IN BRIEF

- **EU Green Paper on Financial Services Policy 2005-2010** plans a period of implementing and enforcing the existing legislative framework and applying better regulation. The ACT's response was generally supportive of this approach. It urged emphasis on codes of conduct with regulation only as a last resort – and even then with a 'light touch' on a 'comply or explain' basis where possible.

- A draft **Pensions Governance Code** for trust boards and management committees of defined benefit and defined contribution pension funds has been issued by The National Association of Pension Funds. It advocates a voluntary 'comply or explain' approach, as for the Combined Code. The report notes the 'governance vacuum' in defined contribution schemes. Various mechanisms to represent the collective interests of members of defined contribution schemes are put forward.

- Draft clauses for a **Company Law Reform Bill** have been published by the DTI. These include: reserve powers to compel companies to provide information to indirect shareholders in paper form; allowing shareholders to agree to limit auditors liability; measures to simplify the procedures for obtaining shareholder approval for political donations; and changes to the ability of shareholders to bring proceedings against the directors for negligence and breach of duty, on behalf of the company.

- The DTI has published ***Promoting Competitiveness, the UK Approach to EU Company Law and Corporate Governance.*** The idea is to encourage UK businesses to become more involved and to influence policy. The Company Law Action Plan is described and a summary is provided of measures completed and those yet to be proposed. See www.dti.gov.uk/cld/pdfs/ukapproachtoeucompanylaw.pdf

- The new Listing Rules, effective 1 July, remove the requirement to announce **secondary-market buy-backs of bonds/debentures**. The new rule 12.5.2 only requires disclosures where over 10% of equity or preference shares have been bought back. Issuers will still need to consider the Disclosure Rule 2.2 and the need to disclose "inside information". Information will be inside where it is "likely to have a significant effect on the price" of a security traded on a regulated market, using the "reasonable investor test".

INTRODUCTION

By MARTIN O'DONOVAN
ACT Technical Officer

IAS 39 *Financial Instruments: Recognition and Measurement* has been controversial, to say the least. Hardly a week goes by without some journalist or analyst publishing a commentary on one aspect or another. Training courses abound and countless business days will have been spent by now on making the necessary implementation changes. It is therefore somewhat surprising that IFRS 7 *Financial Instruments: Disclosures* has reached the standards book with scarcely any public comment.

In fairness it very much covers the same ground as IAS 32 *Financial Instruments: Disclosure and Presentation*, large chunks of which it replaces. However the exact detail and layout of the disclosures on financial instruments will change and are worth early study.

The Update Extra feature this month is a summary of a briefing note recently published on the ACT website. This triggers the thought that it is worth remembering that the website does contain masses of useful information. Searches can be done for articles from *The Treasurer* or via the technical page there is an indexed resources database taking you to back articles.

Probability accounting

The definition of contingent liabilities and assets and the accounting required are being revisited in proposals to amend IAS 37 *Provisions, contingent liabilities and contingent assets* and in the UK's equivalent, FRED 39 *Amendments to FRS 12 Provisions, contingent liabilities and contingent assets*. The concept of a contingent liability would be eliminated and instead contractual rights and obligations would be divided into two types: "conditional" and "unconditional". An entity would recognise a liability relating to an unconditional obligation. Even if the amount required to settle that liability is contingent or conditional on the occurrence or non-occurrence of uncertain future events, the liability is recognised independently of the probability of that future event. Uncertainty about the future event is reflected in the measurement of the liability.

This contrasts with the present convention that a contingent liability is not recognised but is disclosed in the notes. The contingent liability is currently defined as a possible obligation that depends on the occurrence or non-occurrence of an event, or is a present obligation where the obligation cannot be reliably measured or an outflow of resources is not probable.

The new idea is to omit the probability criterion from recognition and move it to measurement. The term "contingent" is used to refer to uncertainty about the amount required to settle the liability, rather than uncertainty as to whether a liability exists.

The measurement amount becomes the amount the entity would rationally pay to settle the present obligation or to transfer it to a third party. It will thus allow for expected cashflows and their discounted values.

So, for example, in the case of a product warranty, the question is not whether it is probable that the entity will be required to repair or replace the product. Rather the question is whether the entity's unconditional obligation to provide warranty coverage will probably result in an outflow of economic benefits. All this could be very relevant to treasurers involved with performance bonds and the counter indemnities for these that will have been given to the banks issuing the bonds. IAS 37 as currently issued says that if the probability of a payout is remote then you disclose but do not create a provision. The amendment would mean that the unconditional indemnity to the bank would need to be provided for, even though the amount would normally be a small percentage of the total notional cover. For exporters of capital goods where performance bonds are the norm there could be major impacts.

