Hotline

Welcome to January Hotline. On the 30 and 31 of this month, the ACT hosts its *Introduction to Treasury* conference, in conjunction with treasury systems experts, TREMA. The event, which is in its 10th successful year, offers an opportunity for those new to the profession to gain a valuable insight into the key issues for corporate treasurers and an introduction to the various disciplines inherent in a career in treasury. Readers still wishing to arrange a booking for either themselves or a member of their treasury team should contact mrahman@treasurers.co.uk. If you have any comments on any of the topics covered in Hotline, please contact technical@treasurers.co.uk. *Sheelagh Killen, Technical Editor. skillen@treasurers.co.uk.*

INTERNATIONAL ACCOUNTING

Standard setter's debate

As part of its project for convergence of UK GAAP with International Financial Reporting Standards (IFRS), the Accounting Standards Board (ASB) has submitted a series of letters to the IASB summarising its views on potential enhancements to IFRS in issue. The opinions are influenced by responses submitted by respondents to the ASB exposure drafts (FREDs 24-29) and to the ASB discussion paper on standards which the UK is not proposing to implement until complete (please refer to June 2002 Hotline, page13).

The standards covered by the debate include IAS 21: *The Effects of Changes in Foreign Exchange Rates*, IAS 1: *Presentation of Financial Statements*, IAS 8: *Accounting Policies, Changes in Accounting Estimates and Errors*, IAS 16: *Property, Plant and Equipment*, IAS 17: *Leases*, IAS 28: *Accounting for Investments*, IAS 33: *Earnings Per Share*, IAS 40: *Investment Property* and IAS 24: *Related Party Disclosure*. Copies of the ASB's detailed comments are available on its website at **www.asb.org.uk**.

INTELLECTUAL PROPERTY

Patently new

The DTI has launched a new consultation aimed at streamlining and enhancing UK patents legislation.

Apart from some limited changes in 1988 and 2000, the proposals represent the first significant revision of UK patents legislation since the introduction of the Patents Act 1977. Melanie Johnson, Minister for Competition, Consumers & Markets, commented: "Changes to the law are essential if the UK is to deliver on its commitment to implement the recent changes to the European Patent Convention (EPC), with which UK patent law is aligned. This will ensure that UK businesses can continue to use a single application to obtain patents that are valid in up to 24 European countries, including the UK."

Other proposed changes are designed to make it easier for businesses to maintain and protect their patents once granted. For example, it may be possible that the UK Patent Office could provide a more rapid and lower-cost alternative to court proceedings, as well as providing a reliable and effective assessment of a patent's validity prior to such proceedings.

Treasurers wishing either to assess any potential implications on the management of risks to their company's intellectual property, or to submit comments to the consultation, should visit the Patent Office website at www.patent.gov.uk. Responses on the proposed amendments to patent law are invited by 19 February 2003.

TAXATION

NIC loophole closed

The Government's Pre-Budget Report has revealed plans for new legislation intended to counter the avoidance of tax and National Insurance contributions (NIC) through the inappropriate use of employee benefit trusts (EBT).

The Finance Bill 2003 will defer tax deductions for contributions to EBTs until payment is made out of the trust in a form that gives rise to a liability to income tax and NIC. This legislation will affect payments made to EBTs on or after 27 November 2002 (when the pre-Budget report was published). Regulations have also been introduced to clarify the rules for collecting NIC where earnings are paid by someone other than the employer, for example, by an EBT. It is not all bad news, however. As reported in the December 2002 Hotline, the Finance Bill 2003 will also introduce a statutory corporation tax deduction for qualifying costs of providing shares for employee share schemes. **www.inlandrevenue.gov.uk**.

PENSIONS – FRS 17

Deferred but not forgotten

The ASB has confirmed its intention to defer the mandatory adoption of FRS 17 *Retirement Benefits* by extending existing transitional arrangements. The decision follows the widely supported proposals set out in the ASB's earlier exposure draft (see September 2002 Hotline, page 12) and will also extend to companies using the Financial Reporting Standard for Smaller Entities (FRSSE).

