INTRODUCTION

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Looking back at the content of last year's Technical Updates, one might get the impression that corporate treasurers are mainly concerned with accounting and law. The fact of the matter is that as a well-rounded financial professional, these aspects are inevitably important. What is more, it is often the case that changes to tax law, company law, accounting law, securities law and the like are the drivers of changes in treasury requirements and constraints.

This month's Technical Update seems to follow the same pattern as we explain the proposals for a revised and compulsory Operating and Financial Review (OFR) standard. The reporting requirements should not change what is economically sensible to be doing in your company or group, but there is no harm in taking the announcement of the proposed standards as the trigger to complete a stocktake of existing policies and practices. Could anything be done differently or better in the area of treasury risk management or in communications with stakeholders about treasury activities?

To provide a more direct treasury-related counterbalance, this month's Technical Update Extra explains a treasury instrument which is not that well known but is, nonetheless, a standard tool for managing emerging market currency risk – the Non-Deliverable Forward (NDF). ■

OFR requirements released

New Company Law regulations are being laid before Parliament to make the Operating and Financial Review (OFR) a compulsory requirement for quoted companies.

The nature of the OFR will be broadly as expected from the DTI consultation held earlier in the summer, bar the fact that some modifications have been made in response to feedback from the public, as well as the ACT. Most significantly directors will be expected to apply 'due care, skill and diligence' in preparation of the OFR; this is the same as required for financial accounts.

The need for a higher prospectus standard of 'due and careful enquiry' has now been removed. The audit requirements have also been simplified; auditors will now state whether the OFR is consistent with the company's accounts. There will be no need to send the OFR to shareholders receiving summary financial statements and the start date has been put back slightly to apply to financial years beginning on or after 1 April 2005.

The ACT's proposal that 'safe harbours should be provided for statements honestly made in good faith' has not been adopted. However, the Regulations and Guidance Notes will allow a distinction between statements made based on good faith judgments – for example, on future events or prospects – and statements based on objectively verifiable data.

As part of the new law, the Accounting Standards Board (ASB) has been charged with producing a Reporting Standard for the OFR. A draft of this has now been published and, once finalised, compliance with the standard will be sufficient to satisfy the company law obligations.

The principles proposed by the ASB require the OFR to:

- Reflect the directors' view of the business;
- Focus on matters that are relevant to investors;
- Have a forward-looking orientation. It should identify those trends and factors relevant to investors' assessment of the current and future performance of the business and the progress made towards the achievement of long-term business objectives;
- Complement as well as supplement financial statements. This means it can be used to provide additional explanations of amounts recorded in the financial statements;
- Be comprehensive and understandable. This does not mean that the OFR must cover all possible matters. It is acknowledged that the objective is quality not quantity of content and that too much information may obscure judgments and will not promote understanding;
- Be balanced and neutral and deal even-handedly with both good and bad aspects;
- Be comparable over time. The ASB proposes that the OFR should be comparable with similar information presented by the entity for previous periods and possibly also with reviews prepared by other entities in the same industry or sector.

The key elements of the proposed disclosure framework cover:

- The nature, objectives and strategies of the business;
- The development and performance of the business, both in the period under review and in the future;
- The resources, risks and uncertainties and relationships that may affect the entity's long-term value;
- The position of the business, including a description of its capital structure, treasury policies and objectives and cashflows and liquidity, both in the period under review and in the future.

Under the treasury heading, the balance between debt and equity must be covered, as must the maturity profile of debt and its rate structure, funding plans and why the entity has adopted this particular capital structure. The purpose and effect of recent major financings should be explained along with the potential impact of interest rate changes. Where segmental cashflows are out of line with the segmental analysis of revenues or profits, this must also be indicated and explained.

The proposals also cover the provisions in the draft regulations that the OFR should include information about issues such as the persons with whom the entity has relations (e.g. customers and suppliers), employees, environmental matters, community and social issues, and receipts from, and returns to, shareholders. The list in the regulations is non-exhaustive and the draft standard gives further areas for coverage – that is, market and competitive environment, regulatory environment and technological change.

The standard provides the basic framework that directors must apply, but it is up to the directors to consider how best to use this framework to structure the OFR, given their companies' circumstances.

On the Key Performance Indicators (KPIs) to be included, the draft standard emphasises that it is for directors to consider which KPIs, and how many, best reflect their judgment of what is required for an understanding of the business.

There is a Draft Implementation Guide which will not be part of the proposed standard. It gives illustrative examples of KPIs that might be disclosed in an OFR, as well as further guidance on the other areas directors will need to consider in this context. ■

CESR consultation on rating agencies

The Committee of European Securities Regulators (CESR) has published a consultation paper which puts forward ideas for possible regulatory approaches in respect of credit rating agencies (CRAs). The ACT working together with the treasury associations in France and the US have been active in the debate on this subject and this is acknowledged in the CESR paper.

