Mission and vision

TREASURERS FROM ALL ACROSS EUROPE MET AT THE FIRST '*TALKING*TREASURY' FORUM IN PRAGUE, ORGANISED BY THE ACT WITH THE CZECH TREASURY ASSOCIATION. OPEN ONLY TO TREASURERS, THE ONE-DAY SESSION CREATED THE OPPORTUNITY FOR A DEBATE AND AN EXCHANGE OF VIEWS ON THREE KEY TREASURY THEMES. **MARTIN O'DONOVAN** REPORTS.

Executive summary

- Treasury management should be holistic or all-encompassing, with all needs aligned with overall business objectives.
- The question remains whether IAS 39 accounting is overriding economics and changing corporate behaviour. The standard needs changing.
- The Single Euro Payments Area project may be moving closer, but users are still unclear about what it means.

In the spirit of comparing notes between treasurers the first of the three themes up for discussion at the *talking*treasury forum, sponsored by JPMorgan Asset Management, was best-in-class treasury. It was accepted that there can be no one answer as so much will depend on circumstances, but whatever detailed operational methods are selected, all treasury management needs to be aligned with overall business and shareholder objectives. Treasury management should be holistic or all-encompassing. David Blackwood, Group Treasurer of ICI and Chairman for the day, felt there was not much point in dealing with only half the issues and not taking account of the other half.

Currency hedging is a core part of any treasury operations and Bjorn Carlbom, Head of Consulting Group at Philips Electronics, outlined an approach to which many might aspire, even those working on a smaller scale. With 1,000 or more reporting units, Philips' old set-up relied on businesses going through local approval procedures and faxing in deal requests to the centre where external dealing, one on one, was done and the hedge reflected back to the unit. A vast number of steps were required and a great deal of paperwork generated. After a complete revamp in 2002 Philips is now highly automated and works on a straight-through processing (STP) basis. Local units capture exposures and forecast cashflows and transmit them to the centre via the web. Previously it was buy/sell requests, but now the nature of the exposure must be given. Exposures are accumulated and net external deals done using forwards. Committed exposures are 100% hedged, anticipated exposures six months out are hedged 30% to 50%, and those at three months are moved up to a maximum of 70% cover. The percentages depend on the unit and the nature of the exposures and are not discretionary so that the dealing needs can be fully automated.

Since such a net deal will not qualify for hedge accounting purposes, the foreign exchange banks are given the breakdown of amounts that make up the net deal and then issue deal confirmations for the underlying component buy and sell deals as if dealt one on one. The centre transacts the corresponding internal back-to-back deals with the operating units. Thus exposures are both identified and hedged at the business unit level, but the accounting entries are determined centrally, where the specialist expertise resides, and passed across to the units for recording.

Gas company OMV, Austria's largest listed company, covered some of the overriding policy matters and had focused on creating the right framework for a coherent treasury mission and vision. Banking relationships were important with a well-defined group of 19 core banks. Stimulated by comments from the delegates the nature of bank relationships were explored, especially in terms of the possible conflict of interests when a relationship bank also acts for an acquisition bidder. Expectations of the strength of relationships in times of stress were not high. It is hard to complain about fickle banks when corporates will make no promises about guaranteed future business. Banks have a duty to their own shareholders to optimise commercial returns and in a bid situation are likely to side with the party whose remuneration stream they feel is more secure.

IFRS IMPLEMENTATION The second session, on international financial reporting standards (IFRS), was introduced by ACT Technical Director John Grout, who challenged delegates to consider whether accounting was overriding economics and changing the behaviour of companies. Also, with a timetable laid out for US convergence, he questioned whether we would see a move from a principles-based to a rules-based approach and if this concerned delegates.

Françoise Florès, IFRS Technical Advisor at the European Financial Reporting Advisory Group (EFRAG), explained EFRAG's structure and the criteria it applied (including the requirement to be true and fair) in advising the European Commission prior to European adoption of each new accounting standard. She explained why it took up to six months for the EU to endorse a standard approved by the International Accounting Standards Board (IASB), and also provided some insight into the history, status and adoption of IAS 39 *Financial Instruments: Recognition and Measurement*. EFRAG may not be well known but it is crucial to the evolution of accounting rules in Europe.

Mark Kirkland from Philips presented three changes he would like to see made in IAS 39:

- **Removal of the 80%-125% effectiveness testing requirements** Kirkland argued that any ineffectiveness affected the profit and loss account, and there was no logic in a 79% effective hedge ceasing completely to qualify as a hedge

- **For combinations of derivatives and non-derivatives to be classed as hedged items** It cannot be right that a fixed-rate dollar bond gets a different accounting treatment from a Eurobond swapped into fixed rate borrowings when both are economically identical. Philips was obliged to borrow inefficiently to obtain the accounting presentation expected by the market.