Once again, the ASB is keen to stress that the purpose of the deferral of full implementation is to facilitate an orderly transition to a revised IAS 19 (which the IASB hopes to agree by 2004) and "reflects no weakening of the ASB's view that the UK standard is the best approach to pensions accounting". **www.asb.org.uk**.

This month in treasury

TECHNICAL AREA	WHAT'S HAPPENING?	WHAT NOW?	WHEN?	WHAT NEXT?
FOR INFO				
FINANCIAL ACCOUNTING	**Business combinations.** The ASB launches consultation on acquisition accounting and goodwill	**More.** Details of this and a draft UITF Abstract on capacity transactions in Hotline	Business combination comments by 4 April 2003 UITF comments by 28 January 2003	**Convergence.** The ASB also contributes to IFRS debate – see Hotline
PENSIONS	**FRS17 on hold.** The ASB confirms plans to delay FRS17 until IAS 19 emerges	**Review.** Please refer to January 2003 and September 2002 Hotline for details		
TAXATION	**Nasty NIC.** Anti-avoidance moves to collect NIC on payments from employee benefit trusts	**Hotline reports.** Refer to Hotline for more details		
LAW	**Company Law Review.** The Association prepares consultation comments on OFR and governance	**More.** Summary in Hotline and full consultation response at **www.treasurers.org**		**IP law.** Proposed changes to UK patents law may offer cheaper protection of knowledge assets – see Hotline

FINANCIAL ACCOUNTING

A tricky combination

The Accounting Standards Board (ASB) has issued a consultation paper which highlights potential issues with the International Accounting Standards Board's (IASB) proposals on the accounting treatment of business combinations and intangible assets, including goodwill.

The IASB proposals have emerged from Phase I of the IASB's business combinations project, which is intended to bring international practice closely into line with standards issued last year by the US Financial Accounting Standards Board (FASB). Key themes of the IASB approach are the prohibition of merger accounting and the subjection of goodwill to periodic impairment review, rather than amortisation. The IASB also recommends adoption in international financial reporting of restrictions on provisions for the costs of restructuring which are already a feature of UK GAAP.

The preface to the ASB consultation document provides a summary of the differences between the IASB proposals and current UK accounting standards for business combinations (FRS 6), goodwill and intangible assets (FRS 10) and impairment (FRS 11). The paper then expresses some reservations, particularly in relation to:

- the IASB proposal to use acquisition accounting for all business combinations with rules for identifying an acquirer, even when one does not exist;
- the IASB proposal that goodwill would never be amortised but would be carried subject to an impairment test;
- the fact that the impairment tests proposed by the IASB are less rigorous than present practice in identifying impairments, particularly of acquired goodwill;
- the likelihood that, under the proposals, more intangible assets than at present will be recognised when they are acquired either individually or in a combination. The validity or usefulness of separate recognition and measurement for some of these seems questionable; and
- the lack of symmetry under the proposals in the treatments of intangible assets and goodwill, which could give rise to problems, given the lack of clarity of the borderline between the two.

Whatever the outcome of the consultation on the IASB's Phase I proposals, the ASB has stated that it will not contemplate adoption of a new regime for business combinations and goodwill into UK GAAP until Phase II of the international project is also complete. It will therefore consult on proposals for UK implementation only at this later stage. Phase II of the international project is being led by the FASB. An exposure draft on the application of acquisition accounting is planned for the first quarter of 2003. Phase II should also provide proposals for accounting for the formation of joint ventures and combinations of entities under common control, as well as 'fresh start' accounting, an innovative method that has many advantages where an acquirer is difficult to identify.

Comments on the consultation paper are invited by 4 April 2003 (the same deadline as for comments on the IASB proposals) and copies of the consultation paper are available at a cost of £20 post-free from ASB Publications, 145 London Road, Kingston-upon-Thames, Surrey, KT2 6SR (020 8247 1264). For background on the business combinations project, please refer to the article by Terry Harding of KPMG in the May 2002 edition of *The Treasurer*, page 36. **www.iasb.org.uk**. **www.asb.org.uk**. ■

FINANCIAL ACCOUNTING

Profit from networking

The Urgent Issues Task Force (UITF) has published a draft Abstract (UITF Information Sheet 56) clarifying the correct accounting treatment in telecoms and energy companies, both for sales of network capacity and for exchange or reciprocal transactions in capacity known as 'capacity swaps'.

