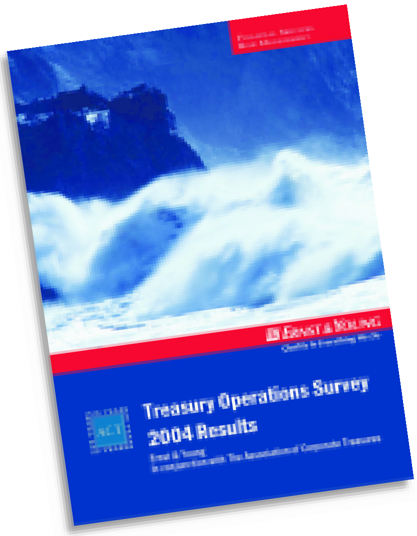
Gearing up for IFRS compliance

Over 80% of companies are on target to comply with the International Financial Reporting Standards (IFRS) that come into effect on 1 January 2005, with many expecting to achieve hedge accounting under IAS 39 for 75% to 100% of foreign exchange (FX) and interest rate contracts.

But the cost of compliance is high, with most firms estimating it between £20,000 and £250,000, while 11% believe it could break the £1m mark. Moreover, less than half of the respondents believe IAS 39 presents "a worse reflection of the risks inherent in a treasury."

These were some of the key findings relating to IFRS in the *Treasury Operations Survey 2004* conducted by the Global Treasury Advisory Services team of Ernst & Young's Financial Services Risk Management practice in conjunction with the ACT. The survey, aimed at treasurers predominantly outside the financial services industry, found that:

- Board level and senior executives are becoming far more interested in the effectiveness of the treasury function – 44% of treasuries now measure their performance.
- The average treasury department has between zero and eight staff; most treasuries expect to re-size in the near future.
- Most treasuries have a specialist treasury system or use the treasury module of an enterprise-wide system.



The Treasury Operations Survey 2004 Results by Ernst and Young and the ACT.

"It is important to get the basics right. This is particularly so for a treasury function. Providing the right policies and procedures is an integral part of managing the treasury function," said Jane Hurworth, Senior Manager, Global Treasury Advisory Services at Ernst & Young. "It is important that senior management are able to monitor and control risks. The treasury needs to be properly structured in order to do this."

The key aims of the annual survey were to provide corporate treasurers with an opportunity to express their opinions on the issues they face; benchmark their operations against those of others, and to identify trends in the structuring of treasury operations and the management of risk; and to understand IAS 39's impact on other organisations.

In the case of IAS 39, though not mandatory, 33% of respondents intend to provide IAS 39-compliant comparatives in their first IFRS compliant financial statements, with 20% providing an indication of what the impact of IAS 39 is likely to be on their businesses.

"Implementation of IAS 39 is one of the biggest accounting shake-ups in history. However, it's much more than an accounting issue," said Ms Hurworth. "Organisations were at varying stages in their conversion. Time is running out as the deadline is now only months away."

The survey found 20% of companies have, or plan, to implement a new treasury system, while 34% will use spreadsheets to meet additional IAS 39 requirements. Others intend to rely on existing systems. Interestingly, only 55% of respondents indicated that their boards were actively involved in IAS 39 projects.

When it came to risk management, most participants described their operations as "very cautious" or "cautious". A worrying aspect was the lack of treasuries with procedures manuals covering all areas of treasury, down from 69% to 52%, but there was a decrease in those with no procedures manuals whatsoever – possibly due to the need to comply with section 404 of Sarbanes-Oxley (SOX). Contingency planning is highlighted in this issue (*Are you prepared for the worst?* p15). Of the treasuries required to comply with SOX, none had completed the work required and 21% are still at planning stage.

When rating risk management, 88% of the respondents put cash and liquidity management among their top three functions, followed by funding (73%) and interest rate risk management (58%) – a shift from last year when 60% cited FX as important.

In determining the derivatives to be used to manage risk, the accounting treatment, risk/reward profile and price were cited as most important. This indicates the increasing importance of accounting treatment as a driver for derivative selection since last year.

Of the respondents, 77% (up 16% from 2003) manage interest rate exposure via a fixed: floating target ratio or range for debt. There has been a definite move away from the number of entities with an even split on last year.

