About this chapter

In this chapter we look ahead over the next five to ten years to see what changes may take place in financial accounting and reporting. As this is a book for non-accountants we will not speculate about those possible developments that would be of particular concern to professional accountants. Instead we have identified five issues that are of relevance to all managers irrespective of their discipline (see Figure 11.1). They are: (1) the pronouncements of the International Accounting Standards Board; (2) the work of the Accounting Standards Board; (3) the development of a conceptual framework in accounting; (4) the treatment of revenue in financial statements; and (5) the role of the auditors.

A ticking clock

Accounting board could lose power to set rules

Nick Mathiason

SIR DAVID Tweedie, chairman of the International Accounting Standards Board (IASB), is to be grilled on Tuesday by European finance ministers and senior EU commissioners.

The development comes as speculation mounts that the IASB will be reformed as a result of the financial crisis. It could even lose powers to set international accounting standards.

A senior source close to the European Commission said ‘There’s a lot of anxiety in many countries and they wonder if the IASB is the right body for future rule setting. The clock is ticking.’

A growing body of opinion is unhappy with the IASB. It approved accounting principles that allowed financial institutions to book profits using financial instruments, and exacerbated institutions’ deterioration as values plunged.

There are also concerns among European power brokers, particularly within France and Germany, that the IASB is an ‘interconnected old boy’s network’. A third of its board had worked for KPMG or firms that KPMG later acquired.

A senior City fund manager said: ‘There’s a recognition on the part of fund managers that were brought in during the good times. And there’s a lot of resistance from technical accounting specialists who believe they have the true view of life.’

A spokesman for the IASB said: ‘We’re planning to provide a response of the IASB to the financial crisis, including an update to replace IAS 39.’

The Observer, 7 June 2009.

Source: Copyright Guardian News & Media Ltd 2009.

Questions relating to this news story can be found on page 262
Why this chapter is important

Accounting is a dynamic discipline. It has to be in order to cope with a rapidly changing world. New problems and new issues arise and some way has to be found of dealing with them as quickly as possible. There may then be a need to report them to interested parties and, if so, how and what form should the report take?

Accountants are expected to take a lead on the reporting issues. This is their expertise but non-accountants should also be heavily involved because the impact of many issues is far too wide-ranging to be left to just one group of specialists. For example, a decision to write-off goodwill to the profit and loss account instead of leaving it on the balance sheet can have a significant effect on a company’s reported profit, the dividend it pays and on its share price.

It is as a result of such consequences that non-accountants need to know what new accounting and reporting issues are currently under discussion in the business, economic,
financial and political worlds and what proposals are being suggested to deal with them. Space does not allow us to deal with all of them in this book but we can give you an indication of some of the changes that are likely to take place in the next five years. We have chosen five of the major ones but you are encouraged to read the business and financial press regularly to keep up with emerging issues in financial reporting.

In summary, then, we suggest that this chapter is particularly important for non-accountants for the following reasons.

- To be briefed about the general business environment in which accounting operates both nationally and internationally.
- To be informed about some contemporary issues in financial accounting and reporting.
- To advise your senior manager of any changes that may affect your own sphere of responsibility.
- To take an active part in any debate on the effect of any proposed financial reporting changes on your own entity.

We cannot be absolutely certain what changes will take place in financial accounting and reporting over the next few years. Some changes that appear highly likely at the moment may be abandoned altogether, while others may be radically amended or delayed well into the long term. We can, however, be reasonably confident that:

- There will be no new UK Companies Act before 2020.
- The International Accounting Standards Board will have become the preeminent worldwide body responsible for setting accounting standards.
- The UK’s Accounting Standards Board will have lost much of its influence.
- Most entities in the UK will have decided to adopt IASB standards.
- Company annual reports and accounts will have become much longer and even more difficult to understand than they are now.

We hope that we are wrong on the last point. There are signs that the problem is recognized (see the News clip below) but we are certainly not confident that much will or can be done about it.

**Overview**

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**News clip**

**Towards easy reading**

‘The Financial Reporting Council (FRC), the UK’s independent regulator responsible for promoting confidence in corporate reporting and governance, has published a discussion paper arising from its project on reducing complexity in financial reporting.’

*Source: Adapted from Press Release (FRC PN 269), Financial Reporting Council, 4 June 2009.*

We now move on to the first of our five topics: what the IASB is likely to require during the next five years.
In this section we are going to summarize the main projects that the IASB was working on in the summer of 2009. This will give you a good idea of the changes that are likely to take place in financial reporting practice over the following five years. In the UK and the other EU countries its requirements will, of course, only be mandatory for publicly listed group companies. Nonetheless, they will inevitably have an influence on other types of entity.