The draft Abstract sets out the limited circumstances under which transactions in capacity should be reported as sales. It goes on to propose that gains on capacity swaps should be recognised only if the assets or services provided or received have a readily ascertainable market value. No accounting recognition should be given to transactions that are artificial or lacking in substance. ■

Further details are available at ***www.asb.org.uk*** *and comments on the draft Abstract are invited by 28 January 2003.*

COMPANY LAW

A point of law

The Association has given voice to treasury opinion on a number of governance issues in its response to the Department of Trade and Industry (DTI) consultation on its review of company law.

Among the points raised by the Association were concerns that:

- while limited liability was fundamental to the development of the economy, the position of creditors should be adequately considered by directors in both policy-making and in making disclosures;
- the proposed abolition of the corporate director was ill-advised and would adversely affect both occupational pension funds and corporate finance structures;
- the extension of criminal sanction beyond the Board would require clear limitations;
- the format of the Operating and Financial Review (OFR) should require directors to explicitly consider in the OFR the impact on the risk profile of the company of all risks in combination (rather than from individual specified factors) and that use of the exemption from disclosure on grounds of commercial sensitivity should be available only where it was additionally disclosed in the OFR that the company had taken advantage of the concession; and
- the removal of the requirement for a company secretary in private companies required further careful consideration. ■

A copy of the Association's full submission to the DTI is available on ACTOnline at ***www.treasurers.org****. Treasurers wishing to find out more about the Association's work on the Company Law Review should contact John Grout, Interim ACT Technical Director, on* ***jgrout@treasurers.co.uk****.*

For comments on Hotline or news, please contact Sheelagh Killen at **technical@treasurers.co.uk**.

News

STANDARDS

Enhanced transparency with IFRS

Following an analysis of the financial statements of 80 listed companies across Europe, KPMG and Goldman Sachs have published a report, based on their findings, looking at the effects of International Financial Reporting Standards (IFRS) on reported financial information. The report finds that IFRS, which becomes mandatory in 2005, will enhance transparency and comparability, facilitating European M&A activity and capital formation, but will also have a substantial impact on reported earnings and increased volatility of earnings.

In particular, accounting for financial instruments (such as derivatives and bonds), mergers and acquisitions, and pensions will be hit most by the reporting stipulations. The subsequent changes to financial statements are likely to significantly alter the results from several key performance measures used by analysts and the investment community, said the study, such as price/earnings (P/E) ratios, return on invested capital (ROIC) and so-called 'sum of the parts' metrics.

The study's authors said the findings underscore the importance to companies of adequately preparing and educating investors on the substantive changes IFRS will bring. "International Accounting Standards will change the complexion and quality of financial information in ways not seen before, and so it is vital that companies understand the extent of the impacts and ensure stakeholders understand it too," said Mark Vaessen, head of IAS Advisory Services at KPMG. **www.kpmg.com**. **www.gs.com**. ■*bfinance*

FORTHCOMING EVENTS

REGIONAL GROUPS:

10 February at 6.30pm **Midlands Regional Group meeting – Cash, FX, Derivative and Repo Transactions.** Speaker: Gary Walker, Wragge & Co Solicitors. Venue: Wragge & Co Solicitors, 55 Colmore Row, Birmingham

For more information, contact John Messore on **01242 284647** *or e-mail* **jmessore@krafteurope.com**

CONFERENCES:

30-31 Jan **Introduction to Treasury**

For further information contact Makayla Rahman **mrahman@treasurers.co.uk**

In brief...