A copy of the survey is available from Ernst & Young at **www.ey.com/uk** and the ACT at **www.treasurers.org** or by contacting Sally Spooner via e-mail at **sspooner@uk.ey.com**. ■

IN BRIEF

A report by HandySoft has revealed that financial managers in the top 100 European companies place greater priority on problems in customer service and operations than managing risk, despite the current focus on Sarbanes-Oxley and the introduction of new accounting standards. The report reveals that corporates' investment in new technology is driven by regulatory compliance and that investment may be made at the expense of other priorities. "Technology support for Business Process Management should not be concentrated solely on spot solutions for regulatory compliance, but should be extensible to manage other priority risk areas and processes in the corporation," says the report.

Airline Virgin Atlantic, global telecom provider AT&T, and Asian networking services provider SingTel, have selected AvantGard-Quantum and AvantGard-Risk for their group treasury operations. Virgin selected the SunGard solution to gauge its true liquidity position at any point in time and gain access to key data, enabling improved management of market, credit and operational risks. AT&T, meanwhile, selected AvantGard to support its global cash management, FX and derivatives business. The solution will be used by treasury personnel in the US as well as in Europe, Asia and Latin America. AvantGard is being implemented at SingTel's Singapore operations to help manage cash, provide a view of positions, and allow flexible forecasting and the ability to take a common view of cash exposures.

SuperDerivatives has launched a new version of SD-FX, the foreign exchange market's benchmark currency option pricing system. The company claims that the new version includes powerful enhancements which have been added to meet customer requirements. New functions include tools to carry out revaluation of positions with real market prices. Portfolios can be uploaded from and downloaded to SD-FX from Excel.

IN BRIEF

■ The Bank of England is changing its official operations in the sterling money markets in order to reduce volatility in the sterling overnight market (see *Technical Update*, p39, July/August). The Bank wants to ensure overnight rates stay in line with the Monetary Policy Committee's repo rate, and is initiating a new system, based on averaging with voluntary reserves. This will allow banks to average out the sums they hold with the Bank over a maintenance period (remunerated at the Bank's repo rate). The greater flexibility allowed in how much they hold, it says, will help keep overnight rates more stable because banks will be able to switch funds between the Bank and overnight money market funds (MMFs) to capitalise on rate changes. If the overnight rate falls, banks will switch funds to the Bank, thereby pushing the overnight rate up again, and vice-versa. The Bank plans to issue a detailed paper setting out the proposed changes in the autumn. In next month's issue, *The Treasurer* will look at how recent moves by the Bank to impact sterling overnight interest rates will affect treasurers and providers of MMFs.

■ As part of the ongoing development of its website, the ACT is launching an online treasury appointments section. As well as featuring regularly updated treasury jobs, the site will contain career-related articles. For more details please log onto **www.treasurers.org/careers/index.cfm**. If you would like to advertise a treasury appointment, please call Caroline Cowen on 0207 213 0701.

■ SimCorp (www.simcorp.com) has released a new version of its treasury management software – IT/2. It claims this will enhance treasurers' abilities to meet corporate governance recommendations/ requirements by offering the functionality to map treasury processes. The solution provides Treasury Process Maps (pictorial representations of the processes in treasury) to document all workflows while also driving business processes. A treasury department can lay out its own specific treasury workflows for reconciliation, deal verification, payment authorisation etc, using a drag-and-drop facility. When users click on an icon within a map, the underlying process element starts. Treasury managers are provided with full visibility of the status of processes, which is audited in real-time.

■ Global energy company BG Group has selected integra-T.com to support treasury and cash management across its global business activities. The solution will be used primarily for cash management and liquidity forecasting, risk management and compliance with the International Financial Reporting Standards. BG's Reading-based treasury team will be the first users before the solution is rolled out to key remote users for cash and liquidity forecasting.

Governance to go under FRC review

Corporate governance has come under the spotlight again recently, with the UK's Financial Reporting Council (FRC) announcing a review of Nigel Turnbull's internal control guidelines for company directors (see *Practice what he preached*, page 50, May 2004) while also introducing regular reassessments of the Combined Code of Practice.

UNDER REVIEW: Nigel Turnbull's (above) guidelines and the Combined Code of Practice.