The Board had divided its projects into five main groups: (i) financial crisis-related projects; (ii) new standards; (iii) amendments to existing standards; (iv) work on a conceptual framework; and (v) research and other related projects.

Financial crisis projects
This group includes six projects that will eventually lead to new IASs. They deal with matters that may be described as ‘advanced’ financial reporting and they are, therefore, beyond this book. All of them should have become standards by the end of 2010 but as new standards usually only become effective some 6 to 18 months after publication they will not be operable until perhaps 2012.

New standards
The new standards group is divided into two sections:

(a) Proposals out for public comment. There are three such proposals: revenue recognition, leases, and income tax. We will be returning to ‘revenue recognition’ later in the chapter. Both the proposed standard on leases and the one on income tax will have become standards by the end of 2011.

(b) Developments currently being advanced. This group includes nine projects. They range from ‘emissions trading schemes’ to ‘post-employment benefits’ (including pensions). However, one project, ‘financial statement presentation’, is of interest to us in this book but it is not scheduled to be published until 2011 (to be effective perhaps as late as June 2012) so we can put it to one side for the time being. One other proposal in this group relates to small and medium-sized enterprises (SMEs).

Amendments to existing standards
This group includes nine projects: one relating to annual improvements 2008–2010 and another for annual improvements 2009–2012. The seven other projects relate specifically to a number of standards such as earnings per share (IAS 33) and liabilities (IAS 37). All seven of them are fairly technical. They should be completed and published in their amended form by the end of 2011.
Conceptual framework
We are going to deal with this project as a separate section later in the chapter.

Research and other projects
There is only one such project: extractive activities. Apparently it is being prepared for the IASB by the national standard setters of Australia, Canada, Norway and South Africa. However, ‘common control transactions’ was added to the agenda in December 2007 and work will begin on it when staff become available. Similarly work on government grants had been deferred but this time until progress has been made on the revenue recognition, related parties, and emissions projects. Presumably their requirements will have a strong influence on what is recommended for the treatment of government grants.

You will appreciate that some of the estimated publication dates indicated by the IASB for its various projects may well be put back. We can certainly expect some projects to be delayed as sudden urgent issues arise, unforeseen difficulties occur in dealing with some issues, and some may even be abandoned as a result of political difficulties in some countries. Nonetheless we hope that the above summary gives you some idea of the depth and breadth of issues that the IASB is facing over the next five to ten years.

We now turn to have a look at what the Accounting Standards Board in the UK expects to be doing over the same period.

Activity 11.1
Log on to the IASB’s website. Find the link relating to current projects. Identify those projects that do not appear in the above summary.

ASB projects

News clip

Accounting crossroads
‘UK GAAP is indeed at a crossroads, and it appears that the ASB will have to stay at that crossroads for some time – perhaps two years or so – before deciding which road to follow.’


Like the IASB the ASB has an active work programme. In the summer of 2009 its main activities fell into three categories: (i) convergence projects; (ii) other projects; and (iii) current proposals.

Convergence projects are those that involve examining some of the ASB’s existing standards and bringing them into line with similar IASB standards. The ASB had five such projects in the summer of 2009: (1) business combinations; (2) inventories; (3) property, plant and equipment costs; (4) disposal of non-current assets and presentation of discontinued operations; and (5) accounting standard setting in a changing environment: the role of the Accounting Standards Board. The first four projects are somewhat technical and we do not need to consider them any further. The fifth project is about the future
role of the ASB and this one is of considerable interest to us because it will have a major
impact on both accountants and non-accountants. We return to this topic shortly.

The ASB has 14 other projects under consideration. Like the convergence projects,
most are of a highly technical nature, e.g. intangible assets, ‘financial instruments, and
insurance. There are, however, two projects that are of particular interest to us: one look-
ing at a conceptual framework and the other examining revenue recognition. We are
going to deal with both these projects in separate sections later in the chapter.

The third grouping, current proposals, relates to documents that are in issue and are
out for comment. At the time of writing there were ten such projects. Two projects went
back as far as 2002 but they were almost at the accounting standards stage. The most
recent project was a discussion paper on heritage assets; it was issued in January 2006.

We can see from the above work programme that the change to IASB requirements
for listed companies in the EU has had a major impact on the role and influence of the
UK Accounting Standards Board. It no longer is quite the premier standard setting body
in the UK that it used to be and its influence is likely to diminish further as the IASB’s
dominance in world accounting increases.

