar charges	4	1,802		6,456	
Dividends received and other income		130		607	
Dividends paid—company		(15,591)		(14,376)	
—minorities		(2,377)		(2,451)	
			(16,036)		(9,764)
Taxation					
U.K. corporation tax paid		(9,280)		(7,154)	
Overseas tax paid		(9,607)		(3,711)	
			(18,887)		(10,865)
Investing activities					
Purchase of tangible fixed assets	10	(12,976)		(18,602)	
Purchase of associated undertakings	11	(5,100)		—	
Purchase of subsidiary undertakings		(1,278)		(24,652)	
Settlement of XYZ litigation case		(13,970)		—	
Proceeds from sale of tangible fixed assets		2,883		3,354	
Proceeds from sale of investments		242		222	
			(30,199)		(39,678)
Net cash flow before financing			(66,773)		12,306
Financing					
Issue of ordinary share capital, net of expenses		—		32,044	
Increase/(decrease) in amounts borrowed		13		(1,515)	
Decrease in finance lease creditors		(3,872)		(2,209)	
			(3,859)		28,320
Increase/(decrease) in cash and cash equivalents	14		(70,632)		40,626

(Continued on next page.)

GROUP CASH FLOW STATEMENT (*cont.*)

		1993		*1992*	
	Notes	*£'000*	*£'000*	*£'000*	*£'000*
Reconciliation of operating profit to net cash flow from operating activities:					
Operating profit			32,250		43,606
Depreciation and profit/loss on disposal of tangible fixed assets			14,803		15,164
Share of associated undertakings profit before tax			(1,998)		(724)
Other items			(113)		(418)
Decrease/(increase) in stock			(2,519)		11,622
Decrease/(increase) in debtors			(10,880)		2,155
Increase/(decrease) in creditors			(33,194)		1,208
Net cash flow from operating activities			(1,651)		72,613

NOTES TO THE ACCOUNTS

1. Segmental Information

	Year to 31 March 1993			*Year to 31 March 1992*		
	Total Sales £'000	*Intra-group Sales £'000*	*External Sales £'000*	*Total Sales £'000*	*Intra-group Sales £'000*	*External Sales £'000*
Turnover by activity:						
Manufacturing	232,603	6,070	226,533	247,631	3,612	244,019
Construction	213,071	64,661	148,410	216,928	48,230	168,698
Facilities management	172,924	10,933	161,991	178,343	3,249	175,094
Materials handling	139,807	2,549	137,258	97,073	6,239	90,834
Other	73,860	–	73,860	151,578	–	151,578
	832,265	84,213	748,052	891,553	61,330	830,223

	Year to 31 March 1993		*Year to 31 March 1992*	
	External Sales by Origin £'000	*External Sales by Destination £'000*	*External Sales by Origin £'000*	*External Sales by Destination £'000*
Turnover by geographic area:				
United Kingdom	523,850	457,785	589,170	509,985
Europe	123,117	103,527	73,343	71,268
Africa	77,034	89,931	154,403	159,292
Other	24,051	96,809	13,307	89,678
	748,052	748,052	830,223	830,223

2. Net Operating Expenses

	1993 £'000	*1992 £'000*
Distribution costs	10,163	9,338
Administrative expenses	90,272	67,555
Investments written off	—	654
Share of associated undertakings' profit before tax	(1,998)	(724)
Other operating income	(91)	(412)
	98,346	76,411

3. Exceptional Items

	1993 £'000	1992 £'000
Provisions for fundamental restructuring of the United Kingdom Manufacturing, Construction, and African Divisions	(13,000)	–
Release of provision relating to litigation in respect of former group business	–	5,960
	(13,000)	5,960

4. Net Interest and Similar Charges

	1993 £'000	1992 £'000
Interest payable and similar charges		
Loans payable within five years	(2,817)	(1,477)
Other interest including finance lease interest	(1,198)	(1,997)
	(4,015)	(3,474)
Interest receivable	5,817	9,930
	1,802	6,456
Included within interest charges are the following amounts relating to liabilities repayable after five years:		
Finance lease obligations	(282)	(28)
Loans	(113)	(112)
	(395)	(140)

5. Profit on Ordinary Activities Before Taxation

	1993 £'000	1992 £'000
Profit on ordinary activities before taxation is stated after charging/(crediting):		
Depreciation on tangible fixed assets		
Owned	11,891	12,182
Leased assets	1,601	3,676
Loss/(profit) on disposal of tangible fixed assets	1,311	(694)
Operating lease rentals		
Plant and machinery	3,359	2,970
Land and buildings	7,169	7,324
Short-term plant hire	5,558	4,169
Auditors' remuneration	552	416
Foreign exchange differences	436	172
Research and development expenditure	1,677	1,189

In addition to the amounts disclosed above the auditors were paid £26,000 in relation to nonaudit services in the United Kingdom.

