MORE THAN 130 DELEGATES ATTENDED THE ACT'S CONFERENCE ON IAS 39 AT LE MERIDIEN PICCADILLY, LONDON.

LEARNING TO LIVE WITH IAS 39

THE STANDARDS HAVE YET TO BE FINALISED, BUT BY 1 JANUARY 2005 ALL EUROPEAN FIRMS WILL NEED TO BE IAS COMPLIANT. **LIZ FISHER** HEARD WHAT THE INDUSTRY HAD TO SAY ON THE MATTER AT THE ACT'S RECENT CONFERENCE ON IAS 39.

The implementation of the International Accounting Standards Board's (IASB) two standards on financial instruments – IAS 32, *Financial Instruments: Disclosure and Presentation* and IAS 39, *Financial Instruments: Recognition and Measurement* – promises to be one of the most difficult issues treasury departments will face in the near future. The standards have yet to be finalised but on 1 January 2005 all listed companies in Europe will be required to be IAS-compliant, and if they are to show the right comparative information, they need to produce IAS information from 1 January 2004 – which is only a few short months from now.

It was hardly surprising, then, that the Association of Corporate Treasurer's (ACT) conference on IAS 39 on 3 June was a sell-out. More than 130 treasurers from a wide range of organisations packed into London's Le Meridien Piccadilly hotel to hear top-class speakers from both standard-setters and corporates.

Wayne Upton, the IASB's Research Director, gave the Board's view of what is expected of companies, while other technical experts advised delegates on how to approach implementation. However, it was the experiences of treasurers from a number of companies which have already attempted to implement the standards that was the most telling. As Stephen Pugh, Director of Corporate Finance at The Economist Group, and the conference's chairman, told delegates: "This standard can be seen as the accountant's judgment on the treasurer. It's the accountant telling us what our handiwork looks like."

PRINCIPLE AIM. Upton began the conference by taking delegates through the principles contained in the standards (see box), stressing

'WE ALL HAVE TO LEARN THAT HEDGING IS AN EXCEPTION TO EVERYTHING WE LEARNED IN DEBIT AND CREDIT SCHOOL.' *WAYNE UPTON, RESEARCH DIRECTOR, IASB (ABOVE)*

the importance of events such as the conference to the standard-setting process. "We are interested in the practical implications of what we do, and getting in touch with that is one of the most difficult things," he said.

Such is the controversy of the proposals that the IASB took the unprecedented step of holding a week of roundtable discussions with interested parties earlier this year. "It was an absolute marathon but enormously valuable," said Upton. There was a hint, too, that the discussions had changed the IASB's mind in some areas. "We have considered some ideas that before the roundtable I would have thought would have had no chance at all," he said. One key change to come out of the discussions, he added, was the IASB's decision to allow companies to choose a second-year basis adjustment approach if they wish – an option it had previously resolved to deny them.

The IASB itself is extremely aware that many of its proposals are unpopular but, according to Upton, the standards are extremely necessary. "A body of accounting standards that did not address the recognition and measurement of financial instruments would be a joke. IAS 32 and IAS 39 are an interim step. They are not perfect conceptual standards. Our aim has been to bring the principles into focus because the previous standards contained virtually no principles at all. And I'm afraid a principle is a principle, even if you disagree with it," he said.

Both IAS 32 and IAS 39 are, effectively, unfinished standards. A new International Financial Reporting Standard (IFRS), that encompasses amendments to IAS 32 and IAS 39 will be published at some point this year. The IASB is scheduled to complete its discussions of the subject over the early part of the summer and, if significant changes are proposed from the original exposure draft that was published last year, a new exposure draft will be issued in September. Even then, the IASB could hit a barrier in the form of the European Commission (EC). A key part of the process will be the endorsement of the final standard by the EC and, although it is likely that the standard will be endorsed, the EC is not obliged to accept any of the IASB's standards. The task of assessing the IASB's work for the EC lies with the European Financial Reporting Advisory Group (EFRAG) a little-known body in the

The principles of IAS 39

- An instrument will be classified as equity if, and only if, it both: contains no obligation to transfer cash or other assets; and will be settled either by the entity unilaterally delivering a fixed number of its own equity instruments, or by the entity exchanging a fixed number of its own equity instruments for a fixed monetary amount of cash or other financial assets.
- Derivatives create assets and liabilities.
- Fair value is the only relevant measurement attribute for derivatives.
- Hedge accounting is an exception to normal recognition and measurement principles. A hedging relationship must be clearly defined by designation and documentation reliably measurable and actually effective.
- To the extent the hedging relationship is not effective, the ineffectiveness is recognised immediately in the income statement.
- To the extent the hedging relationship is effective, the offsetting gains and losses on the hedging instrument and the hedged item are recognised in the income statement at the same time. Only items that meet the definitions of assets and liabilities are recognised as such in the balance sheet.
- Internal contracts must be eliminated on consolidation.

