IN BRIEF

Reducing complexity in accounting for financial instruments is the IASB's objective in a recent discussion paper. This important paper marks the first stage in a wholesale rewrite of IAS 39 *Financial Instruments: Recognition and Measurement*, replacing many of the existing rules with a widely applicable fair value measurement principle plus some optional exceptions, and simplifying hedge accounting. Given the importance of this topic for treasury activity, the ACT is seeking detailed comments from as many readers as possible. Reactions to: **modonovan@treasurers.org**

The **UK sponsor regime for listed companies** is under review by the FSA. Proposed amendments would clarify that the sponsor principles apply only at the time that a sponsor service is required, rather than being a continuing function, and that sponsor competence would be assessed on the basis of the firm, rather than an individual using the concept of the "suitably experienced employee".

SFAS 133 *Accounting for Derivative Instruments and Hedging Activities* has been amended by a new standard, SFAS 161, from US accounting standard setter, the Financial Accounting Standards Board (FASB). This is in response to the increased use and complexity in derivative instruments and hedging activities and concerns that SFAS 133 does not provide adequate information about how derivative and hedging activities affect an entity's financial position, financial performance and cashflows.

The new UK rules for **execution of deeds by a company** came into force in April 2008. The Companies Act 2008 provides for a deed to be executed by affixing the common seal, signature as a deed by two authorised signatories (every director and secretary is "authorised"), or signature as a deed by a director whose signature is witnessed.

The information on the **payer accompanying fund transfers** and the checks required on that information as required under European regulation 1781/2006 is under scrutiny from three European regulators including the Committee of European Banking Supervisors (CEBS). The requirement exists to make it easier for the authorities to trace flows of money in connection with money laundering investigations. The review is to clarify and streamline procedures for dealing with payment service providers who consistently fail to include the necessary detail.

INTRODUCTION

By Martin O'Donovan
ACT Assistant Director, Policy and Technical

Our newspapers of record do a fine job of alerting us to financial news, but do you sometimes seek a little more depth of reporting?

Now and again it pays to go back to the source material and the regular Bank of England Quarterly Bulletin is a good example. The report provides a comprehensive and independent round-up of financial market conditions in both the equity markets and the credit markets.

The data, analysis and predictions range across equity risk premiums, credit spreads and volatility, corporate bond yields, bank funding, short- and long-term interest rates, forward rates and decomposing the various drivers of the markets, including a modelling of sterling government yield curves to derive expectations for real rates, inflation, real term premiums and inflation risk premiums.

All in all, a thorough and impartial current economic manual that treasurers will find it well worth dipping into.

Rogue trader controls

As one distinguished City analyst observed: "All traders are rogues, so it is the job of management to ensure adequate controls exist."

The FSA has accordingly released a *Market Watch* newsletter explaining some of the controls to consider in the light of the Société Générale's losses in Paris. SocGen sustained €4.9bn of losses on unauthorised open futures positions of €50bn on three European stock market indices.

Although aimed at bank trading operations, the newsletter offers food for thought for corporates too.

The FSA recommends thinking about:

- the quality of routine management information and exception reports available – for example, on cancelled or amended trades;
- whether there are clear incentives to ensure that control and oversight by front-office management is promoted and rewarded;
- whether the front-office culture is designed to prevent "rogue trader" activities – for example, requiring traders to take two-week holidays;
- whether trading mandates are in place for each trader, how detailed those mandates are and whether they cover allowed products, markets and risk limits;
- whether there are people in all areas of the control functions with the skill, understanding and authority to challenge front-office staff when parameters for activity are breached or there is suspicious activity;
- whether mechanisms are in place to monitor traders' positions and risks that may be difficult to capture, such as basis and liquidity;
- consideration of any concerns raised by a body outside the internal monitoring framework;
- consideration of reconciliation processes to prevent gaps and significant points of weakness;
- whether there is a framework to track and analyse outstanding confirmations, as well as a process for escalation to senior management;
- whether reconciliations are done directly between departments rather than involving the front office;
- the use of oral affirmation processes to provide near-term control pending the completion of full documentation and confirmation processes;
- unconfirmed over-the-counter trades that may pose greater risks;
- reconciliations of margin and collateral calls to a trader or a book to ensure margin calls are correct and positions on the book accurate;
- whether IT security and access controls are properly implemented and system access rights revisited on a periodic basis; and
- requirements for users to change passwords regularly, with users excluded if they enter a wrong password more than a few times. ■

http://www. WEBSITE WATCH

The current e-invoicing landscape in Europe is moving rapidly forward. A new report from the Euro Banking Association and Innopay, entitled *E-invoicing 2008: Market Description and Analysis*, provides a description and analysis of what models and systems exist, with an emphasis on high-level trends.

The report explains the background to e-invoicing, from the basics right through to the finer detail, and can be downloaded from: **www.tiny.cc/7ClwK**

Big changes to pension accounting in the offing

The Accounting Standards Board (ASB) and the International Accounting Standards Board (IASB) have kicked off a very early stage debate over major changes to pensions accounting.