6. Directors' Emoluments

	1993 £'000	1992 £'000
Emoluments in respect of directors of the company were as follows:		
Fees	116	95
Salaries, including pension contributions	1,016	1,187
Compensation for loss of office	646	–
	1,778	1,282

7. Employee Costs

	1993 £'000	1992 £'000
Particulars of employees, including executive directors, are as follows:		
Employee costs		
Wages and salaries	246,636	248,215
Social security costs	25,065	22,494
Other pension costs (note 19)	12,232	13,533
	283,933	284,242

The number of people employed by the group at 31 March 1993 was 12,184 (1992: 15,422).

8. Tax on Profit on Ordinary Activities

	1993 £'000	1992 £'000
United Kingdom corporation taxation at 33% (1992: 33%)	4,904	12,699
Less: Double taxation relief	(3,065)	(977)
	1,839	11,722
Advance corporation tax previously written off now recoverable	–	(3,267)
Advance corporation tax written off	4,946	–
Transfer from deferred taxation	(4,802)	(590)
Overseas taxation	8,225	6,334
Associated undertakings	676	271
	10,884	14,470

9. Earnings per Share

Earnings per ordinary share on the net basis has been calculated by dividing the profit for the financial year by 537,642,206 (1992: 478,127,578), ordinary shares being the weighted average number of shares in issue during the year. Earnings per ordinary share on the nil basis has been calculated as above after adjusting the profit for the financial year for advance corporation tax written off, or previously written off now recoverable.

10. Tangible Fixed Assets

	Freehold Property £'000	*Short-term Leasehold Property £'000*	*Assets Under Construction £'000*	*Plant and Machinery £'000*	*Total £'000*
Group:					
Cost					
At 1 April 1992	39,497	2,938	8,049	111,527	162,011
Exchange adjustments	1,823	(390)	1,241	3,113	5,787
Additions	1,119	16	1,617	10,224	12,976
Disposals	(25)	–	(1,648)	(5,865)	(7,538)
Reclassification	1,783	(897)	(846)	(40)	–
At 31 March 1993	44,197	1,667	8,413	118,959	173,236
Accumulated depreciation					
At 1 April 1992	(3,665)	(376)	–	(58,102)	(62,143)
Exchange adjustments	(86)	(4)	–	(1,834)	(1,924)
Charge for the year	(1,303)	(31)	(346)	(11,812)	(13,492)
Disposals	–	–	51	3,293	3,344
Reclassification	(147)	143	–	4	–
At 31 March 1993	(5,201)	(268)	(295)	(68,451)	(74,215)
Net book value at 31 March 1993	38,996	1,399	8,118	50,508	99,021
Net book value at 31 March 1992	35,832	2,562	8,049	53,425	99,868

11. Fixed Asset Investments

	£'000	*Associated Undertakings Unlisted £'000*	*United Kingdom Listed Investments £'000*	*Other Investments £'000*	*Total £'000*
At 1 April 1992		3,153	738	733	4,624
Exchange adjustments		–	–	6	6
Share of retained profits		1,192	–	–	1,192
Additions:					
Carter Engineering Ltd.					
Cash consideration	5,100				
Deferred consideration	2,000				
		7,100	–	–	7,100
Purchased goodwill		(6,965)	–	–	(6,965)
Disposals		(60)	–	(182)	(242)
At 31 March 1993		4,420	738	557	5,715

12. Stocks

	1993		1992	
	£'000	£'000	£'000	£'000
Long-term contract balances		12,894		8,014
Less: Attributable payments on account		(6,598)		(6,933)
		6,296		1,081
Other stocks and work in progress				
Raw materials and consumables	7,196		8,502	
Work in progress	21,859		19,004	
Finished goods and goods for sale	9,123		6,855	
	38,178		34,361	
Less: Progress payments	(6,524)		(2,121)	
Provisions	(1,896)		(1,752)	
		29,758		30,488
		36,054		31,569

13. Debtors

	Group		Company	
	1993 £'000	1992 £'000	1993 £'000	1992 £'000
Due within one year:				
Trade debtors	83,990	78,541	—	—
Amounts recoverable on contracts	52,872	47,043	—	—
Amounts owed by subsidiary undertakings	—	—	39,106	19,000
Amounts owed by associated undertakings	311	123	—	—
Payments and accrued income	6,337	6,148	—	—
Pension scheme surpluses	78	1,450	—	—
Other debtors	14,736	15,502	2,278	4,458
	158,324	148,807	41,384	23,458
Due after more than one year:				
Trade debtors	19,722	12,910	—	—
Pension scheme surpluses	31,713	30,750	—	—
Other debtors	2,679	3,783	1,717	3,405
	54,114	47,443	1,717	3,405

14. Cash and Cash Equivalents

	1993 *£'000*	*1992* *£'000*
(a) Analysis of changes in cash and cash equivalents during the year:		
Balance at 1 April	128,918	88,311
Net cash flow	(70,632)	40,626
Effect of foreign exchange rate changes	1,355	(19)
Balance at 31 March	59,641	128,918
Analysis of closing balance:		
Cash and bank balances	64,507	137,369
Bank overdrafts (note 15)	(4,866)	(8,451)
Balance at 31 March	59,641	128,918
(b) Analysis of the net cash flow of cash and cash equivalents in respect of the purchase of subsidiary and associated undertakings:		
Cash consideration:		
Purchase of associated undertakings	5,100	–
Purchase of subsidiary undertakings	1,278	26,239
	6,378	26,239
Cash at bank and in hand acquired	–	(1,587)
Net flow of cash and cash equivalents	6,378	24,652

