The author, chief executive of the Association of Corporate Treasurers, looks ahead at two challenges of 2004 in the continuing arguments over international financial reporting rules on financial instruments, which he believes will create inconsistencies in banking accounts and treasury practices, and in the implementation of the Sarbanes-Oxley legislation which he believes will create a burden of excessive certification.

Financial reporting, Regulation, Financial instruments, Hedging, International accounting, Accounting standards

or the corporate treasurer (and by extension, the finance director) 2003 has been a challenging year but 2004 promises to be even more so. Organizations such as my own, the Association of Corporate Treasurers (ACT), are committed to the development of the practice and the profession of treasury and risk management, and we have been centrally participating in this evolution. This is fundamentally because whilst the treasurer has always seen the role as global – the management of liquidity and risk, and the negotiation of corporate finance, takes place across country and currency borders – the world around the treasurer has in several senses begun to catch up.

From the UK perspective this means that we are deeply and directly concerned about changes in the accounting, regulatory and fiscal environment, with these changes taking place in the European Union and in the USA as well as parochially in the UK. Dealing with the promise, threat or reality of these changes has been a dominant preoccupation for treasurers and the ACT during 2003. We have sought to influence where the opportunity was there – most obviously with international accounting standards; and where the issue has not been one of debate and development but rather one of accommodation and acceptance we have of course tried to ensure that this was understood and the processes of treasury and risk management were appropriately modified.

In no single area has the need to influence, and at the same time to have a watchful eye on the understanding and the reality of treasury practice, been more true than in dealing with international accounting standards (IAS). The work being done on fair value accounting in general and on accounting for derivatives in particular is absolutely central to treasury and to risk management. There has been a major debate with the IASB over their proposals, which at the time of writing shows no sign of having been won. In the simplest possible terms, the issue is over whether or not it is right that implementing the sensible principles of fair value accounting should result in financial statement or behavioral consequences that appear inconsistent with the creation or loss of economic value. To compound the challenge, the current approach by the IASB appears to support divergence rather than convergence of standards, a consequence that seems patently at odds with the IASB's objectives and the aspirations of the corporate community.

The international standard for derivative accounting is IAS 39. As it and the guidance notes are currently worded, application will inhibit a core tool of treasury management generally regarded as embodying best practice. This tool is the gathering into one common point of all the currency exposures arising within the business – bar any exposures where size or regulatory or fiscal factors make such a process uneconomic or simply not possible. What treasurers set out to do is to take currency flows from throughout a group into a treasury center, net these off wherever possible and then enter into external hedges to lay off the remaining risk. This process of netting is economically sensible and reduces operational and control risk, as well as of course giving the group a degree of comfort that risk has been identified and managed in line with policy. Risk awareness and then its minimization is what typically characterizes such a policy – hardly an approach that the drive for international convergence of accounting standards should be discouraging.

By restricting the application of "hedge accounting" (in the language of the standard) where there is centralized management and netting of currency risk, IAS 39 may force groups down one of three roads, none of which is sensible either in economic terms or in the pursuit of clarity in corporate reporting. These consequences are not ones that those of us who wish to encourage and support the global standard-setting initiative can regard as a good thing.

The first option is to continue to do just as has always been done, accepting the limited availability of hedge accounting for the actions involved in netting group risk. The result will be financial statements exposed to mark-to-market valuations of currency flows and hedging instruments, notwithstanding the fact that the group as a whole is perfectly hedged. The second option is to abstain from hedging the net risk. The result will be similar: volatility in earnings as the unhedged risk carried in the central treasury is marked-to-market.

The third option is to abandon the netting process and cover all exposures in the financial markets. This management of risks on a "gross" basis will delight the banks and brokers, who will see a substantial increase in business. The cost will of course be carried by the corporate customer, who will additionally see greater risk in control and operational processes. As an alternative to this third option banks are preparing to offer their largest customers structures that "work-around" the economic inefficiencies of hedging risk on a gross basis: this increase in opacity in order to circumvent an accounting standard is something that should be seriously worrying the IASB. The work-around is unlikely to help the smaller company being left to struggle with IAS 39 without banks prepared to offer such solutions.

There are signs of further such work-arounds being developed, as companies look at the scope to form non-consolidated special purpose vehicles (SPVs), through which "gross" contracts could be written which the SPV itself would net off. Once again this must be a consequence of IAS 39 that the IASB should be extremely concerned about.

The initiative by treasurers and their professional associations such as the ACT to influence the IASB's approach to IAS 39 is a sub-plot in much wider and of course higher profile issues –

those surrounding the movement to harmonize accounting standards, the influence of the USA on this process and the concerns felt within the EU at both country and supra-national level. I am entirely supportive of the case for harmonization. I am in favor of fair value accounting, as to ignore fair value is to forsake the opportunity to move book-keeping away from record-keeping and towards dynamic measurement of value; this must be right if we wish to help stakeholders – the broad constituency that at the very least embraces employees alongside investors – understand value creation and destruction.

At the time of writing it is becoming clear that the EU will not endorse the adoption of IAS 39 until part-way through 2004 (at the least) and therefore listed companies will not be required to begin to produce 2004 comparatives on the new standard. Treasurers are however for the most part enthusiasts for more rather than less level playing-fields; they will therefore welcome the overall aspects of the IAS initiative, even if the finance function will be struggling – as many are predicting – with the challenge of its implementation.

There is of course one other key international area where treasurers and their finance directors are already having to come to terms with the implementation of a radically new regulatory environment. This is in dealing with the Sarbanes-Oxley legislation, which affects any group "enjoying" (I use the word with care) the benefits of a US listing. Much has been written about this over the last year, and an encouraging aspect is that those of us who were most outraged by the more crude and less well-thought through aspects of Sarbanes-Oxley as first proposed have seen many of the rough edges of the drafting honed away. What we are left with is a well-intentioned set of legislation that seeks to raise governance standards, even if the driver for this is the US context with its patently weaker approach than that we are familiar with in the UK.

For treasurers the main burden of Sarbanes-Oxley lies in the frequency and detail of the certification required. Whilst many will rightly say that this merely matches the level of awareness and control that is being exercised by the conscientious professional treasurer already, the codification of this and its consequential administrative burden is having a major impact on how treasurers spend their time – at least those with US listings. The knowledge that the CEO could face criminal charges should there be any inaccuracy in the certification is of course serving to underline the seriousness of the process for which the treasurer is primarily responsible.

The IAS initiative and the Sarbanes-Oxley legislation posed different challenges for those of us concerned to influence how the treasury profession is impacted by – and can contribute to – the evolving international regulatory, reporting and compliance environment. In the ACT we believe we have learnt from our recent experience, even if we have at times been frustrated by the processes of communication and the realization that more powerful representative groups – such as the financial sector – have sometimes seemed to find it easier to command attention and gain their own influence. We hope that 2004 will see a continued process of change leading to higher standards of governance, more assured management of risk and its reporting, as well as the beginning of the practical experience of adopting IAS principles in the major economies.