'IMPLEMENTATION OF IAS IS A LONG JOURNEY. I WAS HOPING IT WOULD BE A STRAIGHT MOTORWAY, BUT IN FACT IT'S A "B" ROUTE WITH A FEW HAIRPIN BENDS ALONG THE WAY.' *JONATHON LOGAN, TREASURY ADVISER, GLAXOSMITHKLINE*

UK, but one with a crucial role in the process. There have been rumours over recent months that EFRAG will refuse to endorse part (or all) of the standard.

Paul Rutteman, Chairman of EFRAG, told delegates at the conference that the group was due to meet again in July, but that IAS 39 was not on the agenda: "We want to consider the result of the roundtable discussions." He added that, in his view, the timetable for implementation of the standards was the biggest cause for concern: "Companies need to produce comparative figures, which means that the system changes required will need to be in place by the end of this year."

The equally complicated standard on insurance contracts and the IASB's proposals on performance reporting, both still in the early stages of discussion, was likely to have a knock-on effect on implementation of IAS 39, Rutteman added. "There is a danger that companies will not want to change their policies in 2004, only to have to change them again in 2005 when the details of the performance reporting standard are finalised," he said.

The implications for companies – and the treasury function in particular – of IAS 39 are huge. But, according to accounting experts, the impact on the bottom line may not be as severe as some people have estimated. Mikkel Larsen, Manager in IAS Advisory Services at KPMG, told the conference that a study of companies that had implemented IAS 39 to date showed a large impact on their systems but not (with a few exceptions) on their opening equity. His advice – backed up by other experts – was that hedge accounting should be a serious consideration for many companies. "Our experience is that you will see double the volatility if you choose to hedge but do not use hedge accounting," he said. "You should ask yourselves if the costs of implementing IAS 39 outweigh the benefits of hedging."

REVEALING COMMENTS. Some of the most telling comments of the conference came from treasurers working within organisations that had already implemented IAS 39. Jonathon Logan, Treasury Adviser for GlaxoSmithKline (GSK), said that the company needed to be IAS-compliant from 1 January 2003 if it was to produce the two years' comparative figures demanded for its US listing.

"The fact that the standards were not complete made implementation a bit of a moving target," he said. Most of the work, as far as IAS 39 was concerned, had concentrated on identifying, tracking and reporting on financial instruments, he explained, and the company had decided to adopt hedge accounting because of concerns about volatility under the fair value requirements of the standard. "Overall," he added, "I'd say the feeling about IAS within our company is not positive."

Antonia Butler, International Treasury Manager at Thames Water, went even further. Thames Water's acquisition by the German group RWE in November 2000, followed by the introduction of a new financial year-end, effectively meant that the company was given just seven months to implement IAS.

"We had no time to set up steering groups or project teams," she said. "The project became a collaboration between the central accounting team and the treasury team." The company found, she added, that its advisers and software providers were often struggling to keep up. "I would say auditors are more aware of the issues now, but we found that they were sometimes struggling to interpret the rules because the message coming out of the IASB was changing. And I would say that you should beware of treasury management system (TMS) suppliers offering IAS 39-compliant software, as many have developed their systems to suit larger customers who mostly used US standards. It is not the same. In fact, the systems side was much more time-consuming than we thought it would be."

The final word came from Graeme Pitkethly, Group Chief Accountant at Unilever, who stressed the importance of involving the whole business in the implementation process. "Getting attention at Board level is crucial and you need a broad brush across the wide business strategy. It's OK to scare people with stories about volatility, but the chances are that they'll turn around and say, 'you're the treasurer – that's what we pay you for'."

A follow-up session on IAS 39 will be held during the ACT's Annual Conference in April or May 2004 at a venue to be confirmed (see page 15).

'THIS STANDARD CAN BE SEEN AS THE ACCOUNTANT'S JUDGMENT ON THE TREASURER. IT'S THE ACCOUNTANT TELLING US WHAT OUR HANDIWORK LOOKS LIKE.' *STEPHEN PUGH, DIRECTOR OF CORPORATE FINANCE, THE ECONOMIST (ABOVE)*