15. Creditors: Amounts due within one year

	Group		Company	
	1993	*1992*	*1993*	*1992*
	£'000	*£'000*	*£'000*	*£'000*
Bank overdraft	4,866	8,451	3,986	924
Bank loans	15,436	10,633	–	–
Other loans (note 17)	113	1,172	–	–
Obligations under finance leases (note 17)	2,637	4,146	–	–
Advance payments	1,587	3,485	–	–
Payments received in advance of turnover	70,697	49,022	–	–
Trade creditors	85,236	73,299	–	–
Contract accruals and provisions	35,573	86,698	–	–
Bills of exchange payable	1,456	626	–	–
Amounts owed to subsidiary undertakings	–	–	45,625	46,534
Amounts owed to associated undertakings	457	26	–	–
Other creditors	11,747	10,465	20	13
Corporation and overseas taxes	11,226	15,748	3,513	5,624
Other taxes and social security	9,562	16,644	–	–
Accruals and deferred income	22,892	21,573	112	274
Proposed dividend	5,914	10,215	5,914	10,215
	279,399	312,203	59,170	63,584

16. Creditors: Amounts due after more than one year

	Group		Company	
	1993	*1992*	*1993*	*1992*
	£'000	*£'000*	*£'000*	*£'000*
Bank loans	2,143	4,332	–	–
Other loans	837	1,143	–	–
Obligations under finance leases	5,269	7,361	–	–
Advance payments	2,497	3,368	–	–
Trade creditors	51	195	–	–
Other creditors	3,221	2,083	–	–
	14,018	18,482	–	–

17. Borrowings

	Group 1993 £'000	Group 1992 £'000
Security arrangements:		
Secured by fixed and floating charges on the assets of subsidiary undertakings	560	2,976
Secured against specific trade debtors of subsidiary undertakings	3,064	4,192
	3,624	7,168
Unsecured borrowings	19,771	18,563
	23,395	25,731

Repayment details:

The total borrowings of the group, at 31 March are repayable as follows:

	1993			1992		
	Bank Loans and Overdrafts £'000	*Other Loans £'000*	*Finance Lease Obligations £'000*	*Bank Loans and Overdrafts £'000*	*Other Loans £'000*	*Finance Lease Obligations £'000*
Within one year	20,302	113	2,637	19,084	1,172	4,146
Between one and two years	908	130	1,746	1,177	146	1,869
Between two and five years	979	46	1,934	2,398	210	3,694
In five years or more	256	661	1,589	757	787	1,798
	22,445	950	7,906	23,416	2,315	11,507

18. Deferred Taxation

	1993		1992	
	Provided £'000	*Full Potential £'000*	*Provided £'000*	*Full Potential £'000*
The major components of the provision for deferred taxation and the potential liability as follows:				
Accelerated capital allowances	(62)	2,431	3,250	7,865
Other timing differences	12,343	14,712	16,176	18,834
Tax losses	–	–	(2,703)	(4,403)
	12,281	17,143	16,723	22,296
Recoverable advance corporation tax	(4,839)	(6,958)	(5,217)	(5,516)
	7,442	10,185	11,506	16,780

19. Pension Funding

The group operates a number of different pension arrangements throughout the world, according to the local requirements of each country. The total pension costs charged to the operating profit of the group were as follows:

	1993 *£'000*	*1992* *£'000*
United Kingdom schemes	10,964	11,553
Overseas schemes	1,268	1,980
	12,232	13,533
Interest on pension scheme surpluses	(2,982)	(3,041)
	9,250	10,492

The three major schemes are in the U.K. and South Africa and are of the defined benefit type. In each case the scheme is funded by payments to separate trustee administered funds and the pension cost is assessed in accordance with the advice of independent, qualified actuaries. The details of the latest valuation of these schemes which have been used for the purpose of these accounts are as follows:

	United Kingdom Schemes		
	Rose	*ABC Group*	*South Africa*
Date of last valuation	31.3.90	1.4.92	1.1.93
Number of active employees	4,022	2,735	506
Method of valuation	Attained aged	Projected unit	Projected unit
Results of last valuation:			
Market value of assets	£113 million	£289 million	£23 million
Level of funding	100%	123%	114%
Principal valuation assumptions:			
Excess of investment returns over earnings increases	1.50%	2.00%	1.00%
Excess of investment returns over pension increases	3.00% to 6.00%	6.00%	5.00%
Annual rate of dividend growth	4.50%	4.25%	5.00%

20. Share Capital

	1993 *£'000*	*1992* *£'000*
Authorized:		
730,000,000 (1992: 620,000,000) ordinary shares of 10p each	73,000	62,000
Allotted, issued and fully paid:		
537,642,206 (1992: 537,642,206) ordinary shares of 10p each	53,764	53,764