City Networks has launched the latest version of its enterprise reconciliation module, Insight. Upgrades include easier extraction of data from internal systems for reconciliation and the addition of a report reader to extract data from standard reports. Insight automatically reconciles data across various front-, middle- and back-office systems, and general ledger and risk management systems. **www.citynetworks.com**. ■

CLS Custody Working Group has agreed enhancements to enable all custodians to settle their fund management client's foreign exchange transactions through CLS Bank. This means custodial banks will be able to pass along CLS's risk and cost reduction benefits to fund management clients. CLS Group will integrate the Custodian's Fund Identifier into the instructions sent to CLS to enable settlement at CLS Bank. **www.cls-group.com**. ■

Market data services group **GFI** has set up an alliance with Lombard Risk Systems, the credit derivative software supplier, to let risk managers revalue credit default swap portfolios, as well as verify pricing using complementary independent data sets. This will improve the accuracy and the transparency of the revaluation process. Twice a month, GFI will make part of its data available through Lombard Risk's ValuSpread Credit service. **www.gfinet.com**. **www.lombardrisk.com**. ■

PricewaterhouseCoopers (PwC) has launched the second edition of *The Financial Jungle: International Taxation of Credit Derivatives*, which analyses the challenges credit derivatives pose to the international tax environment. The book gives an overview of credit derivatives and summarises the general tax issues raised by credit derivatives, in addition to discussing accounting, legal, regulatory, valuation and risk management issues relating to credit derivatives, said PwC. **www.pwcglobal.com**. ■

The asset finance arm of **Siemens** has launched an online leasing product for corporates that it claims can decide on financing within a minute. Siemens Financial Services' (SFS) capaxx e-leasing solution aims to help manufacturers and vendors calculate their leasing offers quickly on the internet. With capaxx, leasing contracts up to €125,000 can be concluded online, without any prior leasing expertise or special training. Using a validation software system, "prompt financing decisions can be made without bank notifications and account checks". **www.sfs.siemens.com**. ■
bfinance

The Trusted Transaction Roaming (t2r) project – to harmonise mobile payment standards across various networks – has received EU funding. This means large-scale trials of the system, managed by wireless commerce industry group Radicchio and implemented by Vodafone, Orange (France), Gemplus, SmartTrust and Globalsign, can go forward. The goal is to create a single, secure infrastructure for customer payment and identity sharing among banks, carriers, and merchants and ultimately provide the framework for an EU-wide digital identity scheme. **http://www.radicchio.org**. ■

BANKING

The future of European banks

A new report released by the European Central Bank (ECB) finds that multi-channel banking and risk management are key priorities for European banks.

The report, prepared by the Banking Supervision Committee (BSC) of the European System of Central Banks, covers the regulatory and market environment, banking structures and operations, structural changes in the overall banking-risk profile, risk-management systems and public-authority actions, among other things.

Banks face growing competition in the face of deregulation, globalisation and the pressure to create shareholder value by increasing income and implementing greater control over costs. This is achieved through diversification of activities, intensified efforts to reduce costs, organisational streamlining and a more cautious approach to risk, according to the report. The ECB also found that risk-management techniques are improving as banks prepare for the new regulatory framework for capital adequacy. **www.ecb.int**. ■

LISTING RULES

Investment co focus

The Financial Services Authority (FSA) will introduce changes to the Listing Rules governing the interests of investors in investment companies – including investment trusts, according to FSA Chairman Howard Davies. The changes include a call for greater clarity in respect of investment policies, gearing, risks and how they will be mitigated, and corporate governance. Crucially, the FSA has said it will limit the percentage of total assets that can be invested in other funds and increase safeguards relating to investment companies that employ investment managers.

The regulator will press for investment managers to be appointed annually, with that appointment ratified by shareholders and for rules governing the independence of investment managers from investment company boards. The FSA also wants limits on any severance arrangements included within investment management agreements. **www.fsa.gov.uk**. ■ *bfinance*

CAPITAL MARKETS

Double squeeze hits Europe's capital markets

Europe's capital markets may not return to historic growth patterns before 2004, according to a report by Moody's Investors Service, and a short-term industry shakeout seems probable before then. That means some marginal European players will likely be driven out of the market, although the longer-term benefit for the stronger players is a reduction in the excess capacity now clogging the market.

