IN BRIEF

▸ The European Association of Corporate Treasurers (EACT) is carrying out a survey to assess the pan-European impact of the current financial crisis on **corporate bank relationships**. It will specifically address how borrowing conditions are changing over time. The short survey is available at:
http://tinyurl.com/knd2ox
All borrowers are urged to take part.

▸ The **Department for Business, Innovation and Skills** (BIS) has been set up to help Britain's global competitiveness. The Department for Business Enterprise & Regulatory Reform (BERR) will be merged with the Department for Innovation, Universities and Skills (DIUS) to create BIS.

▸ An extension to the **credit insurance top-up scheme** has been announced. The UK government had already made available credit insurance for suppliers where commercial insurers have withdrawn or reduced cover from the levels of 1 April. In response to requests from business, eligibility for the scheme will be backdated to suppliers that have had their cover reduced since 1 October last year. Credit insurer HCC will also join the three largest credit insurers (Euler Hermes, Atradius and Coface) as a provider of the government scheme.

▸ The Investment Management Association (IMA) is calling for reform of the **sterling bond market**. An IMA policy paper, "The Impact of the Credit Crunch on the Sterling Corporate Bond Market", concluded that the dealer market model had failed and its failure to provide secondary market liquidity brought a risk of significant funding difficulties for UK corporates. For investors, secondary markets are important and the market-maker model has not brought liquidity. The IMA recommends a further role for exchanges and multilateral trading facilities (MTFs) in offering anonymised trading systems or "bulletin board" facilities with a wider choice of third-party clearing systems to reduce counterparty risk.

▸ In preparation for the end of the recession, the Department of Business, Enterprise & Regulatory Reform has commissioned a review of small and medium-sized firms' access to growth capital. The **Growth Capital Review** will examine whether or not a semi-independent funding agency in the vein of the post-war Industrial and Commercial Finance Corporation is required.

INTRODUCTION

By Martin O'Donovan
ACT assistant director, policy and technical

With some signs starting to emerge that the worst of the financial crisis might be behind us, the regulators and politicians can now move on from fire fighting to legislating for the future shape of the financial world.

The authorities want to be seen to be doing something, acting tough and acting fast. But while things will clearly be different in the future, the regulators need to take care their acts do not have the sort of unfortunate unintended consequences already occurring.

For example, creating a complete replacement for the IAS 39 standard within a year or so (see p13) is a tall order for the IASB, while in the US some politicians want to outlaw tailored derivatives (see p12). At least the Bank of England is trying to find constructive ways to help companies with their financing (this page).

Bank of England ramps up aid for corporates

The Bank of England's asset purchase facility is already bringing extra liquidity to the commercial paper (CP) and bond markets that are funding UK companies (as reported in The Treasurer, March 2009, p11). Through these programmes, the Bank can buy newly issued CP and secondary market bonds issued by investment-grade companies.

Under a new scheme, called the secured commercial paper facility, proposed by the Bank, access to funding will be extended to non-rated entities with high-quality receivables capable of supporting that funding.

The ideas have yet to be crystallised into specific mechanisms, but in essence the Bank is prepared to buy asset-backed CP secured on business receivables or short-term credit to consumers. The securities programmes could be single-seller or multi-seller but, for the Bank to buy, the sellers would need to achieve a short-term rating of at least A1/P1/F1

There will be an initial start-up period to provide a lead time for the creation of suitable programmes, and the Bank plans to give at least 12 months' notice of any withdrawal of its facility.

The Bank is also consulting on a possible supply chain finance facility whereby it would buy tradable paper to provide finance to an entity's suppliers where the credit risk was that of the relevant company whose payables were being financed – ie, non-recourse to the seller. This might be attractive to non-rated or sub-investment grade companies.

Although the period for consultation officially ended on 19 June, the ACT's experience is that the Bank is very receptive to feedback and would probably be pleased to receive any input.

The ACT welcomes these further initiatives from the Bank. Even if the total amounts of funding provided are modest, they can still play a significant role in encouraging other providers of finance to come back into the market. The Bank will act as a catalyst or buyer of last resort rather than itself doing huge volumes.