21. Financial Commitments

Capital commitments

	1993 *£'000*	*1992* *£'000*
Authorized future capital expenditure of the group was as follows:		
Contracted but not provided for in the accounts	1,149	2,885
Authorized by the directors but not contracted for	14,521	269
	15,670	3,154

Operating lease commitments

	1993		*1992*	
	Land and Buildings £'000	*Plant and Machinery £'000*	*Land and Buildings £'000*	*Plant and Machinery £'000*
The annual group commitment under noncancellable operating leases was as follows:				
Lease expiring:				
Within one year	313	837	706	597
Within two to five years	3,092	4,169	2,936	3,956
Thereafter	3,814	21	2,709	1,201
	7,219	5,027	6,351	5,754

22. Contingent Liabilities

a) The company has guaranteed or has joint and several liability for bank borrowing facilities of £118.5 million (1992: £82.1 million) for certain group companies.

b) Throughout the group, contingent liabilities exist in respect of guarantees, performance bonds and indemnities issued on behalf of group companies by banks and insurance companies in the ordinary course of business. At 31 March 1993 these amounted to £149.9 million (1992: £175.6 million), of which the company had counter-indemnified £115.4 million (1992: £136.5 million).

APPENDIX D

Checklist for Comparison of Generally Accepted Auditing Standards in the United States With Auditing Standards in the United Kingdom

General Information	Answer	Comments
1. Is a primary purpose of an audit—		
a. To attest to information used by investors, creditors, etc.?	Yes	1*a.* SAS 600 and Companies Act 1985.
b. To satisfy statutory requirements (for example, the Companies Act)?	Yes	
c. For tax purposes?	No	
2. A. The United States has ten generally accepted auditing standards (GAAS) including general standards, standards of fieldwork, and standards of reporting. Those standards and their interpretations constitute United States GAAS which have been published in *Codification of Statements on Auditing Standards*.[1] Do generally accepted auditing standards (GAAS) exist in the United Kingdom?	Yes	
B. If so, are they published?	Yes	2B. ICAEW *Members' Handbook*, Volume II, and ICAEW's *Auditing and Reporting*, which is updated annually.

C. If auditing standards exist in the United Kingdom, are they similar to United States standards?	Yes				
3. Who is responsible for promulgating auditing standards (for example, the profession, a governmental body)?	The Auditing Practices Board				3. See paragraph 15 of text.

U.S. Generally Accepted Auditing Standards	Required by Government or Professional Pronouncements	Predominant Practice	Minority Practice	Not Done	Comments
4. Do auditors confirm receivables? (AU 330)	Yes. ICAEW Statement on Auditing 901	✓			4. See paragraph 38 of text.
5. Do auditors observe inventory counts? (AU 331)	Yes. Auditing Guideline 405	✓			
6. Do auditors receive written representations from management? (AU 333)	Yes. Auditing Guideline 404	✓			6. See paragraph 38 of text.
7. Do auditors receive written representations from management's legal counsel? (AU 337)	Yes. ICAEW Statement on Auditing 903	✓			7. See paragraph 38 of text.

Notes:

Checklist was completed from the perspective of performing a local audit, *not* a referral audit.
AU numbers refer to sections in the AICPA's *Codification of Statements on Auditing Standards* (Chicago, Ill.: Commerce Clearing House, Inc., 1993), unless otherwise noted.
This checklist does not include the latest GAAS pronouncements issued in the United States.
ICAEW refers to The Institute of Chartered Accountants in England and Wales.

[1] American Institute of Certified Public Accountants. *Codification of Statements on Auditing Standards.*

U.S. Generally Accepted Auditing Standards	Required by Government or Professional Pronouncements	Predominant Practice	Minority Practice	Not Done	Comments
8. A. Do auditors prepare and maintain working papers? (AU 339)	Yes. Auditing Guideline 201	✓			
B. If so, do they include a written audit program outlining procedures to be performed? (AU 339)	Yes. Auditing Guideline 201	✓			
9. Do auditors obtain a sufficient understanding of the internal control structure to plan the audit and to determine the nature, timing, and extent of tests to be performed? (AU 319)	Yes. Auditing Guideline 204	✓			
10. A. Do auditors communicate reportable conditions in the internal control structure to the audit committee? (AU 325)	Yes. Auditing Guideline 414	✓			
B. If so, is the communication documented? (AU 325)	Yes. Auditing Guideline 414	✓			
11. In obtaining evidential matter, does the auditor apply either statistical or nonstatistical procedures? (AU 350)	Yes	✓			11. Both procedures are used.
12. Is the auditor responsible for designing the audit to provide reasonable assurance of detecting errors and irregularities that are material to the financial statements? (AU 316)	Yes	✓			12. See paragraph 30 of text and Auditing Guideline 418. The responsibility is directed toward detecting material misstatements, whether caused by fraud, error, or other irregularities.