The changes will definitely bring more and more liabilities onto the balance sheet. Another example might be an entity that is being sued for damages of £10 million. Legal proceedings have started, but the entity disputes liability. The entity estimates that it has a 20% chance of losing the case. Under the old rules, the entity would disclose a contingent liability in the notes to the accounts. Under the new proposals, the entity has an unconditional obligation to stand ready to pay the damages if awarded. In this case, it would recognise a non-financial liability of £2m. ■

EU Regulations on funds transfers

As part of the European Union's (EU) actions to combat the funding of terrorism the European Commission (EC) has issued a proposed Regulation to tighten controls of money transfers. It requires that all electronic money transfers be accompanied by the identity of the sender including name, address and account number. The measures ensure that the details will be available at once to the law enforcement authorities.

The requirements will apply to transfers of funds in any currency that are sent or received by a payment service provider in the EU. The name, address and account number of the sender of the transfer must always be transmitted together with the funds, and the payer's bank will have to verify the information on the payer. For payments within the EU just the account number will be sufficient. For payments outside the Community less than €1,000 the verification may be limited.

Similarly, when receiving funds, regardless of the amounts involved, the receiving bank will have to check that the required details are included, and may either reject the transfer or ask for complete information on the payer. The bank may either hold the funds pending this enquiry or may make the funds available to the payee. Ultimately a receiving bank dealing with a paying bank that systematically fails to provide information on the sender should reject any unidentified transfers or terminate business relationships with that counterparty. Both the payer and payee sides will need to keep records for five years.

To allow time for the relevant businesses to prepare for implementation the start date proposed is 1 January 2007.

The ACT has fed back comments to the EC including a suggestion that if a funds transfer ends up being blocked the bank should inform the payee of this fact. ■

Company accounts: impact of new accounting and auditing standards on the 'true and fair view' and auditors' responsibilities

The Financial Reporting Council (FRC) has published its analysis of the implications of the new accounting and auditing standards on the 'true and fair view' and auditors' responsibilities.

There have been many changes in key measures such as profit and net assets, the format of financial statements, and the terminology used in the statements. Whether a company has met its financial reporting obligations or whether an auditor has discharged his responsibilities are ultimately matters for the courts to determine. But that sort of process may not happen for years, hence the FRC's desire to clarify these matters, including the replacement of 'true and fair' by 'fair presentation' as the over-arching test that financial statements should satisfy.

The FRC has concluded that:

■ the concept of the 'true and fair view' remains a cornerstone of financial reporting and auditing in the UK.

■ there has been no substantive change in the objectives of an audit and the nature of auditors' responsibilities.

■ the need for professional judgement remains central to the work of preparers of accounts and auditors in the UK. The need for accountants to give judgement has not been replaced by box-ticking.

There have been concerns that the use of the 'true and fair override' (a phrase that encompasses departures both from accounting standards and from a detailed accounting requirement of the Companies Act) will diminish due to the requirement to comply with IAS. As a result, companies' accounts would not show a true and fair view. The FRC explains that this is to misunderstand the circumstances in which the true and fair override has been used in recent years in the UK. An analysis of the use of the 'true and fair override' by Company Reporting Limited shows that in 96% of cases where the override was used, it was invoked to justify departures from provisions of the Companies Act in order to comply with accounting standards. A common example is where investment property companies depart from the statutory requirement to depreciate their properties so as to comply with Statement of Standard Accounting Practice 19 which requires the properties to be shown on the balance sheet at market value. This illustrates the importance that accounting standards now play in ensuring that financial statements give a true and fair view.

Some commentators have argued that auditors have a responsibility to identify and report to shareholders situations in which management has acted contrary to the interests of shareholders. Any interpretation that imposes a duty that goes beyond an auditor's duty to express an opinion on the financial statements of a company would, the FRC believes, go well beyond what Parliament intended. ■

IFRS 7: the new standard on financial instruments arrives

The new accounting standard IFRS 7 *Financial Instruments: Disclosures* has been issued, to apply for periods beginning after 1 January 2007, with earlier adoption encouraged. Large portions of IAS 32 *Financial Instruments: Disclosure and Presentation* are being deleted and relocated in a somewhat modified form into IFRS 7. While the spirit of the required disclosures is much the same the detail has changed. There is far more focus on sensitivity analysis rather than tabular details, and if the year-end data are unrepresentative of the entity's risks during the period this should be explained.

In last year's exposure draft for this standard new requirements were introduced to report on the management of capital including any internally or externally set targets. The ACT's response recognised the importance of capital management but viewed it as more amenable to a narrative-type discussion as part of an OFR rather than linked to financial instruments. To a degree this point has been taken and the new obligations on capital disclosures have instead been included as an amendment to IAS 1 *Presentation of Financial Statements*. The performance against internal capital targets has been dropped. ■