The ASB has set out how it sees its future role in a series of pronouncements. It
believes that it lies in contributing to the development of high quality global accounting
standards by working closely with the IASB and other standard setting bodies. Its spe-
cific activities now fall under five main heads:

1 Contributing directly to the development of the IASB.
2 Influencing EU accounting standards policy.
3 Achieving convergence of UK standards with IFRS.
4 Improving ‘other aspects’ of UK standards.
5 Improving communication between companies and investors.

The above summary is extracted from the ASB’s website. It appears that once UK standards
have become compatible with ISAB standards the ASB will become, in effect, a sub-branch
of the IASB albeit with special responsibility for acting on behalf of the UK. This might
only be likely, however, if IASB requirements become mandatory for both private and
public companies. They are not at present. They only apply to listed group companies. So it
would appear that for the time being the ASB still has a major role to play in developing
and issuing accounting standards for entities that do not fall into this category.

We now turn to an issue we introduced in Chapter 2 and one which the IASB is con-
sidering: the search for a conceptual framework.

Activity 11.2

Opportunity knocks

Log on to the ASB’s website. Check through the list of projects. What are the new projects?

A conceptual framework

The ASB is working with the US Financial Accounting Standards Board (FASB) on a joint
project to ‘develop an improved common conceptual framework that provides a sound founda-
tion for developing future accounting standards’. The two Boards believe that such a
framework is essential (their word) to fulfil the Boards’ goal of developing standards
that are principles based. In addition, such standards should be ‘internally consistent, and
internationally converged'; they should also lead to ‘financial reporting that provides the information capital providers need to make decisions in their capacity as capital providers’.

Just to remind you of some points we made in Chapter 2. In simple terms a conceptual framework is merely a list of rules that accountants use in preparing financial statements. Such a framework is necessary because otherwise different accountants would use different accounting rules in preparing financial statements. This would clearly confuse and mislead users and so they would have difficulty in making sense of the information that they were given. So what the IASB and the FASB are both trying to do is to agree a set of rules that all accountants in all countries could and should adopt.

The current IASB/FASB project was started in 2004. The work was divided into eight phases (A to H) and our comments relate to the position in the late summer of June 2009. Only Phases A to D had by then been reported as being currently active, so clearly the project has a long way to go. We will review the progress on Phases A to D but not in any detail as we cannot be certain that what may already have been decided will necessarily be included in the final draft.

Phase A deals will the objective and qualitative characteristics of financial reporting. Its aims are to consider in respect of financial reporting: (1) the objectives; (2) the qualitative characteristics; and (3) the trade-offs among qualitative characteristics and how they relate to materiality and cost–benefit relationships.

So far the Boards have tentatively agreed that:

1 The term ‘faithful representation’ should replace the characteristic of reliability.
2 Relevance and faithful representation are regarded as fundamental characteristics.
3 The concepts of neutrality, completeness and freedom from error cannot be ‘absolutes’, i.e. completely unlimited or unrestricted.
4 Verifiability, comparability, timeliness and understandability are enhancing characteristics.
5 Materiality and cost are constraints on financial reporting.

There is nothing particularly remarkable about decisions 1, 2 and 4: they are largely confirmations of existing practice. Decision 3 is a little hard to understand: the Board uses the term ‘absolutes’; in other words, no one can ever be absolutely neutral, there will always be an element of bias, and it is impossible to guarantee that there will never be any errors. Finally, Decision 5 is just a recognition of reality.

Phase B covers ‘elements’ and ‘recognition’. Its objectives are (1) to revise and clarify the definition of an asset and a liability; (2) resolve differences and definitions about other elements; and (3) revise and eliminate differences and provide a basis for resolving derecognition and unit of account issues. So this phase is largely about definitions. Of particular interest to us is the proposed definition of an asset and a liability:
Asset. A present economic resource to which the entity has a right or other access that others do not have. All these terms were then defined.

Liability. A present economic obligation for which the entity is the obligor. These terms were again defined.

Phase C provides guidance for selecting measurement bases in financial reporting so that they satisfy the objectives and qualitative characteristics of financial reporting. Work continues on the phase and no specific decisions had been taken. The Boards had simply agreed, in effect, to continue their work in this area.

Phase D. The objective of this phase is to determine what constitutes a reporting entity for the purposes of financial reporting. This phase is still largely at the discussion stage.

The overall impression given by the joint IASB/FASB project on the formulation of an agreed conceptual framework is that we are not going to get anything that is particularly new or earth shattering. It is more likely to be confirmation of the type of conceptual framework that had already been adopted in many countries during the previous 20 years. Its real significance would be that the USA was clearly willing to work with other countries and that it no longer insisted on its own conceptual framework being accepted by the international community.