13. A. Does the auditor perform procedures to identify related-party transactions and their effects on the financial statements? (AU 334)	No	✓		13A. See paragraph 38 of text.
B. If so, list the procedures.				
14. Does the auditor consider the adequacy of cutoff procedures to ensure that movements into and out of inventories are properly identified in the accounting records? (AU 313)	Yes. Auditing Guideline 405	✓		
15. A. Are specific auditing procedures applied to transactions occurring after the balance-sheet date? (AU 560)	Yes. Auditing Guideline 402	✓		
B. Are other auditing procedures applied to ascertain the occurrence of subsequent events that require adjustment to or disclosure in the financial statements? (AU 560)	Yes. Auditing Guideline 402	✓		
16. The concept of "joint auditors" in certain countries (for example, Canada and Australia) is that two auditors or audit firms jointly audit the financial statements of a company and issue a single report signed by the two firms. This practice is not generally followed in the United States. Does the concept of "joint auditors" exist in the United Kingdom?	No		✓	16. The concept of *joint auditors* is recognized in the United Kingdom and provided for in the Companies Act. This is not a requirement, but rather a decision made by the shareholders.

U.S. Generally Accepted Auditing Standards	Required by Government or Professional Pronouncements	Predominant Practice	Minority Practice	Not Done	Comments
17. When a principal auditor is reporting on financial statements that include one or more subsidiaries, divisions, branches, or investees: (AU 543)					
A. Must the principal auditor assume responsibility for the work of the other auditor as it relates to the principal auditor's opinion?	Yes. Auditing Guideline 415	✓			17A,B. See paragraph 50 of text.
B. May the principal auditor decide not to assume that responsibility by making reference to the other auditor and indicating the division of responsibility?	No			✓	
18. A. Is there a standard form of auditor's report? (AU 508)	Yes. SAS 600	✓			
B. List the circumstances that require a departure from the standard report and indicate the type of report required. (AU 508)					18B. See paragraphs 47 and 48 of text.
19. A. Does the auditor's report require an explanatory paragraph for a change in accounting principles or in the method of their application? (AU 508)	No			✓	
B. If not, does it imply that either consistency exists or the financial statements disclose the inconsistency?	Yes. SSAP 2	✓			

20. A. Is the auditor's report dated as of the last day of fieldwork? (AU 530)	No		✓	
B. If not, what date is used?				20B. The report should be dated when actually signed, which is when the financial statements are approved by the company's directors. The auditor should never sign or date the report earlier than when the financial statements are approved by the directors.
21. To express an opinion, must the auditor be independent? For the purpose of this checklist, independence is defined as not having a financial interest in or connection with the client. (*Code of Professional Conduct*, Rule 101, and its interpretations.)	Yes. Audit Regulations 3.03b. Guide to Professional Ethics 1.201 Section A	✓		
22. Please describe any standards for the United Kingdom for which there are no corresponding United States standards.				22. The standards are as follows: • Standards for certain specific industries unique to the United Kingdom (for example, *Auditing Guidelines on Trade Unions and Employers' Associations, and Housing Associations*) • Auditing Guideline 401, *Bank Reports for Audit Purposes* • Auditing Guideline 412, *Prospectuses and the Reporting Accountant* • ICAEW Statement 904, *Guidance for Auditors on the Implications of Goods Sold Subject to Reservation of Title* • ICAEW Statement 911, *Auditors' Relationships with Actuaries Concerning Actuarial Valuations of Long-term Business Funds of Insurance Companies*

APPENDIX E

Checklist for Comparison of Generally Accepted Accounting Principles in the United States With Accounting Principles in the United Kingdom

General Information	Answer	Comments
1. Are there generally accepted accounting principles (GAAP) in the United Kingdom? If so, are they codified?	Yes	See paragraph 52 of text.
2. Who is responsible for promulgating accounting principles (for example, the profession, a governmental body)?	The Accounting Standards Board under authority delegated by the Department of Trade and Industry to the Financial Reporting Council.	

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncements	Predominant Practice	Minority Practice	Not Done	Comments
3. Are assets and liabilities recorded on the historical cost basis?	Yes. CA 1985, Schedule 4	✓			3. See paragraph 68 of text.

4. Are interest costs, incurred while activities that are necessary to get an asset ready for its intended use are in progress, capitalized as part of the historical cost of an asset? (I67)	No		✓	4. The Companies Act permits but does not require this treatment. Property companies frequently capitalize interest costs, but it is less widespread among other companies.
5. A. Is a general revaluation (either upward or downward) of assets permitted? (D40)	Yes. CA 1985	✓		5A. Upward revaluation is usually restricted to tangible fixed assets and investments.
B. If so, define the basis.				5B. There are no general requirements in this area. See paragraphs 72 and 73 of text.
6. Are nonmonetary transactions that culminate an earnings process accounted for on the basis of the fair market value of the assets involved when that value is determined within reasonable limits? (N35)	No	✓		
7. Is revenue recognized when it is earned and its realization is reasonably assured (rather than when money is received)? (Statement of Financial Accounting Concepts No. 5)	Yes. CA 1985, Schedule 4 and SSAP 2	✓		

Notes:

References are to sections in FASB Current Text, unless otherwise noted.
This checklist does not include the latest GAAP pronouncements issued in the United States.
CA 1985 refers to the Companies Act 1985 as amended by the Companies Act 1989.
SSAP refers to Statements of Standard Accounting Practice.
FRS refers to Financial Reporting Standards.

