IN BRIEF

The Pre-emption Group is being reformed following the recent Myners report on pre-emption. The Group's role will be to keep the Pre-emption Guidelines up to date, and early on they will need to consider the implications of re-issuing from Treasury Shares. They will also deal with specific or general issues arising in the market. For the issuer side the ACT has been invited to nominate a representative, as have the 100 Group of Finance Directors, The Quoted Company Alliance and the Biotech Industry Association.

With effect from 6 April 2005 **the Pensions Regulator** must be informed about "notifiable" events. This duty falls on the trustees and the employer and is part of the arrangements for protecting the Pension Protection Fund from unnecessary calls. Notifiable events include breach of a banking covenant, unless the bank agrees not to enforce it, and any change in the employer's credit rating or the employer ceases to have a credit rating.

The Payments Task Force at the Office of Fair Trading (OFT) has issued its first report. Agreement has been reached with the industry that faster payment through the **BACS** system will be introduced, with same day value for payments made early in the morning. The float period, where the direct credits and debits do not occur simultaneously, will be eliminated. A 30-month period for planning and implementation is expected.

The Committee of European Securities Regulators (CESR) is considering changes to the **Prospectus Regulation** to allow securities regulators to require that where an issuer has a complex financial history then historical financial information from related entities must be provided in addition to that of the issuer. This is to correct a deficiency in the original regulation, and would apply for example where the issuer is a newly incorporated holding company inserted over an established business, or where the issuer has made a significant acquisition during the three-year record period.

Tax alert The deadline to opt out of the 'Disregard Regulations' (see *The Treasurer* June 2005 p45) has been extended from 30 June to 30 September. This relates to the taxation of certain hedging transactions and whether they are based on IFRS or old UK GAAP.

INTRODUCTION

By MARTIN O'DONOVAN
ACT Technical Officer

***The Treasurer's* June editorial reported the challenge from Sir David Tweedie for treasurers to participate in a radical rethink on IAS 39 *Financial Instruments: Recognition and Measurement.* Clearly we are not going to resolve all the thorny issues in a matter of months, when the accountancy world has been working on the subject for years, however we can use this as an opportunity to think more broadly than just tweaking the odd rule. The debate has started, as mentioned below. In addition to the usual current news, this month's technical update extra continues our in-depth look at the ISDA swap agreements and homes in on the Confirmation.** ■

A new IAS 39? Time for a radical rethink

Sir David Tweedie, Chairman of the International Accounting Standards Board (IASB), addressing The Treasurers' Conference in May, specifically asked for views from treasurers and the ACT on how one might devise a new form of standard for financial instruments to replace *IAS 39 Financial Instruments: Recognition and Measurement.* He asked for a radical rethink, effectively starting with a clean sheet of paper. (See *The Treasurer* June 2005, p1). The ACT is rising to the challenge and is formulating ideas. We could go for absolute simplicity and mark-to-market through the profit and loss account (P&L) all financial assets and liabilities and financial instruments, but this would create a hugely complex task of explaining to investors all the pluses and minuses appearing in P&L. The difference between realised and unrealised gains and losses might be made prominent here to help characterise these movements. The ripples would be felt with consequences for the presentation of the P&L, the concept of distributable profits, the key measures of performance like earnings per share (EPS), taxation and in the volume of extra analysis and explanations needed.

Alternatively, can the principle of using fair values be made more acceptable through a more relaxed approach to what constitutes a hedge but without opening the doors to misuse and abuse? If treasury management revolves ultimately around planning and managing cashflow is there some accounting concept that can be invented to incorporate this management intent and at the same time be prudent? Taking a leaf from the comments of Ian Mackintosh – Chairman of the Accounting Standards Board – to the recent ACT members evening (reported on page 21), should we base accounting on the probabilities of realising the market-to-market gains and losses?

If you wish to contribute to the debate or just be copied in on developments please contact modonovan@treasurers.co.uk ■

IAS 21 issues

In all the excitement around *IAS 39 Financial Instruments: Recognition and Measurement*, it is easy to fail to give proper attention to the treasury implications of IAS 21 *The Effects of Changes in Foreign Exchange Rates and Foreign Currency Effects.* However this subject was up for discussion at the June International Accounting Standards Board (IASB) Board meeting as this issue went to press, so some further news should be available in early July in the decision summaries published on the IASB website. The complications on quasi-equity loans and on functional currency for a treasury company were clearly explained in *The Treasurer*, June p24, *Meet the skeletons in the IFRS closet.* The outcomes stated there give rise to some apparently perverse and potentially misleading appearances in the accounts, and for this reason the ACT has written to the IASB prior to its meeting to explain why the outcomes are illogical and seeking clarifications. The wording of

Who are your owners?