We now move on to consider another contentious issue in financial reporting: revenue recognition.

Activity 11.3 Log on to the FASB’s website. What is the current status of the FASB/IASB’s joint conceptual framework project?

Revenue recognition

News clip

Revenue and commission

Andy Halford, the Chief Financial Officer of Vodaphone has called for clarity in the way that accounting rules relate to statutory reporting because there is an increasing risk that financial and non-financial staff interpret them differently. This is alleged to cause problems for his staff when they calculate their commission on sales because of different ways of recognising revenue.

Source: Adapted from Andy Halford, Vodaphone CFO, Accountancy Age, 7 May 2009, p. 15.

Revenue may be defined as:

The gross inflow of economic benefits during the period arising in the course of the ordinary operating activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants. (IAS 18, para. 7)
IAS 18 then goes into considerable detail as to when revenue should be recognized. Apart from the rather stiff language its intentions appear to be reasonably clear, so what is the problem? The main problem arises from having to apply general pronouncements to specific circumstances. As a result a considerable number of gaps and loopholes begin to appear and preparers of financial statements are left to decide for themselves just how they should be filled.

The problem is so fundamental that the IASB has joined together with the FASB with the intention of publishing an accounting standard that would satisfy both bodies and their members. The project began in 2002 but an agreed standard is not expected until at least 2011. The driving force behind the project is a realization that revenue is a crucial element in financial statements because it helps users to assess a company’s performance and its prospects. However, the experience of most countries is that the definition and recognition of revenue is quite unsatisfactory and as a result users are being fed highly unreliable information. It follows that something has to be done to correct a most unsatisfactory situation.

Revenue is usually the largest single item in financial statements and the two Boards suggest that there are a number of practical and conceptual reasons why a standard is necessary. In summary they are as follows.

- Revenue recognition problems are the main cause of errors and fraud in financial statements.
- Insufficient information is shown in them about the individual items making up the total revenue figure.
- Revenue accounting policies are too general to be useful.
- There is little guidance for emerging industries and for service entities.
- There is little comparability among different entities and industries.
- Revenue recognition in the USA is not based on a conceptual framework, there is no comprehensive standard, and there are over 200 pronouncements about the treatment of revenue.

It follows from the above list of problems that the main objective of the project is to deal with them by developing a coherent conceptual framework for revenue recognition. Such a framework would:

1. Eliminate inconsistencies in existing conceptual guidance and in existing standards.
2. Provide conceptual guidance.
3. Fill those voids where there is no revenue recognition guidance.
4. Establish a single comprehensive standard on revenue recognition.

The above outline of the IASB/FASB’s revenue recognition project is taken from various publications and updates issued by the FASB on behalf of both bodies. If you want to read more about the project and you want an update, you will find the FASB’s website very helpful (log on to: www.fasb.org/project/revenue-recognition).

In December 2008 the Boards published a discussion paper for comment on its preliminary views on revenue recognition ‘in contracts with customers’. A single recognition ‘model’ was suggested for application across a range of industries and geographical regions. Revenue would be recognized when it satisfied ‘the performance obligations in the contract’, i.e. when it fulfilled a promise to provide a good or service to the customer. This pronouncement does not seem particularly different from existing practice but the Boards believe that by applying and clarifying the principle it will improve the comparability and understandability of revenue for users of financial statements.
The discussion paper was open for discussion until June 2009. Following a review by the Boards and, no doubt, some modification, it was then hoped that an Exposure Draft would be issued, possible in early 2010. The standard was still scheduled to be issued in 2011. It could then take another 6 to 18 months before it becomes operative. It is, therefore, going to take a very long time before the various revenue recognition problems we identified earlier are sorted out. That is, of course, assuming that the new standard fulfils all its objectives.

Auditors are usually qualified accountants who specialize in checking financial statements and who are employed by a firm of chartered or certified accountants. Most firms of accountants are very small and they don’t have either the staff or the experience to audit large public companies. Indeed, in the UK there are probably only about four or five firms of accountants capable of doing a very large audit for an international group of companies.

There is no evidence to suggest that auditors in the UK colluded in the type of scandals that took place in the early 2000s although they were undoubtedly placed in a very difficult position. This was partly due to their role in company auditing and partly because they had little guidance on what accounting practices the new industries such as electronics and information technology should adopt.

The law states that shareholders appoint the auditors of the company. In practice they cannot do so because it is impossible for them all to get together and vote on the merits of the various firms. So it is usually left to the directors to select a firm and put the name forward to the shareholders at a general meeting for their formal approval. As it is rare for the shareholders to vote against the directors’ recommendation, the auditors are well aware that if they fall out with the directors they are likely to lose the audit. Auditors are not, therefore, as independent as is sometimes believed.