The ASB has produced a discussion paper entitled *Future Directions for Pension Reporting*, while the IASB is covering more limited ground with its paper *Preliminary views on amendments to IAS 19 employee benefits*.

The ASB has proposed that a pension liability should reflect only the benefits an entity is presently committed to pay, and not genuinely discretionary benefits. Expected increases in pensionable salaries would therefore no longer be taken into account up front, unless required by law or contract. As a result, the pension expense of each period would reflect the extra pension liability incurred by increases in pensionable salaries given to date. The ACT intends to support this accounting change. But for funding decisions this sort of treatment might not be so appropriate: sponsors and schemes should consider the effects of future salary increases.

Currently, changes in actuarial valuations of assets and liabilities can be deferred over remaining service lives or only recognised once they exceed a given threshold. Given the huge volatilities in asset and liability valuations, deferral offers companies a welcome smoothing effect. Some may feel uncomfortable about using a single point in time valuation for such long-term assets and liabilities but there is little accounting logic in postponing recognition of a change in valuation that has already happened.

A more contentious proposal is that the current value measure of future payments of benefits should be the best estimates of cashflows discounted at the risk-free rate. The debate is complex, but heads down the route of taking a settlement amount which might be derived from a run-off by paying benefits as they fall due, or from an immediate buy-out transferring the liability to a third party. Another method (which the ASB does not favour) would be to measure the liabilities by reference to a regulator's funding requirements, building in prudence, strength of sponsor covenant and expected investment returns.

Current standards require the expected return on plan assets to be recognised and reported within profit or loss. But this does not reflect the economic events of the period, so taking actual returns is proposed as the preferred route. Information on expected returns would be provided by disclosure only.

For users of accounts to obtain a clear view of the risks and rewards from pension assets and liabilities, the ASB proposes employers should disclose assumptions and sensitivities of reported amounts to changes in those assumptions.

The paper goes on to discuss whether pension plans should be consolidated into the sponsor's accounts, meaning that both gross assets and gross liabilities would appear. Most UK pension plans are independent and not controlled by the sponsor, so consolidation would not be appropriate.

The ACT would appreciate any feedback from readers, especially on the concept of discounting liabilities at the risk-free rate.

Meanwhile, the IASB wants to change the IAS 19 employee benefits standard, removing the options for deferred recognition of gains and losses in defined benefit plans and introducing a new classification of benefit promises into contribution-based promises and defined benefit promises, with a new measurement attribute for contribution-based promises. ■

ACT tells government to opt into Rome I

The threat of an unwelcome change in contract law has been averted after years of patient work by the government (encouraged by the ACT and CBI) and, eventually, the rapporteur of the committee in the European Parliament.

The European Commission had proposed an EU regulation based on the Rome I convention (from which the UK has opted out). It would have introduced uncertainty by allowing a third-party country's law to be applied even if the parties had agreed a specific applicable law.

The final regulation now allows the contractually agreed law to apply save where the laws of a country where the contract obligations have to be performed make the performance illegal. This is similar to UK law. The ACT has written to the government to recommend the UK now opts into the Rome I regulation.

IN BRIEF

▸ **The Pensions Regulator** published updated guidance on clearance in March 2008 to help trustees and employers applying for a clearance statement in relation to corporate transactions and events that may have a material detrimental effect on a pension scheme. The guidance provides additional information about identifying type A events and assessing the impact of an event, and the actions that applicants and trustees should take during the clearance process, including mitigation and negotiation. A clearance statement from the regulator provides assurance that it will not use issue a contributions notice or financial support direction in relation to the particular event.

▸ The latest revised **NIPs code** has been posted on the Bank of England website. The non-investment products (NIPs) code is intended only as guidance on good practice for trading in these markets, specifically the sterling, foreign exchange and bullion wholesale deposit markets, and the spot and forward foreign exchange and bullion markets. The market conduct section of the FSA Handbook includes a chapter on inter-professional conduct (MAR 3), covering products outside the NIPS code.

The NIPs code is drawn up by the Bank of England and the FSA and a wide cross-section of market participants including the ACT. It covers the standards of behaviour and process expected, including dealing mandates, confirmations, procedures for standard settlement instructions and other controls.

▸ The UK's **Faster Payments** system is to go live on 27 May. E-payments will be possible in near real-time, initially for sums under £10,000. It is being launched first for individuals; companies will not be able to use it for payments until later, although they will need to use it to collect payments from customers. An ACT briefing will be available from early May at: **www.treasurers.org**

▸ **Disclosure of treasury risk policies** has been subject to research analysis by the ICAEW. In a report entitled *Managing Interest Rate Risk and Foreign Exchange Risk: Disclosure of Objectives, Policies and Processes*, it reviews the extent to which the policies and activities get disclosed and the quality of that disclosure by comparing published material with the information that is actually available internally to management. The paper provides a convenient comparative study into what other companies are doing. The full report is available at: **http://tinyurl.com/4j2jmu**