

G4 + 1 = go!

Accounting

Current issues for global standard setters

From the report on the April meeting of the G4+1, it is obvious that things are hotting up in the world of standard setting. A number of controversial papers is expected soon, not least proposals to account for stock-based compensation in the profit and loss account.

The G4+1 also discussed accounting for pensions but we have had no indication from the ASB where they are heading following the consultation period for FRED 20 which ended some months ago.

Financial instruments

Most importantly, a draft standard on accounting for financial instruments is due to be presented to G4+1 in September for

publication by national standard-setters by the end of October. This is expected to propose that all financial instruments are accounted for at 'fair' value. Some of the problems associated with this approach were outlined in the article by Nigel Dealy and Valerio Pace in last month's *The Treasurer*. In addition, following the recent meeting in Reading hosted by the Association, The International Group of Treasury Associations (IGTA) issued a press release on the topic, which is published on the Association website, in the 'What's new' section. The main point made in the release is that the accounting requirements being adopted presently by some accounting regulators would cause a company to change its behaviour, with changes in the resulting economic outturn, in order to meet, or avoid, the requirements of over complex accounting rules. IGTA members were particularly concerned by the way in which FAS 133 has eroded the basis on which treasurers may make prudent decisions in the management of financial risk within their companies.

The technical committee is discussing how to elicit the views of members so that it can respond appropriately to the draft standard when it is issued for consultation. Since the status quo is not an option under discussion, the response will ideally focus on practical alternatives to the approach likely to be proposed by the ASB. Readers with views on this important topic should contact me so that we can properly reflect the views of the membership. ■

Legal

Financial law panel – simplified bonds

The FLP is working with market participants towards the goal of dematerialisation of corporate bonds governed by English law. Progress is slow but, helpfully, the Treasury has amended the current Finance Bill to redraft the definition of 'quoted Eurobond' to remove the requirement that debt must be evidenced by a bearer instrument. ■

Regulation

Financial Services and Markets Bill

The Association's response to the FSA consultation paper on the Conduct of Business Sourcebook (COBS), which will apply to business between banks and 'intermediate' customers, is published on the website.

In the meantime, a new consultation paper has been received and is under consideration by the technical committee. This is on the draft Inter-Professionals Code (IPC) covering dealings between what will be called market counterparties. For more information on how these two codes fit together see Back to Basics on page 19.

The committee is considering the draft IPC from two points of view. Firstly, does it provide sufficient protection and clarity to corporates dealing in the wholesale markets as professionals (market coun-

terparties) and secondly, does it provide suitable guidance for the conduct of business by corporates in these markets?

Our response is due to be sent to the FSA by the end of July.

Regulation of money transmission

Following the recommendation of the Cruickshank report that payment systems be regulated, HM Treasury offered the Association the opportunity to comment on the Government's intentions before the formal consultation document is published. Our comments in response to this approach will be posted on the Association website, as usual. One of the points we have made is that there seems to be an assumption underlying some of the comments in the Cruickshank report that having more than one payment system competing for business is better than only

one. We do not support this view, citing the UK versus the US cheque clearing system as one example and the multiplicity of euro payment systems as another, where having a number of competing systems causes additional cost and delay to customers. ■

Tax

Tax law rewrite project – consultative process

The Association has been invited to support the consultative process relating to this project. The re-written bill on capital allowances is expected to be published some time in July. If anyone is interested in contributing to this please contact:

cbradley@treasurers.co.uk. ■

Operations

FX trading over the internet

Seven of the leading foreign exchange (FX) banks have announced that they are developing a system which will provide corporate and other customers with cost-effective and price-competitive internet currency trading. At present such trading is largely bilateral between companies and their relationship banks. It is difficult for customers to compare prices and services offered by different banks so most currency transactions are still conducted over the telephone.

Some take the view that the wholesale market will not be interested in using the internet to deal. If it was confined to FX deals which support actual business transactions the volumes would be very small in relation to total turnover in the London market. The new system, however, will be designed specifically to appeal to the wholesale market.

Futures and Options Association – Managing Derivatives Risk: guidelines for end-users of derivatives

This publication, originally issued in 1995, with the support of the Association, is now being up-dated. We have been asked to review the revised version, probably in early Autumn, to check that it is balanced. If any member is willing to assist in this review, please contact me.

Day count on euro transactions

ISDA is still attempting to gain agreement from its members on the definition of actual/actual for euro transactions. We are hoping that this will be resolved in time to include a section in the next edition of *The Treasurer's Handbook*.