**Activity 11.4**

A building has now been under construction for three years. It is expected to be completed in two years’ time. The agreed contract price is £1,000,000. The costs to date are £400,000 and it is expected that another £200,000 will be spent on the building before it is completed. What amount of revenue would you recognize in each year?

<table>
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<th>Year 1</th>
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<th>Year 5</th>
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**Auditors’ powers**

As a result of poor trading, Bay Trading Company has collapsed into administration. The auditors of the parent company, Alexon, said they were likely to issue an ‘emphasis of matter’ paragraph when they publish the company’s audit report. This gives a signal that the company may have difficulty in continuing as a going concern.

Source: Adapted from *The Financial Times*, 23 April 2009, p. 56.
The auditors’ independence may also be compromised because of a number of other factors:

- They may become heavily dependent on the fee earned for a particular audit.
- The staff generally, and the partner in charge particularly, may become too friendly with the directors.
- It is common for staff to leave an audit firm and take up a full-time position with the client company.
- Audit firms often do lucrative non-audit work for the company, such as management consultancy and tax advice.

All these factors are of very real concern because they could compromise the audit firm’s independence. So if a company engages in dubious financial practices then the auditors may be accused of not doing anything about it because they are in the directors’ pockets.

This may be so in some cases but a more likely cause is the expectations gap that we referred to in Chapter 1, i.e. the public think that the auditors are there to do one job, whereas in reality they are there to do an entirely different one. Their job is primarily to confirm that the accounts represent a true and fair view and not to discover if there has been any fraud.

So what about the questionable accounting practices that some companies might be tempted to adopt and which would then receive a lot of media coverage along the lines of ‘another accounting scandal’? It might not always be obvious, of course, that some practices are questionable. As we have argued throughout this book, accounting is not a form of simple arithmetic where 2 + 2 always = 4. There are often difficult decisions to take and the directors may then have to convince the auditors that what they want to do is fairer and more reasonable than what the auditors want to do. It may only be well after the year end that what seemed fair and reasonable at the time does not seem so two or three years later.

Referring back to Activity 11.4, what was your decision? Recognizing revenue in the construction industry is not easy. As in this case, projects often take longer than one year. So should you wait until a project is finished before you recognize any revenue? That would be a highly prudent approach. Should you instead recognize some revenue in each year of the contract? That would normally be regarded as being highly imprudent. Or might you recognize some revenue when the project is nearing completion? That is the conventional accounting approach. But then, of course, you have to decide in which year you begin and how much to take in each subsequent year. A further complication is that you would also have to charge some of the costs in each year that you recognized some revenue. The conventional approach is to take some profit based on the contract price less the costs to date and an estimate of the costs to completion. The balance (i.e. the estimated profit) would then probably be adjusted by an arbitrary factor, e.g. two-thirds. All of these decisions are likely to go horribly wrong and the contract may eventually result in a considerable loss.

There are no absolutely right or wrong ways of dealing with such situations. Ultimately it is largely a matter of experience and judgement of what to do: the directors may take an optimistic view while the auditors may take a much more pessimistic one. The latter approach was certainly the one that auditors appeared to be taking during the recession which hit the UK in 2007. It became obvious just how many auditors were concerned about whether a particular company was a ‘going concern’ and whether the financial statements needed to be ‘qualified’.
This brings us back to the conflict between two accounting concepts: neutrality and prudence. Accountants are trained to be cautious about financial matters, i.e. prudent. If you did not need to be extremely cautious then you have still got the money in the bank but if you were too optimistic, the profit will have long since been paid out to shareholders. The deep recession in the first part of the twenty-first century was probably caused by caution being thrown out of the window and as a result the UK (among many other countries) is still paying for it. All that those accountants trained in the old school can do is to shake their heads and mutter, ‘It wasn’t like that when I was young: we were trained not to take risks’.

Activity 11.5

(a) Should an independent body appoint company auditors?  
(b) Should auditors be allowed to do other work for their clients in addition to auditing?  
(c) Should auditors be allowed to take up full-time employment with a former client?  
(d) Should auditors be allowed to do an audit for only a limited period?

Questions you should ask

Allowing for changes that may have taken place since the book was published, you might like to pose the following questions.

- Have we had to change our treatment of any accounting matters as a result of new IFRSs/FRSs?
- Has the ASB published anything during this last year that affects us?
- Are there any new accounting concepts that we have incorporated into our financial statements this year?
- What definition of revenue do we adopt?
- What methods do we use to recognize the amount of revenue we take to the profit and loss account?
- Have our auditors raised any concern about our financial statements?