The long-term underlying forces driving European capital markets expansion remain intact, according to Moody's, which includes their smaller size, relative to GDP, compared with US markets, as well as the pressure for public pension reform and the need to restructure Europe's corporate balance sheets. In addition, the volatility of the bear market has led to a shift away from equities toward fixed income and alternative investments.

Margin compression and market contraction are giving European capital markets players a double squeeze, said the report, and uncertainty in the timing and pace of recovery means strategic decision-making is more difficult and tends to have acute immediate effects. **www.moodys.com**. ■

Fund managers want corporates to reduce debt

Fund managers, while showing increased optimism about the world marketplace and economy, still have "considerable misgivings" about recovery in the medium term and continue to shorten their investment time horizon, according to a Merrill Lynch fund manager survey.

Although three quarters of participants were surveyed before the Federal Reserve's November interest rate reduction, "the evidence also suggests fund managers want companies to repay debt rather than use funds for capital expenditures," said David Bowers, Chief Global Investment Strategist at Merrill Lynch.

According to the survey, fund managers believe there is a low nominal growth environment now existing, and 75% think that cost-cutting, rather than top-line sales growth, will be the main driver of earnings growth over the coming year. **www.ml.com**. ■*bfinance*

CORPORATE GOVERNANCE

Investors want better business practice

The investment arm of British bank HBOS has launched a project to sign up companies and investors to global corporate governance principles. In a statement, Insight Investment, which has £63bn ($99.57bn) undermanagement, said it plans a three-year project to establish greater clarity about what constitutes good business practice. How companies conduct business in emerging markets should be a priority, it said.

The fund manager, saying the most acute problems arise in relation to developing country operations, proposed that international standards, such as OECD guidelines for multinationals and the UN's human rights declaration, should form the basis for shareholder expectations.

A number of institutional investors – shaken by the collapse of Enron and others – have started laying down the law about how companies should operate. Last month, Britain's Association of Investment Trust Companies issued a code of practice aimed at combating poor corporate management through shareholder activism. **www.insightinvestment.com**. ■*bfinance*

BANKING

EC capital changes

The European Commission (EC) has published a Working Document outlining a new capital requirements framework for banks and investment firms. According to the EC, the goal of the new framework, which forms part of the EU Financial Services Action Plan, is to modernise the existing framework to make it more flexible, comprehensive and risk-sensitive and to foster enhanced risk management for the wide cross-section of financial institutions.

The framework should take effect at the end of 2006, in parallel with the new Basel Capital Accord.
http://europa.eu.int/comm/index_en.htm. ■

The cost of Basel

Compliance with the Basel II Capital Accord could cost UK banks as much as £500m, according to a survey of UK and European banks put together by the Centre for Economics and Business Research (CEBR). Major data warehousing and integration projects are needed over the next three years for banks to aggregate risk exposures and model the risk profile of their lending portfolios, according to the CEBR. Although most banks have started preparing for the 2006 Basel deadline, fragmented systems could cause major problems, said the report.

In addition, in the event of early adoption of the euro, the ability of UK banks to convert systems could also be affected by the use of IT resources in reaching Basel compliance. **www.cebr.co.uk**. ■

Percentages...

FX and interest rate risk are the biggest issues of concern for US corporates in defining their risk strategy, according to a survey of treasurers and finance directors conducted by *Treasury & Risk Management* magazine. Whereas in 2001 the buzzword was financial accounting standard FAS 133, in 2002, 75% of the firms taking part in the the survey said they used derivatives cited FX (60%) and interest rates (66%) as the core areas of concern.

