Fellows debate financial instruments accounting

Three senior members of the ASB faced a grilling on accounting standards from Fellows of the ACT, with lessons learned on both sides. David Creed explains.

A Fellows' evening was held on 14 June at which Mary Keegan, Chairman of the Accounting Standards Board (ASB), Allan Cook, Technical Director and Paul Ebling, Project Director explained the background to, and led a debate on, the Joint Working Group of 10 Accounting Standards Setters (JWG10) proposals for the fair market valuation of all financial instruments. Paul briefly summarised the proposals:

- all financial instruments are to be valued in the balance sheet at exit market value; and
- all changes in value are to be reported in the current performance statement, ie there is to be no hedge accounting allowing deferral of gains and losses to a future period.

Complexity

Mary explained that, comfortable as treasurers might be with the current UK package of accounting and disclosure, this would most likely have to change, particularly if the EU requires all quoted companies to adopt International Accounting Standards (IAS) in 2005.

The present IAS on financial instruments is IAS 39, a mixed model standard rather like FAS 133, which allows hedge accounting under certain circumstances. Many commentators have questioned the complexities of FAS 133 and IAS 39; however, she doubted that any revisions to those standards would make them less complicated and onerous to apply.

It seemed that if we wanted simplicity we would have to adopt the broad principle proposed by the JWG10, but that this could make the performance statement much more volatile. Some felt that this could in turn lead to companies preparing a separate statement of normalised earnings to show analysts what is really going on.

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Mary agreed that it was unfortunate that the JWG10 had not given sufficient explanation of the performance statement implications of its proposals. She suggested that, for non financial services companies, the primary performance statement would need to separate operating profit from fair value gains and losses arising on financial instruments. The implications of these different facets of performance for future projections are quite different.

Issues for discussion

Allan Cook took us through some of the issues for discussion. These centred on:

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- the nature of financial markets;
- the way treasurers thought about financial performance; and
- how that performance might best be presented.

Much of the debate covered the implications of the demise of hedge accounting, particularly for anticipated but uncontracted transactions. For example, there may be a large gain on such a hedge taken into a current performance statement, but the downside would be the concomitant threat to the future sustainability of earnings from a continuation of the currency movement that had caused the gain. While this could be explained in a text note, some felt that it was difficult to see that putting one consequence in the performance statement without the other added to an understanding of the company's position.

Responses

Fellows were urged to encourage their companies to respond to the JWG10 proposals by the response deadline of end June.

Members of the ACT's Technical Committee who were also present at the debate confirmed that the ACT would be putting in its response by the end of the month and a copy of this will be published on the ACT's website in the technical section.

Our thanks to go the ASB team and to PricewaterhouseCoopers for their hospitality for the evening. ■

DAVID CREED

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