Conclusion

This chapter has looked ahead to some of issues that may affect financial accounting and reporting practices over the next five to ten years.

We have reviewed the current work of both the IASB and the ASB as it was in the summer of 2009 and highlighted those projects that are likely to result in changes to financial reporting over the next few years. We have also considered in a little more detail two projects that are being undertaken by the IASB: the development of a new conceptual framework, and the introduction of a completely new standard covering revenue recognition.

Finally, we examined the role external auditors play in financial reporting and the conflict that arises between their responsibilities to shareholders and the dilemma they face in not antagonizing the directors.
Key points

1. Both the IASB and the ASB have an active development programme which should result in new standards coming on stream within the next five years. Most of their projects are highly technical and they are not of immediate relevance to non-accountants.

2. The IASB is working jointly with the FASB on a new conceptual framework, i.e. a statement of accounting principles.

3. Of particular interest is another joint programme the IASB has with the FASB: an accounting standard on revenue recognition.

4. Auditors act on behalf of shareholders but they cannot afford to fall out with a company’s directors. They also face difficult decisions about supporting the directors in the treatment of certain contentious accounting matters. In more recent times it has been difficult to determine whether or not a company is actually a going concern.

Check your learning

The answers to these questions can be found within the text.

1. What do the initials ASB, IASB and FASB represent?
2. When do IASB standards normally become effective?
3. What do the initials EPS mean?
4. Why has work on government grants been deferred?
5. What is convergence?
6. With who or what is the ASB converging?
7. What five specific activities has the ASB set itself?
8. What is a conceptual framework?
9. Who has become the IASB’s partner?
10. What is another term for faithful representation?
11. Why are neutrality, completeness and freedom from error not absolutes?
12. Give an example of a fundamental characteristic.
13. Give two examples of enhancing characteristics.
14. What are two constraints on financial reporting?
15. What is revenue?
16. What is meant by recognition?
17. Give three reasons why an accounting standard on revenue recognition is needed.
18. What is an auditor?
19. What is an external auditor’s basic job?
20 Give three reasons why an external auditor’s independence may be compromised.

21 Why might an auditor disagree with the accounting treatment a client may have adopted?

**News story quiz**

*Remember the news story at the beginning of this chapter? Go back to that story and reread it before answering the following questions.*

**Questions**

1. How would it be possible for the IASB to lose its powers?

2. What could replace the IASB if the European Union abandoned IASB’s requirements for its member countries?

3. What would be the implications for international financial reporting if the IASB was disbanded?

**Tutorial questions**

11.1 Examine the prospects of one set of accounting standards being applicable on a worldwide basis.

11.2 Assess the likely future of the UK’s Accounting Standards Board?

11.3 Outline the accounting principles that you think should be included in a conceptual framework.

11.4 Explain why revenue recognition is a major problem in financial reporting.

11.5 Discuss the relationship between a company’s external auditor and its directors.

Further practice questions, study material and links to relevant sites on the World Wide Web can be found on the website that accompanies this book. The site can be found at [www.pearsoned.co.uk/dyson](http://www.pearsoned.co.uk/dyson)
Devro plc is a Scottish-based company with its headquarters at Moodiesburn near Glasgow. It is one of the world’s leading producers of manufactured casings (‘skins’) for the food industry. It supplies a wide range of products along with technical support to manufacturers of sausage, salami, hams and other cooked meats. The company concentrates on producing edible collagen products. Collagen is a common form of animal protein. In recent years such products have been replacing gut casings in all of the company’s markets.

Besides its operations in Scotland, Devro has production plants in Australia, the Czech Republic and the USA. It also services markets from appropriately located offices around the world and through agents and distributors.

The appendix to this case study includes some information about Devro’s activities for the year ended 31 December 2008.

Required:
Based on the above information and that contained in the appendix, draft a chairman’s statement covering the year to 31 December 2008.