Since the new working capital facilities could be complicated and involve special structures and systems, the ACT is recommending that existing providers and infrastructures in these markets should be involved as far as possible. ■

Cheque it out

In celebration of the 350th anniversary of the invention of the cheque, a report from the Cheque & Credit Clearing Company (the organisation that manages the cheque clearing system in Britain) takes a look at the history of the cheque. The report examines the cheque's role in British culture and heritage, gives data on cheque usage, explains why we are using them ever less frequently, and also includes some lesser-known facts.

The Great British Cheque Report can be downloaded from the organisation's website at: **www.chequeandcredit.co.uk**

Practical framework for going concern guidance

The Financial Reporting Council (FRC) has issued an exposure draft, entitled "Going Concern and Liquidity Risk: Guidance for directors of UK companies".

The FRC refined its existing guidance late last year but the new version has been completely rewritten. It aims to create a practical framework to help company directors determine whether it is appropriate to adopt the going concern basis for their accounting.

Under company law and accounting standards, a review of liquidity and going concern is required, and for listed companies there are further requirements from the listing rules.

The new guidance is structured to explain and work through the following:

- the need for an assessment;
- the review process and what needs to be analysed;
- the review period; and
- the disclosures.

A significant change in the proposed revision comes for half-yearly and interim accounts where, as for the full year-end, a 12-month review period from the date of approval of the accounts is specified. However, the paper acknowledges that in the absence of any new issues that might trigger the need for a full review, the half-year assessment can be slightly less rigorous.

The guidance quite rightly calls for a thorough review of cash forecasts including sensitivity analysis and stress testing and the need for committed financing. But at the end of it all it still leaves the company directors to make their own judgement.

In the example wording given, the FRC accepts that a company could be disclosing difficult business circumstances and loans that require renewal or replacement but still feel that it is able to say that the "directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future".

Likewise, the auditors need only modify their report with an emphasis of matter if they conclude "that a material uncertainty exists which leads to significant doubt about the ability of the entity to continue as a going concern".

Feedback can be provided direct to the FRC. Alternatively, send comments via the ACT, which will be submitting a response. ■

Treasury and transfer pricing

Whenever companies arrange a transaction between group companies – whether for the sale of goods, the right to use trade names, or in the case of treasury an intercompany loan – transfer pricing issues arise, especially if the transaction is cross-border.

Quite apart from the directors being concerned that they are acting in the best interests of the company, the relevant tax authorities will want to make sure that the pricing occurs at arm's length. To take the example of an intercompany loan, were the rate of interest to be artificially low there would in effect be a transfer of profit from the lender to the borrower, which would not please the lender's tax authority.

To deal with this, rules or established practices exist along with a network of double-tax treaties between countries. These are all explained in a new guidance note issued by the European Association of Corporate Treasurers (EACT) and prepared primarily by the AFTE (the French association) with help from other associations including the ACT.

The focus of the guidance is solely treasury transactions: loans, guarantees, foreign exchange and risk management, and the provision of other services.

It explains the main international guidance in this area, which comes from the Organisation for Economic Co-operation and Development (OECD). And it goes through the methods for establishing what is arm's length – namely, the comparable uncontrolled price method and the comparable price method – and how these can be turned into a practical way of operating for treasury activities across a group.

The full guidance is available at **www.treasurers.org/transferpricing**

IN BRIEF

▸ The May issue of the FSA's regular List publication offers some important reminders for issuers.

On the **disclosure of risk factors in a prospectus**, it offers a commentary on the Prospectus Directive requirements and the UKLA approach. In the current environment the risk factors section is coming under greater scrutiny and issuers should avoid the inclusion of generic and irrelevant risk factors.

The FSA has also found that a significant number of issuers across the market are still failing to meet the basic requirements to produce an interim management statement (IMS). Many are still not including specifics such as an explanation of the impact of material events on financial position. The regulator has warned that issuers that do not comply with the IMS requirements should be aware that they risk enforcement action.

List also contains an update on the progress of the rights issue regime review.