Shareholders have been vociferous in wanting to call to account the companies they invest in and to ensure the directors comply with appropriate codes of good corporate governance, but there are times when the boot is on the other foot. Companies have very legitimate reasons to want to know who their owners are and what dealings are taking place in their own shares. Traditionally this was straightforward in that the register of shareholders held the names of shareholders which could be supplemented by sending out Section 212 notices to discover the beneficial holders behind nominee names. The position now is more complex given the rising popularity of derivative style instruments, the use of shares as collateral and other agreements over shares such as stock lending.

Stock lending is an important mechanism to assist in providing good liquidity in the market, but in legal terms it involves a transfer of shares with an agreement to buy back at a future date. The stock borrower will have the shares registered in his name and will have the voting rights, but the economic benefits and risks stay with the lender. The lender bears the share price risk and through the lending agreement is entitled to receive any dividends and the results of any share reorganisations that occur during the loan. If the lender wishes to he can recall the shares at any time, perhaps in order to vote the shares. (The ACT website www.treasurers.co.uk includes a guide to stock lending in the technical section.)

Given the growing complexity the authorities are trying to make sure that the legislation and market rules stay up to date. In May the Takeover Panel moved to the next stage in consulting on the obligations for investors to make disclosures during a takeover. The initial ideas were covered in *The Treasurer* (March 2005 p46) but the thinking has evolved so that the new proposals are such that disclosures will be triggered by an “interest in shares” of 1% or more rather than by “ownership or control” of 1% or more of any class of relevant securities. An “interest in shares” will be much wider in scope and will be based on having a long economic exposure to the shares. “Interest in shares” includes:

- owning them or having the right to direct the voting rights.
- having the right to acquire or obligation to take delivery under any agreement to purchase, option or derivative.
- being party to a derivative whose value is determined from the share price or creates a long position in the shares.

The Takeover Panel recognises that there will be grey areas where judgements may have to be made, for example a normal sale but with an abnormally long settlement period. This area can become complex so that it is possible even for two parties to be interested in the same securities, giving rise to apparent double counting, but this is accepted as reflecting the true economic position. This could happen where a person enters into a long derivative referenced to relevant securities and his counterparty hedges its position by purchasing an equivalent number of relevant securities, so that both persons will be treated as interested in relevant securities of that class. Another example is where a shareholder grants a call option to another person. The shareholder will be interested in the shares which are the subject of the option as a result of owning the share, and the option holder will be interested in those shares as a result of having the option to acquire the shares.

Interests in shares will need to be evaluated only at a single point in time, which is to be midnight London time. An anti-avoidance provision will look through “bed and breakfasting” arrangements to prevent a disclosure obligation from being circumvented.

The other disclosure obligations for investors derive from the Companies Act. The 1985 Act says that once a person’s holding goes above 3% or more of a public company's voting shares (any shares held by a company in treasury are disregarded in calculating the percentage of shares held for disclosure purposes), they have to inform the company, and this applies whether or not a takeover is contemplated (sections 198-203, Companies Act 1985). Further disclosures must be made each time the holding increases or decreases through another whole percentage.

The Department of Trade & Industry (DTI) has recently been consulting on a Company Law Reform White Paper (see The Treasurer, May 2005 p48) and, prompted by the Transparency Directive from Europe, is considering changing the meaning of “interests in shares” for Companies Act purposes to a more narrowly defined “control of exercisable voting rights”.

Within the ACT’s response to the DTI we have argued for the use of the wider definition as in the Takeover Code since a public company is potentially interested in understanding what activity is going on in its shares or in relation to its shares at all times, not only once a takeover is in progress. It can be critical to have this information when a takeover is perhaps being threatened or when some contentious shareholder action is in the offing, such as dissatisfaction with the Chairman or board. Although extended disclosures will not be popular with institutional investors we believe that transparency and good governance apply equally to a company’s shareholders. ■

IAS 21 issues cont.

the standard leaves room for ambiguity and indeed there is still plenty of debate around the correct interpretations.

Take the quasi-equity loan point for example, where there is a monetary payable or receivable between two group companies which have different functional currencies. As this is an internal balance, which is eliminated in the group balance sheet, it does not impact group net assets (i.e. shareholder funds). You have the position where the entity foreign exchange (FX) differences end up in group profit and loss (P&L) and the consolidation adjustment is in group equity. Quite rightly group net assets do not change but yet there is a revaluation effect in group P&L. This is wholly illogical as well as misleading.

IAS 21 addresses this to a limited extent via paragraphs 15, 32 and 33, however this requires the intra-group monetary item to form part of the net investment in a foreign operation and it must also be long term. With certain provisos paragraph 33 allows the FX difference to be reclassified to equity so that there is no overall group P&L distortion. The ACT believes that the allowed circumstances for this reclassification should be extended or at least clarified. For instance, the reclassification occurs when the item is “in substance” part of the net investment, which raises doubts over whether a direct parent/subsidiary relationship is strictly needed. ■