TARGET days

The ECB has announced TARGET closing days in 2001. This is the same as in 2000 (ie, New Year's Day, Good Friday, Easter Monday, 1 May, Christmas Day and Boxing Day) plus 31 December. This is to allow the smooth conversion of retail payment systems and internal bank systems to the euro.

By the end of 2000, the ECB intends to establish a long-term calendar of TARGET operating days to apply as from 2002 until further notice. ■

CAROLINE BRADLEY

The Association's Technical Officer

Loan documentation

It is common for loan documentation to provide for some kind of auditors' opinion in connection with the borrower's compliance with financial covenants. Before finalising such a loan document, a well-advised borrower (or issuer) should discuss this with their auditors to ensure that they are able to provide the required opinion or report and to agree the terms under which it might be given.

The Association has received the following letter from Tim Pope at PricewaterhouseCoopers.

"Dear Sirs,

We find that we are increasingly being asked to prepare reports for our clients and for the benefit of third parties as a result of terms written into various types of borrowing agreements and related trust deed documentation entered into by our clients. The types of report that we are requested to give are usually in respect of aspects of covenant compliance.

These clauses give us difficulty because we are not signatories to the contract or agreements and consequently we are not bound by them. However, if we respond to the request we are assuming liabilities to third parties with which we have no engagement contract. In accordance with advice issued by the ICAEW it is our practice only to report to parties with whom we have an engagement contract containing satisfactory terms regarding such matters as the scope of the engagement, the nature of the report and its distribution, and the limitation of our liability.

We have found ourselves on an increasing number of occasions being unable to comply with requests from our client and the difficulties that subsequently arise for them could have been avoided with proper discussion before the agreement was entered into. It is important, therefore, that when dealing with loan agreements or giving advice in relation to any other form of agreement that requires a report from an auditors, the parties discuss with us whether or not we are prepared to provide such reports and, if we are agreeable, the terms under which we will agree to provide them.

I would also make the point that agreements often refer to "auditors' certificates". We do not provide certificates; rather we make reports based on the conclusions of work carried out in relation to the agreed terms of engagement.

I would be grateful if you would bring this letter to the attention of your members to ensure that, where they are dealing with agreements containing a requirement for auditors' reports, they advise the parties to obtain our agreement to provide such reports and to allow the parties to gain an understanding of the terms on which this would be based before the agreements are completed."

Comment by the Association's Technical Officer

The thrust of the letter is of course sensible: borrowers need to agree with their auditors what work is to be done, and the terms for this, before signing a loan agreement. In the case of a syndicated loan or a bond issue, it is essential that agreement on the issue is reached with the arranger/lead manager and auditors at the term-sheet stage of negotiation.

Failure to discuss the requirements of the lenders/trustees with the auditors in

advance can cause considerable difficulties for the borrower and can also prove more expensive than might be anticipated.

The essential point to grasp is the concern of auditors that, in providing information to lenders/trustees, they may owe a duty of care and hence could be liable in negligence. As a result, they may want to agree terms of engagement that set out the scope of their work and limits on liability. However lenders/trustees are likely to take the view that the value of the

auditors' report is greatly reduced if their liability is capped. There have been circumstances in which the only way around this has been to arrange for auditors' certificates to be provided by a firm other than the company's auditors.

The Company Law Review, which is currently underway, proposes to extend auditors' duty of care to include creditors who rely on audited information. This follows the House of Lords decision in *Caparo Industries v Dickman* in 1990. A White Paper is expected in March 2001.

The background to the letter also includes the huge upsurge there has been recently in highly leveraged financings in London: these contain very large numbers of increasingly complex financial covenants. Very sophisticated covenants and ratios are likely to involve figures which are not just line items but which require calculation specifically for the purpose of the covenant. As a result, the work to be carried out by the auditors for the purposes of checking covenant compliance on these financings is much greater, both in volume and complexity, than on a plain vanilla deal. This obviously impacts on costs.

Borrowers need to be sensitive to the different connotations of a certificate, an opinion and a report, and (as mentioned above) to the issue of the addressee. The LMA primary documents, for example, include a form of 'compliance certificate', signed by two directors of the borrower and certified by the auditors, which is specifically addressed to the agent.

There is a wide range of possible compromises which can satisfy the sensitivities of the auditors, on the one hand, to the liabilities they assume; the requirements of the lenders/trustees for professional advice on the calculations; and the need of the borrower for a fair deal.

Note also that auditors often feel unable to give a simple certificate as to compliance: from their perspective it may be preferable for the borrower to give that certificate and for them instead to give an opinion on the extraction of information on which the certificate is based and the calculations.

Further developments on this topic may emerge over the next few months, and these will be reported in the Hotline and on the Association website at www.treasurers.org. ■