Accounting enters crucial phase

The accounting world is in a crucial phase of change that will have far-reaching consequences, according to Fitch Ratings.

The agency said that the standard-setters' conceptual framework project – in particular, the discussion on measurement – would set the financial reporting scene for years to come.

Bridget Gandy, Head of Accounting Research at Fitch, said: "The IASB and the FASB are going back to basics. They are working together to establish on a global scale what will get reported as assets, liabilities, gains and losses, and how these will be valued. It is vital that analysts and investors get involved in the debate and start to think about what they want financial reporting to give them. This is a one-off opportunity."

Fitch also said that tighter financial scrutiny had resulted in high numbers of restatements in US financial reporting, which had numbed analysts' reaction to restated numbers, especially as many confuse as much as they inform.

"Filtering what needs to be looked at carefully from all the noise remains a necessary part of analysis," said Gandy, "although it has become more burdensome."

● Investors can now access detailed analysis of issuers with an online tool created by Fitch. The peer analysis tool, which allows access to information on 100 countries and over 800 corporate entities, was launched in early February.

Fitch Group Managing Director Trevor Pitman said: "This is a straightforward way for investors to compare issuers. Investors are increasingly interested in global information on companies."

The service allows users to generate tailor-made reports comparing key financial data and metrics over specified time periods. Reports can be customised according to a variety of parameters including by date, rating or entity.

Head of Sovereign Ratings, David Riley, said: "Investors are increasingly looking for centralised source of sovereign credit and economic data has already been collated and adjusted to enable meaningful peer analysis to be made."

Increased borrowing costs fuels caution

After the interest rate increase from the Bank of England at the beginning of the year and speculation of further moves upwards, the price of European credit looks set to ratchet up in 2007, *writes Julia Berris*.

Moody's review of credit trends in 2006 the outlook for 2007 predicts an interesting year for the bond market, with tightening spreads in investment-grade sectors.

There was a total of 5,293 western European bond issues last year, raising $1,191bn, which amounts to an increase of 11.3% over the previous year's total of $1,070bn.

Christine Li, Economist at Moody's, said: "We have certainly seen ongoing growth in some sectors. We expect the economy to slow in the next year. Against our expectations, speculative spreads continue to tighten. As interest rates continue to rise, we expect the price of borrowing to increase."

After the earlier than expected hike in January of 25bp, many market commentators predicted another interest rate rise in February after the latest quarterly inflation report. In the end, the Bank of England left rates unchanged but many analysts expect to see further increases in 2007.

Li said: "As the cost of borrowing increases, interest-rate-sensitive high-yield debt becomes less attractive to investors, leading to lower demand. In turn, prices will be pushed down and yields will rise steeply compared with investment-grade debt."

Moody's warned that caution was necessary with borrowing costs and monetary tightening reducing the liquidity of the increasingly indebted corporate sector. Meanwhile merger and acquisition (M&A) activity continues at a rapid pace.

The first quarter of 2007 has seen continuing activity in the private equity sector. There has been speculation of a bid for Sainsbury's by a private equity consortium including CVC Capital and KKR, which are both involved in high-profile bids such as Debenhams and NXP respectively.

Li said: "Going forward, we certainly expect to see a high number of issuances in western Europe and we expect to see M&A and private equity activity to perform well this year."

Paul Guest of Moody's said that the deterioration in credit quality in western Europe during 2006 had been the worst experienced since the dotcom crash in 2002.

Moody's upgraded 73 issuers and made 117 downgrades in 2006. The creditworthiness of non-financial sector issuers in 2006 softened faster than it has for three years.

Guest said: "With interest rates still on the rise and the corporate appetite for borrowing still healthy, it would be premature to signal a turnaround."

The report predicts a positive outlook for 2007, particularly in the investment-grade sector, with upgrades expected to outnumber downgrades within the next eight to 12 months.

Guest said: "Based on our various probabilities and the segment-by-segment analysis, there will be a trough in credit quality some time mid-year. Towards the end of 2007, nearly all measures indicate that upgrades will outnumber downgrades and the credit cycle will be in recovery mode." ■

Christine Li: expect price of borrowing to rise.

Paul Guest: trough in credit quality approaching.