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncements	Predominant Practice	Minority Practice	Not Done	Comments
8. Are costs recorded when incurred rather than when money is paid? (Statement of Financial Accounting Concepts No. 5)	Yes. CA 1985, Schedule 4 and SSAP 2	✓			
9. A. Are consolidated financial statements required when one company has controlling financial interest over another company? (C51)	Yes. CA 1985, Schedule 4A and FRS 2	✓			9A,B. See paragraphs 59 to 63 of text.
B. Is control usually indicated by ownership of over 50 percent of the outstanding voting shares? If not, how is control indicated?	Yes. CA 1985 and FRS 2	✓			9B. Control can also exist when the parent has a participating interest and exercises dominant influence or where the companies are operated on a unified basis.
10. A. Are there instances when an entity would not be consolidated even though control is present (C51)?	Yes. CA 1985, Schedule 8				10A,B. There are exceptions, such as when control is intended to be temporary. See paragraph 61 of text.
B. If so, list them.					
11. If consolidation is not otherwise appropriate, is the equity method used for unconsolidated subsidiaries, corporate joint ventures, and other investees if the investments give the investor the ability to exercise significant influence over the investees' operating and financial policies? (I82)	Yes. SSAP 1	✓			

12. Are there two methods of accounting for business combinations: the pooling-of-interests method and the purchase method? (B50)	Yes. CA 1985 and SSAP 23	✓		12. See paragraphs 80 to 85 of text.
13. Is the method used to account for a business combination disclosed? (B50)	Yes. CA 1985, Schedule 4 and SSAP 23	✓		
14. A. Do criteria exist for treatment of business combinations as poolings of interests? (B50)	Yes. CA 1985 and SSAP 23	✓		
B. If so, list the criteria.				14B. See paragraphs 80 to 85 of text.
15. A. Is goodwill arising from a business combination accounted for as an asset? (I60)	No		✓	15A,B. The Companies Act permits goodwill to be accounted for as an asset and amortized or alternatively to be written off immediately. SSAP 22 suggests goodwill should be written off immediately. This is the predominant practice.
B. If so, is it amortized as a charge to income over the period estimated to be benefited?			✓	
16. Are the following disclosures made for related-party transactions: (R36)				16. See paragraph 114 of text.
a. The nature of the relationship?	Yes. CA 1985, Schedule 4 and SSAP 1	✓		
b. A description of the transactions for the period presented?	Yes. CA 1985, Schedule 6	✓		
c. The amounts of the transactions for the period presented?	Yes. CA 1985, Schedule 6	✓		
d. The amounts due to or from related parties at the balance-sheet date?	Yes. CA 1985, Schedule 4 and Schedule 6	✓		

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncements	Predominant Practice	Minority Practice	Not Done	Comments
17. Is an estimated loss from a loss contingency accrued only if it is probable that an asset has been impaired or a liability incurred and the amount of loss can be reasonably estimated? (C59)	Yes. CA 1985, Schedule 4 and SSAP 18	✓			
18. If a loss contingency is not accrued because both conditions for accrual listed in question 17 are not met, is disclosure of the contingency required when there is at least a reasonable possibility that a loss may have been incurred? (C59)	Yes. CA 1985, Schedule 4 and SSAP 18	✓			
19. Are guarantees of the indebtedness of others or other loss contingencies disclosed in financial statements even though the possibility of loss may be remote? (In the United States, guarantees are usually disclosed as loss contingencies even if the possibility of loss is remote.) (C59)	Yes. CA 1985, Schedule 4 and SSAP 18	✓			
20. Are the following items disclosed in a public enterprise's financial statements for each industry segment (S20):					
a. Sales to outsiders and intersegment sales?	Yes. CA 1985, Schedule 4 and SSAP 25	✓			
b. Operating profit or loss?	Yes. SSAP 25	✓			

c. Identifiable assets and related depreciation, depletion, and amortization expense?	No			✓	20*c.* SSAP 25 requires only disclosure of segment net assets.
d. Capital expenditures?	No			✓	
e. Equity in net income and net assets of unconsolidated subsidiaries and other investees?	Yes. SSAP 25		✓		20*e.* Disclosure required only where these account for 20 percent or more of the reporting entity's results or net assets.
f. Effect of a change in accounting principle?	Yes. SSAP 25	✓			
21. A. Are there any requirements or recommendations to disclose the effects of inflation? (C28)	No		✓		21A. Required only for foreign subsidiaries operating in hyperinflationary economies.
B. If so, list the disclosures required.					21B. CA 1985 required disclosure of material differences between carrying amount of inventories and replacement cost.
22. Are assets segregated into current and noncurrent classifications with a total for current assets presented? (B05)	Yes. CA 1985, Schedule 4	✓			
23. A. Are noncurrent assets those not expected to be realized within one year or the current operating cycle? (B05)	No			✓	
B. If not, how are noncurrent assets defined?					23B. Fixed assets are defined by the Act as those intended for use on a continuing basis. All other assets are current assets.
24. A. Is an allowance established for uncollectible receivables? (C59)	Yes. CA 1985, Schedule 4	✓			
B. If so, what is the basis (for example, percentage of sales, aging of receivables) for calculating the allowance?					24B. Various bases are used.