Appendix

Board changes
Retirements: Pat Barrett, Chairman at the next AGM. John Neilson, Finance Director since 1993, on 1 May 2008. Successor: Peter Williams. Board now has five directors: three executive (two appointed since 2006) and two non-executive directors (again both appointed since 2006).
**Dividend**

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<tr>
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<th>2008</th>
<th>2007</th>
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<tr>
<td></td>
<td>£000</td>
<td>£000</td>
</tr>
<tr>
<td>Final paid of 3.025 pence per share (2007: 3.025 pence)</td>
<td>4927</td>
<td>4926</td>
</tr>
<tr>
<td>Interim paid of 1.425 pence per share (2007: 1.425 pence)</td>
<td>2321</td>
<td>2321</td>
</tr>
<tr>
<td>Unclaimed dividends from previous years</td>
<td>(5)</td>
<td>(2)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>7243</strong></td>
<td><strong>7245</strong></td>
</tr>
</tbody>
</table>

The directors proposed a final dividend in respect of the financial year ended 31 December 2008 of 3.025 pence per share, which it was estimated would absorb £4,927,000 of shareholders’ funds. It was planned to be paid on 15 May 2009 to shareholders who were on the register at close of business on 17 April 2009.

**Financial**

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Before exceptional items:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td>183125</td>
<td>156252</td>
</tr>
<tr>
<td>Operating profit</td>
<td>20595</td>
<td>17692</td>
</tr>
<tr>
<td>Profit before tax</td>
<td>18818</td>
<td>15567</td>
</tr>
<tr>
<td>Profit after tax</td>
<td>3286</td>
<td>10323</td>
</tr>
<tr>
<td>Basic earnings per share</td>
<td>8.2p</td>
<td>6.0p</td>
</tr>
<tr>
<td><strong>Exceptional items</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating profit</td>
<td>(3478)</td>
<td>651</td>
</tr>
<tr>
<td>Taxation</td>
<td>2641</td>
<td>1044</td>
</tr>
<tr>
<td>Basic earnings per share</td>
<td>(0.6p)</td>
<td>1.0p</td>
</tr>
<tr>
<td>Cash and cash equivalents at 31 December</td>
<td>4243</td>
<td>9495</td>
</tr>
</tbody>
</table>

* Mostly due to reorganization of manufacturing activities in the Czech Republic (£3.7 million) less profit on sale of Moodiesburn land (£238,000).

**Operational**

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sales to external customers</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Collagen casings</td>
<td>144695</td>
<td>125104</td>
</tr>
<tr>
<td>Distributed products</td>
<td>21523</td>
<td>18080</td>
</tr>
<tr>
<td>Other products</td>
<td>16907</td>
<td>13068</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>183125</strong></td>
<td><strong>156252</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Geographical segmental revenue:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Europe</td>
<td>107289</td>
<td>92515</td>
</tr>
<tr>
<td>Americas</td>
<td>33627</td>
<td>28778</td>
</tr>
<tr>
<td>Asia/Pacific</td>
<td>42209</td>
<td>34959</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>183125</strong></td>
<td><strong>156252</strong></td>
</tr>
</tbody>
</table>

Prices were raised by 3.2% on average during 2008. Raw material costs were broadly similar to those in 2007.
Outlook

It was thought likely that the banking crisis in the UK would be a major headache during 2009 and beyond and that credit would also be very tight. The UK’s national debt was considered huge and that it would take many years before it could be brought down to a sustainable level. Taxes would probably have to rise and government capital and revenue expenditure would be cut fairly severely.

The outlook for Devro was much healthier. Increased investment in capital expenditure would help (up from £10,469,000 in 2007 to £12,949,000 in 2008). Most of its income was earned overseas and like the UK other countries were also in economic difficulties.

Note: For further information about Devro plc log on to its website (www.devro.plc.uk).
After preparing this case study you should be able to:
- evaluate a set of financial statements for a public limited company;
- identify the main changes in the company's financial position over a period of time;
- summarize the information contained within such statements.

Robert Wiseman Dairies is a public limited company. Its head office is in East Kilbride near Glasgow. The group’s revenue and profits arise wholly from the processing and distribution of liquid milk and associated products. It operates entirely within the UK with seven major processing dairies at Aberdeen, East Kilbride, Glasgow, Manchester, Droitwich Spa, Okehampton and Bridgwater. The average number of persons employed by the group during the year to 4 April 2009 was 4508 (3888 on production and distribution, and 620 on administration).

The company was originally a small family business. In recent years it has expanded rapidly. It has done this partly by natural growth and partly through acquiring other companies. It became a public company in 1994.

The appendix to this case study shows some data extracted from the Group’s annual report and accounts for 2005, 2006, 2007, 2008 and 2009.