SunGard buys up XRT

SunGard's recent acquisition of fellow technology company XRT will not disrupt customers of XRT treasury products, Sungard has said.

The takeover includes all XRT product lines, including Globe$ and TWS, which will join SunGard's existing suite of treasury management solutions.

Ken Dummitt, President of SunGard's AvantGard business unit, said: "With AvantGard's award-winning customer service and strong portfolio of solutions we feel we are able to offer Globe$ and TWS customers a sound future, with a viable support programme and growth path."

Customers are being told that quality of service will not be compromised. Dummitt assures all users of XRT products that they will continue to receive a tailor-made service, designed to fit into specific organisations.

He said: "We offer a comprehensive approach, bringing together treasury, receivables and payments management for a single view of cash and liquidity management. Globe$ and TWS customers can benefit from our long-term vision and the strength of our global customer."

The acquisition includes all current customer contracts, intellectual property, sales, marketing and development assets relating to these product lines as well as responsibility for customer support and maintenance of these product lines.

The terms of the acquisition were not disclosed. ■

Corporates struggle to hold down their costs

A lack of ambition is blighting companies' cost-cutting efforts around the world, according to a new survey.

Almost two-thirds of companies set themselves cost reduction targets of no more than 3% a year, according to research by the Economist Intelligence Unit, commissioned by KPMG. And even these limited cost savings are proving difficult to achieve, with only a disappointing 8% of respondents actually reaching or exceeding their targets.

As profits and revenues rise, companies increasingly lose control of costs, according to the 427 senior executives questioned. Nearly half of all the companies admitted that they did not know what drove costs and profitability at a business unit level.

According to KPMG, the findings indicate that businesses could increase profits by at least 10% a year (assuming a current profit on sales level of 10% for the average company) if they shifted their non-core activities to shared service centres.

- Nearly three-quarters (74%) predicted that in the next three years the biggest rise in costs would be pay and benefits costs associated with recruiting and retaining top talent.
- The rising cost of raw materials (listed by 66%) and the need to invest in technology (64%) were identified as the next two biggest cost drivers.
- Only 16% believed that cost management was a responsibility for all staff, showing a worrying lack of accountability.

Tim Jones, Partner at KPMG Advisory, said: "Executives around the world admit that the more successful a company becomes, the more likely it is to lose control of costs. Increased profits and revenues are masking a bloated cost base that could leave a company at risk of hostile takeover."

When companies did turn their attention to reducing costs, the most frequently cited reasons were a challenging competitive environment (50%), downward price pressure (42%) and to fund growth (31%).

Jones said: "Reducing costs that are built into a company's business model requires changing embedded culture and practices. This isn't something that can be achieved overnight. It requires clear leadership and communication from the board to change practices that will deliver long-term benefits. ■

Avis guarantees senior notes of subsidiary business

A US parent company has agreed to guarantee the senior notes of its subsidiary car rental company after extensive negotiations with investors in credit default swaps (CDS).

Budget rental group Avis announced its decision to guarantee the $1bn aggregate principal amount of senior notes issued by subsidiary Avis Budget Car Rental in April last year, after a corporate restructure repaid the parent's bonds but wiped out the CDS reference debt.

Assistant Director, Policy and Technical, at the ACT, Martin O'Donovan, said: "A CDS on $10m became worth just $40,000. This minimal residual value of the CDS was simply due to the possibility that if some bonds were issued in the future, then the CDS would become useful again."

The previously orphaned credit default swaps subsequently leapt in value from $40,000 to $190,000, for a fee of $14m paid to Avis and institutional investors.

The transaction was arranged by Deutsche Bank Securities.

O'Donovan said: "Avis had the incidental benefit of being able to dispense with filing full Securities and Exchange Commission accounts for the subsidiary."

Euro money market grows strongly

The euro money market has performed strongly compared with previous years, a recent study from the European Central Bank reveals.

The research found that the aggregated turnover of the euro money market increased strongly in the second quarter of 2006, after two years of slow growth.

This increase was particularly strong for overnight indexed swaps (EONIA swaps), forward rate agreements and other interest rate swaps, which recorded a year-on-year growth rate of over 40%. The study also confirms that the secured (repo) segment remains the largest euro money market segment.