The paper analyses possible rules for a Code of Conduct covering areas such as conflicts of interest, fair presentation and the methodologies of CRAs, and access to confidential information in the context of the Market Abuse Directive.

The second significant part of the consultation looks at whether, and how, CRAs might be regulated. This is particularly relevant given the Basel II Accord and the use of credit ratings in the Capital Requirements Directive (CRD) applicable to banks and investment firms, which stem from it.

The particular options identified by CESR are:

- **Registration/regulation regime (1) –** The establishment of a European registration scheme (administered by a European organisation, such as CESR. Registration would be granted on the basis of assessment of well-specified criteria, such as credibility, independence and expertise of staff, adequacy of funding and the existence and disclosure of proper procedures for ratings decisions and related matters. There would be ongoing supervision and compliance requirements.
- **Registration/regulation regime (2) –** the setting up of a regime similar to the above, but with much 'lighter' criteria for registration, based on the International Organisation of Securities Commission's (IOSCO) Code, as just published in December 2004.
- **Inclusion of the IOSCO Code of Conduct within the CRD's recognition procedure –** there would be an assessment of each CRA's implementation of the IOSCO Code. This would be done at a national level and in parallel with recognition of ratings for the purposes of the CRD.
- **Third party certification or enforcement of the IOSCO Code –** to have a third party certify or endorse the compliance of a CRA's rules and procedures with the IOSCO Code.
- **Reliance on rules covering only specific aspects of CRAs' activity –** selective regulation combined with a 'comply or explain requirement' for the CRAs, or separate national forms of enforcement.
- **Monitoring the market developments –** To do nothing now, but instead rely on market forces and reconsider things later in the light of market developments. ■

Tax avoidance decision

The eagerly-awaited decision of the House of Lords in Barclays Mercantile Finance Limited v Mawson has provided some further clarification of the 'Ramsay doctrine' regarding the interpretation of tax law.

The case concerned a complex sale and leaseback transaction for a gas pipeline connecting Great Britain and Ireland. However, using a chain of companies, all of the sale proceeds were initially deposited back with the Barclays group, since the customer did not actually need any finance. There were further complexities to the structure to avoid the UK rules regarding lower allowances when leasing to foreign lessees.

The Inland Revenue contended that, since on an overall basis no finance was provided to the customer, the lessor was not entitled to capital allowances. The House of Lords, however, favoured the taxpayer.

After a brief reference to the earlier case law, the Lords concluded that the purpose of the statute under discussion was to give capital allowances to companies that purchased assets that were let out under a lease.

As these circumstances existed, the lessor was entitled to capital allowances, and all the peripheral transactions engaged in by other companies had no impact on this.

However, the judgment provides less guidance regarding the Ramsay principle than had been hoped for in the build-up to the decision. ■

IN BRIEF

The Accounting Standards Board (ASB) has published an Exposure Draft of amendments to the Financial Reporting Standard for Smaller Entities (FRSSE). The new standard for smaller entities reflects changes in company law and the development of international accounting standards since the original FRS was first published.

The SWX Swiss Exchange has announced changes to its listing rules to encourage the listing of foreign bonds. Commentators have indicated that this may be a means of luring issuers away from the EU where rules are stricter. In particular, issuers would not need to report under IFRS.

The Association of British Insurers (ABI) has published revised guidelines on executive remuneration. Changes include recommendations to discourage windfall payments to executives after a change of control; to publish, in advance, the approach to adjusting performance hurdles for accounting changes; and that chairmen should not receive share incentives linked to share price performance.

The **ACT** has published a briefing note on its website (www.treasurers.org http://www.treasurers.org/) covering compliance with financial covenants after the adoption of IFRS accounting. It flags the risks from cross defaults, difficulties in maintaining a going concern basis of accounting and, in extremis, the need for an announcement under any relevant Listing Rules.

The Inland Revenue has issued proposals for reform of the taxation of finance leases. The new approach will equate the tax treatment of finance leasing with that of other forms of finance. The lessee will be treated as borrowing to acquire the asset and will, therefore, obtain capital allowances and deductions for interest. Lessors will no longer be able to claim capital allowances.

The Financial Reporting Council (FRC) has issued a consultation document on the Turnbull internal control guidelines. It is seeking views on the effectiveness of the current guidance, in what ways it may need to be updated, and what information companies should be asked to disclose to their shareholders. Any proposals that may result will be produced in mid 2005. ■