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncements	Predominant Practice	Minority Practice	Not Done	Comments
25. Are receivables and payables not arising in the normal course of business or subject to normal trade terms recorded at an amount that takes imputed interest into account? (I69)	No			✓	25. See paragraph 78 of text.
26. A. Is inventory stated at the lower of cost or market (or net realizable value)? (I78)	Yes. CA 1985, Schedule 4 and SSAP 9	✓			
B. If not, how is inventory stated?					
C. Is the basis disclosed?	Yes. CA 1985, Schedule 4 and SSAP 9	✓			
27. Does cost for inventory purposes include (I78)—					
a. Materials?	Yes. CA 1985, Schedule 4 and SSAP 9	✓			
b. Direct labor?	Yes. CA 1985, Schedule 4 and SSAP 9	✓			
c. Factory overhead?	Yes. CA 1985, Schedule 4 and SSAP 9	✓			
d. If the answer to *c* is yes, is an allowable share of all factory overhead included?	Yes. CA 1985, Schedule 4 and SSAP 9	✓			
28. A. Are the following cost methods permitted for reporting purposes (I78):					

a. First-in, first-out (FIFO)?	Yes. CA 1985, Schedule 4 and SSAP 9	✓		
b. Last-in, first-out (LIFO)?	Yes. CA 1985, Schedule 4		✓	
c. Average cost?	Yes. CA 1985, Schedule 4 and SSAP 9	✓		
B. Are the same methods permitted for tax purposes?	No		✓	28B. CA 1985 permits LIFO but SSAP 9 and the tax authorities do not.
29. Is the inventory costing method used disclosed? (I78)	Yes. CA 1985, Schedule 4 and SSAP 9	✓		
30. A. Are fixed assets depreciated over their estimated useful lives by systematic charges to income? (D40)	Yes. CA 1985, Schedule 4 and SSAP 12	✓		
B. If so, is an accumulated depreciation account used?	Yes	✓		
31. Are disclosures made of (D40)—				
a. Depreciation expense for the period?	Yes. CA 1985, Schedule 4 and SSAP 12	✓		
b. Balances of major classes of depreciable assets?	Yes. CA 1985, Schedule 4 and SSAP 12	✓		
c. The methods used to compute depreciation for the major asset classes?	Yes. CA 1985, Schedule 4 and SSAP 12	✓		
d. Accumulated depreciation, either by major class of assets or in total?	Yes. CA 1985, Schedule 4 and SSAP 12	✓		

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncements	Predominant Practice	Minority Practice	Not Done	Comments
32. A. Do criteria exist for classifying leases as operating leases? (L10)	Yes. SSAP 21	✓			
B. If so, list the criteria and disclosure requirements.					32B. See paragraphs 92 to 99 of text.
33. A. Do criteria exist for classifying leases as other than operating leases for the lessor and lessee? (L10)	Yes. SSAP 21	✓			
B. If so, list the criteria, type of lease, and disclosure requirements.					33B. See paragraphs 92 to 99 of text.
34. Are liabilities segregated into current and noncurrent classifications with a total for current liabilities presented? (B05)	Yes. CA 1985, Schedule 4	✓			
35. A. Are noncurrent liabilities those whose liquidation is not expected to require the use of current assets or the creation of current liabilities? (B05)	No			✓	
B. If not, how are noncurrent liabilities defined?					35B. CA 1985 distinguishes between liabilities due within one year and those due in more than one year.
36. For notes payable, is disclosure made of (C32)—					36. Interest and repayment terms must be disclosed for items maturing wholly or partly after five years.
a. Interest rates?	Yes. CA 1985, Schedule 4	✓			
b. Maturities?	Yes	✓			

c. Assets pledged as collateral?	No			✓	
d. Covenants to reduce debt?	No			✓	
e. Minimum working capital requirements?	No			✓	
f. Dividend restrictions?	No			✓	
37. A. For long-term construction-type contracts, are the percentage-of-completion and completed-contract methods used? (Co4)	Yes. SSAP 9	✓			37A,B. SSAP 9 favors the use of the percentage-of-completion method when the outcome can be assessed with reasonable accuracy. Otherwise, the completed-contract method should be used.
B. If so, what are the criteria for determining the method to be used?					
38. A. Are research costs charged to expense when incurred? (R50)	Yes. CA 1985, Schedule 4 and SSAP 13	✓			
B. Are such costs disclosed?	Yes. CA 1985, Schedule 7		✓		38B. The Act requires the Directors' Report to disclose research and development activities. Financial details are not specifically required.
39. A. Are development costs charged to expense when incurred? (R50)	No	✓			
B. Are such costs disclosed?	Yes. CA 1985, Schedule 4 and SSAP 13		✓		39B. See question 38 and paragraphs 89 to 91 of text.
40. A. In the United States, events and transactions are presented in the income statement as extraordinary items when they are unusual in nature and are of the type that would not reasonably be expected to recur in the foreseeable future. Do	Yes. FRS 3	✓			40A. Extraordinary items are defined in FRS 3 as material items having a high degree of abnormality that arise from events or transactions that are outside the company's ordinary activities and are not expected to recur.

