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Rotation of audit partners will be required every five years according to the Auditing Practices Board (APB) Ethical Standards ES 3 (revised) document issued in October 2009. However, the APB has agreed a concession that an audit committee of listed companies can agree an extension of the rotation period to seven years in limited circumstances where the committee is satisfied that it is necessary to safeguard audit quality. In such cases there must be clear disclosure in the annual accounts, including the reasons for it. The APB has also launched a consultation paper on audit firms providing non-audit services to listed companies that they audit.

Reduced investor demand for corporate bonds could be the unintended side effect of proposals by the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS). In its response to the CEIOPS proposals, the ACT has warned that valuing long-term liabilities based on government yields would lead long-term insurers and other affected bodies to reduce their investments in corporate obligations so as to avoid volatility. This would have negative effects on real economies – on activity, investment and employment levels, for example. Logically, one might not wish to include credit spreads in the discount rate, but it is appropriate to include the liquidity premium.

Short-selling disclosure obligations will remain unchanged, according to the FSA, following its earlier consultations. For the moment the FSA requires disclosure to the market of net short positions of 0.25% or more of the issued share capital of UK financial sector companies or companies carrying out a rights issue. However, the FSA is considering a proposal from the Committee of European Securities Regulators (CESR) for private disclosures to be made to the regulator at a 0.1% threshold.

The Financial Reporting Review Panel (FRRP) has been added to the list of bodies to which employees may safely disclose information regarding wrongdoing by their employer. Under the Public Interest Disclosure (Prescribed Persons) (Amendment) Order 2009 – the most recent **whistleblowing** legislation – individuals are now protected if they make a qualifying disclosure in good faith to the FRC and its sub-bodies the FRRP, the Accountancy and Actuarial Discipline Board, and the Professional Oversight Board.

INTRODUCTION

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

Part of the ACT's policy and technical work is to keep a lookout for new legislation or other rules that could affect treasurers, positively or negatively. In the case of the OTC derivative proposals in the US and Europe, we have been actively engaged with all manner of official bodies trying to limit any unintended and unwelcome consequences.

With the support of many ACT members and through providing concrete example of the potential effects, the message seems to be getting through. In the jargon, I believe the phrase is that we are "cautiously optimistic".

ACT gains ground in OTC battle

Signs are that the concerns of non-financial companies over EU and US proposals to change the operation of over-the-counter (OTC) derivative markets have been heard and accepted.

The proposals were devised to remove systemic risk should a major participant in the derivatives market collapse. The ACT accepted the objective as laudable but questioned why non-financial corporates were included in the measures when their involvement poses no systemic risk and when the total volume of their outstanding positions is less then 10% of the total market.

As explained in the September 2009 issue of The Treasurer (Technical Update, page 08), the proposals push more deals into a standardised form that can be exchange-traded and centrally cleared. Where possible, OTC deals would also be novated to a central counterparty (CCP) so that both parties had a credit exposure to the CCP rather than each other. The CCP would require daily margin payments to protect its credit position.

While such extensive netting off of exposures would greatly reduce risk for financial counterparties, it would utterly change the nature of derivative transactions for non-financials.

Having to cash-collateralise all trades would create an immediate and continuing cashflow as the transaction's market value changed. For companies this potentially huge incremental borrowing need would create problems.

The ACT has been active in making sure that the ways in which companies typically use derivatives are properly understood among policymakers and that the implications for cashflow and economic activity generally are properly recognised.

Other treasury associations across Europe have been similarly active, with the EACT (European Association of Corporate Treasurers) taking a prominent role. Individual companies that make extensive use of derivatives for hedging purposes have also been vocal.

The US had been taking the most forceful actions but has now produced a draft bill with specific exemptions for non-financial companies. This is encouraging as the EU is keen to ensure any new rules it brings in are broadly consistent with those of the US and other countries.

In October the European Commission followed the US lead and recognised that most non-financial institutions are not of systemic importance. The Commission said it wanted to avoid the downside that if companies had to pay margin calls it might undermine their ability to use derivatives for transferring risk. On the other hand, it also wants to avoid creating loopholes that would let financial firms engage in regulatory arbitrage.

The devil will be in the detail, or in the risk that politicians may feel obliged to regulate everything regardless, but this represents good progress. ■

CDS prices

The credit default swap (CDS) market has a poor reputation for pricing risk correctly, but even if absolute prices are unreliable, the trends in CDS spreads do give an indicator of relative confidence, or lack of it, about credit risk. Along with monitoring the credit rating of financial counterparties, treasurers could look for unusual movements in CDS spreads as another early warning signal of credit risk. Markit is a major information and data provider and has general CDS indices available. Its general page has prices for 450 of the most liquid entities, including sovereigns, from across the world. Go to: **www.markit.com/cds/cds-page.html**

Revamp of IAS 39 moves into top gear

The IASB (International Accounting Standards Board) is working flat out to devise a revised IAS 39 standard on financial instruments, having held no fewer than three extra board meetings during September and October to deal with it.

