NEW ACCOUNTING RULES EXPLAINED

MANY TREASURERS HAVE NOT YET DECIDED THEIR APPROACH TO NEW HEDGE ACCOUNTING RULES, **ANDREW FOULKES** OF KPMG REPORTS FROM SEPTEMBER'S ACT SYMPOSIUM.

New hedge accounting rules will have serious implications for corporate hedging practices but not all treasurers seem to have got to grips with what they need to do or when. Judging from the complexity of new standards and exposure drafts discussed at a recent symposium, this is perhaps understandable.

The ACT symposium *New Derivatives Accounting Rules – why should the corporate treasurer care?*, hosted by KPMG on 12 September, was prompted by the Accounting Standards Board's (ASB) two new exposure drafts designed to implement aspects of the international rules on financial instruments in advance of 2005. Two speakers from KPMG set the scene before the floor was opened to a panel discussion.

Terry Harding, Partner in KPMG's IAS Advisory Services group, presented the requirements under IAS 39, the IASB's standard on financial instruments which is due to be implemented in 2005. The main treasury implication is that IAS 39 places strict criteria on a company's ability to apply hedge accounting to its economic hedging strategies. Experience in Europe and elsewhere shows that IAS 39 is complex, costly and difficult to implement.

Andrew Buchanan, Senior Manager in KPMG's UK Technical Accounting Group then spoke about the ASB's proposal that FRED 23 should come into effect for financial statements ending on or after a date in early 2003. This timetable would require companies to have the processes in place to document, control and monitor their hedging relationships, test them for effectiveness and recognise ineffectiveness in the income statement. FRED 30, which would likely apply in 2004, would introduce new rules on the classification of preference shares and convertible bonds as debt or equity, and would provide an option for companies to adopt most of the measurement and hedge accounting requirements of IAS 39, before the 2005 deadline.

Paul Ebling, Project Director at the ASB, and Mark Morris, Group Treasurer of Rolls Royce plc, then joined the presenters for a panel discussion which highlighted some of the issues which treasurers are trying to address.

CRITICAL QUESTION. "Can treasurers escape all the problems of changing hedging strategies and processes by not bothering to seek hedge accounting?" was a critical question that was asked. The response was, yes, but at the risk of severely impacting reserves, covenants and even rules under Articles of Association. European companies have already discussed this with market analysts and been advised that such an approach could be damaging, due to the volatility it could introduce to the profit and loss statement.

To the key question of whether accounting standards could therefore radically change hedging strategies, it was clear that there is a high risk of this happening. Despite the hope that hedges are already closely aligned to exposures, treasurers obviously have different interpretations of just what this means. There was little doubt that the specific requirements of the new standards will force some treasurers to change what they now consider to be acceptable economic hedges, if they want to gain hedge accounting treatment.

Notwithstanding the discussion around whether the ASB will bring in changes ahead of IAS 39, a fundamental question was "Is the IAS 39 standard now fixed?" Unfortunately it appears that there is room for a degree of change as the IASB, FASB and national accounting boards do not have a common view on all aspects of the standards. Indeed part of the reason for differences of detail between the FREDs and the IASB standards appears to be due to the ASB's desire to reflect expected changes in IAS 39 in the UK exposure drafts.

Effectiveness testing was one thorny aspect of the standards which was raised. To the question "Will the ASB and IASB be issuing further guidance on acceptable methods for effectiveness testing?" the answer appeared to be "No". While this may leave treasurers a welcome degree of discretion, it does mean they will need to think carefully about how they do this and what tools will be needed.

As a general summary, it seemed to be recognised that transparency and openness around the use of derivatives are to be welcomed and that the UK has been in need of hedge accounting standards for some time.

As to whether the FREDs indicate the way forward for the UK – many in the audience seemed to echo the views of the ACT, that it would be simpler for the treasurer to move straight to the IASB requirements rather than implement the UK standards as a stepping stone towards this. What the discussion certainly indicated was that treasurers and finance directors should be aware of the potentially significant changes in exposure management and processes which the new standards may require.

Despite this, it appears that the number of treasurers who have analysed the implications of the new standards and prepared a battle plan for dealing with them is still small.

Of course, those who have already implemented FAS 133 have a head start (although there are important differences in the international standards), but many who report under US GAAP have chosen to duck the hedge accounting issue and therefore still have some important questions to address going forward.

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