- **For hedge accounting to be made available for hedges of net positions** This would remove the current requirement to enter into numerous contrived trades with banks.

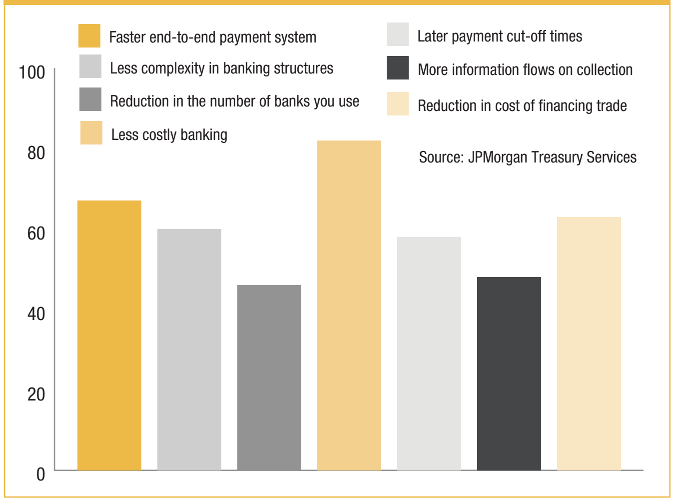
Warming to his theme, Kirkland offered an insight into the workings of the IASB's Financial Instruments Working Group, of which he is a member. Frustration with the lack of progress and participation in "theoretical debates" prompted some members to request and subsequently hold a meeting with Sir David Tweedie, Chairman of the IASB. Tinkering with IAS 39 to rectify one-off anomalies was not on the agenda, but the working group should be setting overall guidelines for an eventual complete review of the standard. The discussions among delegates raised a number of additional issues:

- Embedded derivatives – a desire to simplify the rules regarding currency of contracts;
- Difficulties in obtaining hedge accounting on index-linked swaps;
- Hedge accounting for internal current accounts (linked to IAS 21 *The Effects of Changes in Foreign Exchange Rates*);
- Net investment hedging capacity being restricted to book values, with no regard to the economic values being hedged; and
- Difficulties in hedge accounting for commodity portfolio risk.

Altering the 80%-125% rule and hedge of derivative combinations attracted almost unanimous support in a straw poll of delegates, with treasury centre netting and embedded derivatives both coming a close second. The other issues were identified as being more specialised but deemed important to those delegates directly affected by them.

PAYMENTS AND SEPA The European Payments Council (EPC) represents the banking industry and as a market-led initiative it has taken on responsibility for delivering the Single Euro Payments Area

Figure 1. What benefits do you expect to derive from SEPA?



(SEPA) project. Gerard Hartsink, Chairman of the EPC, explained the importance of hitting the planned 2008 start date for early adopters and the 2010 stage of achieving a critical mass of users. It is a major project, but the European authorities are determined to encourage its design and completion, and its success relies on input and active involvement from corporate users. It was not logical to continue with many different payment clearing platforms across Europe. Other infrastructures – such as credit cards, bond clearing and Euronext – had consolidated and harmonised, and these had all worked.

The SEPA project deadline is getting closer, yet users still seem unclear about what it all means for them. The EPC will be producing a comprehensive communication to explain SEPA in May, but in the meantime the European Central Bank's fourth progress report provides a good briefing and is available at www.ecb.int/pub/pdf/other/singleeuropaymentsarea200602en.pdf.

While corporates are at the early stages of thinking about the possibilities, banks such as JPMorgan are taking a positive approach and viewing the new payments process as an opportunity to build value-added services for customers. JPMorgan, the sole bank present, had a wider vision, seeing SEPA as part of a once in a generation step change, linking it to a harmonisation of infrastructures and possibilities for e-invoicing. Direct cost savings on payments would be welcomed yet the ancillary savings and benefits could be even bigger.

Treasurers may feel that within their own companies there are few others who talk the same language of risk and finance, but national treasury associations, meetings and conferences offer opportunities for networking and cross-fertilisation of ideas and practices. The *talking*treasury forum in Prague extended this concept by creating an atmosphere of friendliness and professionalism in a gathering of approximately 70 treasurers from 16 countries.

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talking treasury

A full report will be published in due course and a further forum is being planned for the autumn, when the ACT will be working with the DACT in the Netherlands.