But stringent corporate governance requirements, akin to the tough new internal controls which come into effect for US-listed companies under Sarbanes-Oxley (SOX) at the start of next year, are not currently on the FRC's agenda – despite rumblings that similar corporate governance legislation may spread across Europe in the future.

"The reviews are in response to the same things that brought about SOX, such as the collapse of Enron and WorldCom. They are not a reaction to SOX," confirmed a spokesman for the FRC. "We are not sure how regularly the Combined Code will be reviewed, but it will be more a case of ongoing monitoring rather than leaving it for a few years, and then changing it completely."

The committee, set up to review Turnbull's guidance on internal controls and risk management, first meets this month for what will take the from of a two-stage consultation process – general issues and then, revisions to the guidelines. The latter are anticipated in the third quarter of 2005 and are likely to take effect for accounting periods commencing on or after 1 January 2006.

"There have been developments in the UK and internationally since the Turnbull guidance was published. It is now appropriate to review the guidance and make sure it remains relevant," said Bryan Nicholson, Chairman of the FRC.

Meanwhile, the first formal review of the Combined Code on Corporate Governance is scheduled for the second half of 2006. The FRC believes that by this time UK-listed companies will have reported on their compliance with a revised version of the code that came into effect on 1 November 2003.

"It is not in anybody's interest to have a framework for corporate governance that is continually changing, and there should be no presumption that an annual review will lead to annual revisions to the Combined Code," said Sir Bryan Nicholson, Chairman of the FRC. "However, if issues emerge or any clarification is needed, it is obviously desirable that there is some flexibility to make changes in an orderly and timely way."

However, companies' response to changes in the Combined Code have come under question recently with a KPMG-sponsored survey indicating that few FTSE 100 companies have yet dealt with the revised code's demands.

Over one quarter do not meet revised requirements for a board's balance to be roughly half executive and half independent non-executive directors. Another area to be addressed is that of chairmen sitting on the audit and/or remuneration committee of the firms – something outlawed under the revised code. This was found to still be the case for 21 and 35 companies respectively.

However, companies still have time to make necessary changes as they do not have to report their compliance with the revised code until their next annual reports – between April and September 2005 for most listed companies. They also have the option of explaining their non-compliance with the code.

FORTHCOMING EVENTS
REGIONAL GROUPS

A market based measure of default risk

Speaker: Brian Dvorak, Managing Director, Moody's KMV

Tuesday 28 September 2004 – 18.00 for 18.30
Cadbury Schweppes plc, 25 Berkeley Square, London WIJ 6HB.
Nearest tube: Green Park or Bond Street

For more information, contact Anna McGee amcgee@treasurers.co.uk 020 7213 0719. Or visit our website at ***www.treasurers.org/membership/rgoevents.cfm***

On the move...

■ **Susan Alexander MCT** has joined Cable & Wireless as Treasury Manager. Susan previously worked for EDF Trading Ltd as Assistant Treasurer.

■ **Andrew Baillie AMCT**, formerly Manager at Tetra Laval International, Switzerland, is now Senior Account Executive at American International Company, Bermuda.

■ **Rosemarie Barry AMCT** has joined Fidelity Investment Management (Ireland) Limited, as Corporate Treasury Manager. She previously worked for DuPont as Cash Manager – Corporate Treasury.

■ **Caroline Bushman MCT**, formerly Group Treasury Manager at Pilkington plc, has been appointed Assistant Treasurer at Octel.

■ **Simon Dunne AMCT**, formerly Associate at Doughty Hanson & Co, is now Vice President at Morgan Stanley & Co International Ltd.

■ **Jason Grover FCT** has been appointed Finance Director at UK pharmaceutical wholesaler UniChem. Previously he was Group Financial Controller at Alliance UniChem plc.

■ **Richard James MCT**, previously Head of Investor Relations and Corporate Communications at ICI, has joined Cable & Wireless as Group Treasurer.

■ **Matthew Lynas MCT** has been appointed Programme Director – FSTA, within Rolls-Royce plc's Defence Aerospace division. He was formerly Assistant Treasurer within the Corporate HQ.

■ **David Marshall AMCT** has been appointed Director of Project Finance at Grant Thornton. David was formerly an Associate Director at KPMG LLP.