▸ In its response to the FSA's consultation on **short selling**, the ACT has said it does not want to see an outright ban on the practice. However, to minimise the risk of abusive behaviour and to promote well-informed and transparent markets, the ACT agrees that a disclosure regime for holders of short positions would be beneficial. In a separate response to the FSA, the ACT supported the continuation of the temporary reporting of short positions in certain financial services firms, pending the outcome of the wider review.

▸ The Financial Reporting Council (FRC) has been reviewing the impact of the **Combined Code** on corporate governance, which sets out best practice for UK listed companies. Listed companies must comply with the code or explain their non-compliance.

In its response to the FRC, the ACT concluded there was little missing from the code and that governance structures were broadly fit for purpose. Any weaknesses appear to have stemmed from ineffective challenge or lack of objectivity.

The emphasis for the future, the ACT said, should be making sure that the code's objectives were turned into satisfactory outcomes even to the extent of loss of office with reduced or no compensation for directors who failed in their responsibilities.

The ACT recommended some refinements to the code, notably to increase the importance attached to risk management, and to encourage more active shareholder involvement.

IN BRIEF

A study of **boardroom behaviours** has been produced by the Institute of Chartered Secretaries (ICSA). It covers six areas: boardroom culture and behaviour; the Combined Code; directors' skills and resources; disclosure; risk management; and the role of shareholders. It is intended to contribute to the Walker review of governance.

Unintended consequences could well arise from the EU's **regulation of credit rating agencies** through an amendment inserted at the last minute by the European parliament. The EU amendment legally binds agencies to give issuers 12 hours' notice of a ratings change. Issuers will be pleased to be given notice by the agencies of any ratings announcement, if only to have the opportunity of correcting obvious errors or removing any confidential information.

The amendment reads: "The credit rating agency shall inform the entity subject to rating at least 12 hours before publication of the credit rating and of the principal grounds on which the rating is based in order to give the entity an opportunity to draw attention of the credit rating agency to any factual errors."

However, the well-intentioned move means that if a company is announcing an acquisition, say, and has briefed the agency the night before in the hope of a ratings announcement to reassure the market shortly after it goes public, this will not longer be possible.

Quite where it leaves investors to have a credit rating lagging behind some significant change is yet another question.

The IASB has issued an exposure draft on **fair value measurement**. The aim is to replace the guidance found in individual standards with a single unified definition, including guidance on the application of fair value measurement in inactive markets.

Fair value will be based on exit values with the core principle stated as: "Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."

This guidance does not extend in any way the occasions when fair values are required.

The definition is identical to the definition in the SFAS 157 standard and the supporting guidance is largely consistent with US GAAP. The same three-level hierarchy is used: level 1 for quoted prices in active markets; level 2 for models using observable inputs; and level 3 for models using unobservable inputs.

Regulation bludgeon threat to OTC derivatives

Fortunately, corporate treasurers are largely immune from any financial regulation, but following the financial crisis a greater degree of regulation of banks and markets is definitely on the cards. While the regulation of financial services firms could have an effect on pricing, other than that it will probably have little effect on what can be done operationally – apart from the regulation of over-the-counter (OTC) derivatives.

Every bilateral deal between a company and its bank for an interest rate swap, a foreign exchange (FX) option or even spot and forward FX could count as an OTC derivative and be subject to new regulation.

For the moment any new regulation is very much in the air, but politicians in Europe and the US are bouncing around all kinds of ideas. At its most basic the thinking is to standardise derivatives that are amenable to standardisation and require them to be dealt through an exchange, with settlement handled through a clearing house or central counterparty (CCP).

Interposing a CCP with rules on margining and collateral is designed to reduce counterparty risk. It should also facilitate the regular offsetting and netting down of deals and, in the case of actual default, an orderly wind-down.

Once this idea becomes accepted, the next step might be to require that OTC trades dealt directly between two parties are subsequently booked through a CCP, again to control counterparty risk. There would be tighter regulation of dealers and CCPs with extensive reporting requirements on trades and positions.