The ACT has welcomed the proposed simplification of moving to just two categories of classification for financial instruments. However, we expressed concern over the consequences for embedded derivatives, reclassification and the valuation of equity investments.

On the latter point the IASB proposals had stipulated that all investments in equity be carried at fair value and had removed the existing exception where the fair value cannot be reliably measured. The IASB is now minded to allow a simplified measurement for equity investments if determining fair value is impractical.

The exposure draft had proposed that financial instruments could be held at amortised cost where they included basic loan features and were managed on a contractual yield basis. The standards board has tentatively decided to replace the phrase “managed on a contractual yield basis” with a test based on how an entity manages its financial instruments. The test would be whether the corporate objective was to hold the instrument for its cashflows rather than to sell it before maturity to realise fair value changes, and be dependent on the contractual cashflow characteristics of the instrument.

The IASB reaffirmed the fair value option allowing an instrument normally carried at cost to be fair-valued if that eliminates or significantly reduces a measurement or recognition inconsistency. However, it put forward new ideas on reflecting changes in a company’s own credit risk on financial liabilities not carried at cost.

The tentative decision here is to require a frozen credit spread measurement method for all financial liabilities that are not eligible for amortised cost but are managed as part of a contractual cashflow business model. It follows that this measurement would not apply to financial liabilities held for trading, including derivatives, and financial liabilities for which the entity uses the fair value option. There will be disclosures required on the methods and inputs used to isolate the initial credit spread, and certain fair value disclosures in accordance with IFRS 7. ■

Corporate CO_2 allowances loom

The UK’s Carbon Reduction Commitment (CRC) scheme is changing its name to the CRC Energy Efficiency Scheme. At the same time the government has announced that the requirement to purchase emissions allowances will be postponed until 2011/12.

The scheme will extend emissions limitations much further than at present and apply to any users of more than 6,000MWh during 2008 (roughly equivalent to an annual electricity bill of £500,000) aggregated across the UK group. It will catch 20,000 large public and private sector users.

During the introductory phase, allowances will be sold at a fixed price of £12 per tonne of CO_2. Following the initial sale period, participant organisations will be able to buy and sell allowances by trading on the secondary market. From April 2013 there will be a cap on the number of allowances available each year and all allowances will be put up for auction.

The revisions to the scheme give recognition to organisations that take action early to improve energy efficiency or that use onsite renewable energy such as wind turbines or solar panels.

Ever more companies will find themselves brought into the CRC Energy Efficiency Scheme, so treasurers may need to consider their group’s arrangements. Wherever the prime responsibility sits, treasury departments should surely help in creating the information systems, the monitoring and controls. Arrangements for forecasting exposures, trading between subsidiaries and centralising emissions positions will have similarities with foreign exchange management and internal accounting.

More information is available from the Department for Energy and Climate Change at **www.decc.gov.uk**

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- Revised guidance on **going concern and liquidity risk** for directors of UK companies has been released by the Financial Reporting Council (FRC). The guidance brings together the requirements of company law, accounting standards and the listing rules (if relevant) on going concern and liquidity risk for small, medium and large UK companies and provides assistance on their application. The guidance takes a practical approach and methodically works through the process and the principles to be applied in assessing going concern, the review period and the disclosures required. Go to: **http://tinyurl.com/ygwjms2**

- **The Prospectus Directive** is under review by the European Commission with the aim of reducing the administrative burdens for issuers and intermediaries, while also improving the level of investor protection and ensuring that the information provided covers the needs of retail investors. Changes proposed include requirements to keep summaries brief and non-technical and act as an introduction to the prospectus as a whole, being subject to civil liability only if they are misleading, inaccurate or inconsistent when read together with the other parts of the prospectus. The prospectus requirements for rights issues and issuers with smaller market capitalisations will be subject to a proportionate disclosure regime.

- A policy statement on **strengthening liquidity standards** has been published by the FSA. Its more exacting requirements for holdings of liquid assets, with a narrower definition, will be phased in as economic conditions allow. In a speech Sally Dewar, FSA managing director of risk, said that risky business models would require too great a level of liquid assets and capital to be viable. If and when the system as a whole comes under liquidity pressure in the future, companies should be permitted to draw on the buffers they have been carrying to help deal with such stresses. The G20 countries have all pledged tighter liquidity rules, but the UK is the first to adopt formal requirements.

- **The cheque guarantee card scheme** has announced a closure date of 30 June 2011. This follows an earlier decision by the Payments Council to plan for an orderly rundown of the scheme. Of the 1.4 billion cheques written last year only 95 million (7%) were guaranteed.