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncements	Predominant Practice	Minority Practice	Not Done	Comments
similar criteria for identifying extraordinary items exist in the United Kingdom? (I17)					
B. If not, what are the criteria?					
41. Are material events or transactions that are unusual in nature or expected to occur infrequently, but not both (and thus do not meet the criteria for classification as extraordinary), shown as a separate component of income or expense? (I22)	Yes. FRS 3	✓			41. Under FRS 3, material events or transactions that are within the company's ordinary activities should be disclosed based on their size or incidence to give a true and fair view. They are termed "exceptional items."
42. A. Are disclosures required for—					
a. Extraordinary items? (I17)	Yes. CA 1985, Schedule 4 and FRS 3	✓			
b. Material events or transactions not classified as extraordinary items? (I22)	Yes. CA 1985, Schedule 4 and FRS 3	✓			
c. Disposal of a segment of a business? (I13)	Yes. CA 1985, Schedule 4 and FRS 3	✓			
B. Indicate the financial statement presentation of these items.					42B. Presentation as follows: *a.* Face of profit-and-loss statement (after post-tax profit on ordinary activities) with details and explanation in notes.

				b. and *c.* Face of profit-and-loss statement (before profit on ordinary activities).
43. A. Are pension costs provided for covered employees over the term of employment? (P16)	Yes. SSAP 24	✓		
B. If so, do they include charges for costs assigned under the actuarial method used in years prior to the plan's inception?	Yes. SSAP 24	✓		
44. A. Are specific disclosures required relating to pension plans? (P16)	Yes. CA 1985, Schedule 4 and SSAP 24	✓		
B. If so, list them.				44B. See paragraphs 108 to 110 of text.
45. A. When accounting income and taxable income differ, are deferred income taxes recorded for temporary differences (as opposed to permanent differences)? (I27)	Yes. SSAP 15	✓		
B. If so, are deferred taxes provided for all temporary differences (as opposed to only those meeting certain criteria)?	No		✓	
46. A. Are deferred taxes determined on the basis of current tax rates? (I27)	Yes. SSAP 15	✓		
B. If not, on what basis?				
47. A. Is specific information related to income taxes required to be disclosed? (I27)	Yes. CA 1985, Schedule 4	✓		
B. If so, list the requirements.				47B. See paragraph 105 of text.

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncements	Predominant Practice	Minority Practice	Not Done	Comments
48. A. Are operating losses reported on the income tax return allowed to be carried back to earlier periods? (I27)	Yes	✓			48A. Permitted under United Kingdom tax law when there are sufficient profits in the earlier period available for setoff.
B. If so, are the tax effects of a loss carryback included in the income in the period?	Yes	✓			
49. A. Are operating losses reported on the income tax return allowed to be carried forward? (I27)	Yes	✓			
B. If so, are the tax effects of a loss carryforward included in the income in the period realized?	Yes	✓			
50. Are financial statements of a foreign entity prepared for consolidation purposes measured in the currency of the primary economic environment in which the entity operates? (F60)	Yes. SSAP 20	✓			
51. Are all elements of financial statements translated at current exchange rates? (F60)	No	✓			51. See paragraphs 117 to 122 of text.
52. A. Are translation adjustments reported separately? (F60)	Yes. SSAP 20	✓			
B. Are they accumulated in a separate component of stockholders' equity until ultimately realized?	No			✓	
C. Is there an analysis of the changes during the period in	No	✓			

the component of stockholders' equity relating to translation adjustments?				
53. A. Are gains and losses resulting from transactions denominated in a currency other than that of the environment in which the entity operates included in determining net income for the period in which the exchange rate changes? (F60)	Yes. SSAP 20	✓		53A. See paragraphs 119 to 121 of text.
B. Is the aggregate transaction gain or loss included in determining net income for the period disclosed in the financial statements or notes?	No		✓	
54. Are gains or losses on foreign currency transactions that are intended to hedge a foreign currency commitment deferred and included in the related transactions? (F60)	No		✓	
55. Is information disclosed about foreign currency restrictions? (F60)	Yes	✓		
56. Are significant events arising subsequent to the balance-sheet date reflected in the financial statements or notes thereto? (C59)	Yes. CA 1985, Schedule 7 and SSAP 17	✓		
57. Please list any standards for the United Kingdom for which there are no corresponding United States standards.				57. The standards are as follows: • SSAP 4, *Accounting for Government Grants* • SSAP 5, *Accounting for Value Added Tax*

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncements	Predominant Practice	Minority Practice	Not Done	Comments
					• SSAP 8, *The Treatment of Taxation Under the Imputation System in the Accounts of Companies* • SSAP 19, *Accounting for Investment Properties*

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