In the US the political heat is building with an initial set of proposals from US treasury secretary Tim Geithner. But there have been calls from Tom Harkin, chair of the Senate agriculture committee, who wants to see all derivatives done on exchange and regulated by the Commodity Futures Trading Commission. The Senate's financial services committee chairman, on the other hand, is going for a more measured reaction with regulation via the Securities and Exchange Commission (SEC).

If all OTC derivatives were to be banned, ordinary risk management by companies would become far more difficult since tailored hedges would be impossible and hedge accounting difficult to justify. For some, exchange-traded derivatives would be totally inaccessible.

The corporate sector is trying to point out that any heavy-handed attempts to reduce risk in the banking sector would probably transfer that risk to businesses, leaving companies unable to hedge their financial risks from normal commercial activities. ■

Simpler company reports

The UK Financial Reporting Council (FRC) has released a discussion paper on ways to reduce the complexity of corporate reporting.

The paper recommends taking a commonsense approach to complexity reduction based on eight guiding principles.

Four of the principles cover better communication in reports (focused; open and honest; clear and understandable; interesting and engaging). The other four aim to improve the quality and effectiveness of regulations (targeted; proportionate; co-ordinated; clear).

The hope is that by providing a principles-based approach rather than a prescriptive rules-based system, the drafters of company reports will be better able to concentrate on those matters that are of material interest to shareholders and other stakeholders. To this end the FRC has identified the following areas for action:

- cashflow and net debt reporting (could these be better aligned with user needs such as by including a net debt reconciliation?);
- reducing reporting burdens for wholly owned subsidiaries;
- cutting clutter (could preparers reduce immaterial information that might be undermining the quality of reports?); and
- disclosures (could guidance be provided about when they can be deleted as not relevant?).

Race on to replace IAS 39

The IASB (International Accounting Standards Board) plans to rush out a replacement for the IAS 39 standard on the measurement and recognition of financial instruments

However, the standards body is taking the process in stages. It will issue an exposure draft on the classification and measurement of financial instruments in July 2009, and have the standard in place by December 2009 in time for December 2009 year-end accounts.

This October the IASB will also publish an exposure draft for accounting for impairments and provisioning, and another on hedging by December. These are in addition to the current exposure draft on derecognition.

Last month the IASB reaffirmed a classification model that measured all financial instruments at amortised cost or fair value. It tentatively concluded that amortised cost provided useful information to users if a financial instrument had only basic loan features and it could be demonstrated that the instrument was managed on a contractual yield basis. For all other instruments, only fair value provides useful information to users.

Reclassification between the two methods after initial recognition would be prohibited.

The current "tainting" rules that limit the further use of amortised cost after disposal of other financial instruments measured at amortised cost would be eliminated.

A fair value option would be retained at the initial recognition of a financial instrument that would normally be at amortised cost if use of the option eliminated or significantly reduced a measurement or recognition inconsistency.

A principle would be introduced to determine equity instruments whose fair value changes were recognised in other comprehensive income but without any subsequent transfers to profit or loss (either on disposal or otherwise).

The board still has to finalise its position on derivatives embedded in a financial host contract, but is proposing to change the embedded derivative requirements in IAS 39 for non-financial host contracts.

The board will be consulting on the fair value measurement of liabilities and the effects of changes in a company's own credit risk. ■

IN BRIEF

Preparers of corporate accounts are reminded that the March 2009 amendments to **IFRS 7** require them now to provide an analysis of financial instruments according to the three-level valuation hierarchy, including movements into or out of level 3.

Although there is no need to create prior year comparatives so as to be able to analyse movements in the current year, treasurers will need to recreate the analysis by valuation bases that would have existed at the start of the year.

Pension accounting changes to IFRIC 14 and IAS 19 were published in an IASB exposure draft at the end of May. The proposed amendments are aimed at correcting an unintended consequence of IFRIC 14, which is an interpretation of the IAS 19 employee benefits standard.

As a result of the interpretation, entities are in some circumstances not permitted to recognise as an asset some prepayments for minimum funding contributions to company pension schemes.

TREASURY, RISK AND FINANCE PROFESSIONALS
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