■ **Andy Matthews AMCT**, formerly Interim Treasury Manager at Cadbury Schweppes plc, has been appointed Treasury Manager at Associated British Foods plc.

■ **Richard Miles AMCT**, former Managing Director of the Debt Capital Markets area at Deutsche Bank, has joined the UK coverage group of BNP Paribas. He will be responsible for UK clients in the utilities and business service sectors.

■ **Tony Piggott AMCT**, formerly Head and UK Treasury Sales at Société Générale, is now Director, Capital Markets Group UK Corporate Sales at Calyon Corporate & Investment Bank.

■ **Colin Robertson AMCT**, formerly Corporate Finance Manager at the Royal Bank of Scotland Group plc, has transferred to Coutts Bank (Asia) as Head of Strategic Projects.

■ **Keith Strachan MCT** has joined Deloitte & Touche LLP as Director, Corporate Treasury Advisory. He previously worked for Kingfisher plc as Assistant Treasurer.

■ **Elizabeth White AMCT**, previously Manager at Ernst & Young LLP, has been appointed Derivatives Reporting Analyst at Standard Life Assurance Company.

■ **Martin Whiteley AMCT** has joined the British Bankers' Association as Director on a 12-month secondment from Barclays Bank, where he was Head of Credit and Market Risk in the Private Clients and International division.

■ **Gary Williams AMCT**, formerly Interim Treasury Manager at Powergen (UK) plc, is now Treasury Centre Manager at Mitsubishi Corporation (UK) plc.

■ **Diane Wilson MCT** has joined Imperial Tobacco Group plc as Deputy Group Treasurer. She previously worked as Assistant Treasurer at Kingfisher plc.

MEMBERS' DIRECTORY: *Members' contact details are updated on* **www.treasurers.org**.

CAREERS: *For up-to-date treasury vacancies and careers articles log on to:* **www.treasurers.org/careers/index.cfm**.

LETTERS Sound risk management at mercy of IAS 39

I disagree with your article on IAS 39 (*Editorial*, page 01, *The Treasurer*, July/August 2004). I believe the new standard's questionable accounting logic has adverse consequences and is inconsistent with good risk management practice.

The International Accounting Standards Board's (IASB) consultative process was mainly cosmetic, a waste of time, and rational suggestions and examples were not taken on board. The reaction has been a massive effort to find ways to work around the standard, which weakens treasury controls and impairs risk management.

One issue that highlights this is managing the two basic risks that are introduced when putting debt on a balance sheet: security of funding (refinancing risk) and interest rate risk.

Although arduous, ensuring security of funding is usually dealt with by diverse sources and maturities. Capital markets work well in this respect, but there is a limited demand for floating rate instruments in the investor community. Consequently, corporates with large debt loads which require security of funding are bound to issue predominantly fixed-rate term debt instruments.

Business cashflows may warrant floating financial liabilities for risk offset and financial covenant management. Initially, corporate treasurers will enter into interest rate swaps from fixed to floating to achieve this and deal with the initial interest risk problem. Hedging treatment for such swaps is permitted under IAS 39. However, business cashflow profiles evolve and it is often necessary to refix a portion of the hedged debt. Regrettably, under IAS 39, a swap to perform such a refix would be considered a hedge of a hedge. In most circumstances, this second swap is ineligible for hedge accounting treatment and must be marked to market through profit and loss (P&L)... bringing years of interest risk into a single accounting period.

The introduction of IAS 39 will leave corporate treasurers with the difficult choice of whether to introduce almost certain P&L volatility at the interest line, or remain unhedged. Regrettably, IAS 39's imminent implementation means treasurers are already facing this decision and many will remain less well-hedged to interest risk than they should.

This may seem to have been brought about by a simple case of naivety on the part of standard setters. Much of the standard seems to rest on a Finance 101 assumption that the capital markets are perfect, with treasurers issuing debt in sufficiently diverse forms and managing the two risks by using debt instruments. Nothing could be further from the truth. Derivatives arose to fill the resultant economic gap and have a central role to play in every corporate treasurer's arsenal.

With its hostile stance against rational hedging techniques, IAS 39 will discourage legitimate risk management practices and the adverse consequences will be to the detriment of the treasury profession. ■

The News section was compiled by Liz Salecka • Press releases should be addressed to lsalecka@treasurers.co.uk.