More than 90% of survey respondents said treasury and finance units were directly responsible for hedging strategy within the company – 6% said operational units managed hedging, and FX forwards (60%), FX options (33%), Interest swaps (66%) were the types of derivatives used most for FX hedging. Energy (20%), equities (11%), and credit (9%) were the other key areas of derivative employment. **www.treasuryandrisk.com**. *bfinance*

The use of factoring and invoice discounting by UK firms continued to grow in the second quarter of 2002, according to a **Bank of England** report on SME finance. The growth of domestic factoring and domestic invoice discounting saw volumes grow 3.5% and 6.9% respectively on the second quarter 2001, and year-on-year growth at 7.0% and 20.8% respectively. During 2001, manufacturers made the greatest use of factoring and invoice discounting in the UK, with 38% of the total. The service sector's share continued to fall, from 34% in 1998 to 28% in 2001. In terms of leasing, there was a 13.4% decline in finance provided to firms in the £1m to £5m turnover band, from £5.4bn in 2000 to £4.7bn in 2001. **www.bankofengland.co.uk** *bfinance*

Online multibank fx trading has taken off, according to a recent study by the research and analysis firm, ClientKnowledge. Transaction volumes have to about $14bn per day in October 2002, which is about 7% of the FX market - up from around $7bn a day in May 2002. The three big players make up most of that figure, with State Street averaging some $7bn in trades daily through FXConnect, Currenex, seeing about $3.5bn daily and FXall, the bank-owned consortium, averaging $3bn a day. Both State Street and Currenex are on course for profitability, said the report, and are therefore most able to meet market demands for broader product capability – leaving FXall as the most vulnerable to a financial squeeze. Single bank sites see total volumes of about $30bn per day, making up about 15% of the market. **www.clientknowledge.com**

Treasury and finance professionals, concerned with the quality and timeliness of credit ratings, believe the SEC should take additional action to improve its oversight of ratings agencies and foster greater competition, according to a survey by the **US Association for Financial Professionals**. Nearly a third of corporate respondents believe their company's ratings are inaccurate and most respondents identify several other major problems that adversely affect their trust in the ratings, said the survey. Many corporates believe their company's rating reflects their industry rather than the company's financial condition and, according to the report, most treasury and finance professionals do not believe the ratings favour the interests of investors in debt. **www.afponline.org**

The latest **Bond Market Association** (BMA) survey has found 81 electronic trading systems currently operating in the US and Europe versus 79 last year. According to the report, after several years of expansion and consolidation among fixed-income trading systems, platform operators are focusing more attention on product enhancements, although the BMA does expect some consolidation going forward as less-efficient platforms exit the space or are absorbed into larger systems. **www.bondmarkets.com**. ■

EU INTEGRATION

Funding costs expected to be cut

The European Commission (EC) has launched a report saying its plans for an integrated financial services market in Europe would cut the cost of equity capital by 50bp and the cost of corporate bond finance by 40bp over a 10-year period.

The London Economics/PwC research – *The Macro Economic Impact of Integration of EU Financial Markets* – revealed that trading costs could fall sharply as a result of market integration "impacting positively on the cost of equity capital".

However, the UK is set for the smallest reduction in the cost of equity finance, compared with other member states. Whereas Austria can expect a fall of about 60bp, France 58.9bp, and Germany 56bp, data for the UK suggests a reduction in the cost of equity capital of just 36bp.

The report also said that the cost of bond debt would be reduced by 40bp. "Financial market integration will result in a deeper and more liquid market," noted the Commission, "and should lead to further reductions in the credit spread required by investors".

By assuming that the share of bond financing will increase, while the proportion of bank financing will fall, the report surmised that Europe's bond market would close the gap on the US "by at least a quarter". **http://europa.eu.int/comm/index_en.htm**. ■ *bfinance*

BANKING

More prudent banks across Europe

The European Parliament has adopted the Financial Conglomerates Directive, which will, according to the European Commission (EC), enhance the prudential soundness and effective supervision of financial conglomerates and promote convergence in national supervisory approaches.

This is the first comprehensive implementation in the world of international G10 recommendations on supervision of financial conglomerates. The Directive was proposed by the EC in April 2001, and will become law as soon as it has been formally signed. It sets out requirements on solvency – especially in relation to multiple gearing of capital and downstreaming of parent company debt into subsidiary equity. It also offers guidance on group-level risk concentration, the suitability of inter-company transactions and the ability of management to ensure appropriate risk management and internal controls. **http://europa.eu.int/comm/index_en.htm**. ■

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