Required:
Analyse the company’s financial performance for the five years 2005 to 2009 inclusive.
# Appendix

Robert Wiseman Dairies plc  
Five-year financial statement summary

<table>
<thead>
<tr>
<th>For the year ended</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£000</td>
<td>£000</td>
<td>£000</td>
<td>£000</td>
<td>£000</td>
</tr>
<tr>
<td><strong>Income statement</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td>489,168</td>
<td>568,564</td>
<td>605,289</td>
<td>721,983</td>
<td>847,702</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>(373,400)</td>
<td>(429,883)</td>
<td>(448,594)</td>
<td>(551,829)</td>
<td>(667,309)</td>
</tr>
<tr>
<td>Gross profit</td>
<td>115,768</td>
<td>138,681</td>
<td>156,695</td>
<td>170,154</td>
<td>180,393</td>
</tr>
<tr>
<td>Profit from operations</td>
<td>25,077</td>
<td>27,495</td>
<td>35,659</td>
<td>31,645</td>
<td>35,147</td>
</tr>
<tr>
<td>Profit before tax</td>
<td>25,221</td>
<td>26,726</td>
<td>34,592</td>
<td>29,184</td>
<td>30,767</td>
</tr>
<tr>
<td>Profit for the year</td>
<td>21,551</td>
<td>18,450</td>
<td>24,156</td>
<td>19,320</td>
<td>6,581</td>
</tr>
<tr>
<td><strong>Balance sheet</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property, plant and equipment</td>
<td>146,228</td>
<td>150,119</td>
<td>176,309</td>
<td>216,455</td>
<td>221,881</td>
</tr>
<tr>
<td>Inventories</td>
<td>6,826</td>
<td>7,037</td>
<td>7,079</td>
<td>8,887</td>
<td>10,581</td>
</tr>
<tr>
<td>Trade receivables</td>
<td>32,237</td>
<td>39,876</td>
<td>41,958</td>
<td>53,310</td>
<td>57,130</td>
</tr>
<tr>
<td>Current assets</td>
<td>49,851</td>
<td>56,328</td>
<td>59,432</td>
<td>71,607</td>
<td>80,995</td>
</tr>
<tr>
<td>Trade payables</td>
<td>(38,321)</td>
<td>(44,803)</td>
<td>(52,155)</td>
<td>(63,140)</td>
<td>(69,906)</td>
</tr>
<tr>
<td>Current liabilities</td>
<td>(67,889)</td>
<td>(76,170)</td>
<td>(81,798)</td>
<td>(101,861)</td>
<td>(107,173)</td>
</tr>
<tr>
<td>Total equity</td>
<td>114,069</td>
<td>119,258</td>
<td>139,796</td>
<td>139,509</td>
<td>134,521</td>
</tr>
<tr>
<td><strong>Cash flow statement</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating activities</td>
<td>31,424</td>
<td>36,010</td>
<td>44,109</td>
<td>52,937</td>
<td>57,964</td>
</tr>
<tr>
<td>Investing activities</td>
<td>(18,953)</td>
<td>(23,871)</td>
<td>(41,679)</td>
<td>(62,731)</td>
<td>(30,983)</td>
</tr>
<tr>
<td>Financing activities</td>
<td>(20,585)</td>
<td>(15,724)</td>
<td>(3,737)</td>
<td>10,563</td>
<td>(21,978)</td>
</tr>
<tr>
<td>Net increase/(decrease) in cash and cash equivalents</td>
<td>(8,114)</td>
<td>(3,585)</td>
<td>(1,307)</td>
<td>859</td>
<td>5,003</td>
</tr>
<tr>
<td>Cash and cash equivalents at start of year</td>
<td>16,431</td>
<td>8,317</td>
<td>4,732</td>
<td>3,425</td>
<td>4,284</td>
</tr>
<tr>
<td>Cash and cash equivalents at end of year</td>
<td>8,317</td>
<td>4,732</td>
<td>3,425</td>
<td>4,284</td>
<td>9,287</td>
</tr>
<tr>
<td><strong>Statistics</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basic earnings per share (p)</td>
<td>28.38</td>
<td>25.35</td>
<td>33.38</td>
<td>26.76</td>
<td>9.19</td>
</tr>
<tr>
<td>Dividends per share (p)</td>
<td>8.00</td>
<td>9.00</td>
<td>12.00</td>
<td>14.00</td>
<td>15.00</td>
</tr>
<tr>
<td>Market price per share (p)</td>
<td>270</td>
<td>312</td>
<td>459</td>
<td>458</td>
<td>324</td>
</tr>
</tbody>
</table>

**Notes:**

(1) According to the notes to the financial statements (p. F29), the current year’s tax (2009) was significantly affected by a change in legislation phasing out an industrial building allowance. The deferred tax impact on the Group was over £17 million. There was no immediate cash impact, i.e. it was a ‘book’ entry. This change was not expected to occur again.

(2) Additional information may be obtained by logging on to Wiseman’s website (www.wiseman-diaries.co.uk).