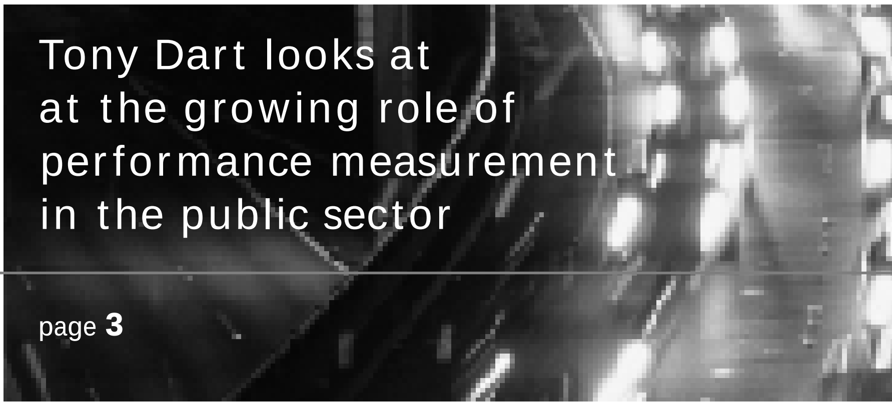
Finance & Management

Issue 89 JULY 2002

THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND & WALES

Faculty of Finance and Management

Performing in public



Tony Dart looks at at the growing role of performance measurement in the public sector

page 3

plus

FRS 17 – the debate continues

page 16

CFO 2010

Why CFOs need to communicate

Interview with John Connors, CFO of Microsoft page 11

ISSN 1471-1818

Faculty faces

Main contact numbers
Tel: 020 7920 8486
Fax: 020 7920 8784
Web site:
www.icaew.co.uk/fmfac

Chris Jackson
Head of Faculty
Tel: 020 7920 8525
Chris.Jackson@icaew.co.uk

Kirsten Fairhurst
Services manager
Tel: 020 7920 8508
Kirsten.Fairhurst@icaew.co.uk

Judith Shackleton
Technical manager
Judith.Shackleton@icaew.co.uk

Debbie Came
Administrator
Tel: 020 7920 8486
Debbie.Came@icaew.co.uk

Web sites that will help your performance

Readers interested in exploring further management and measurement issues may find these web sites of value.

International Society for Performance Improvement – described as the 'leading international association dedicated to improving productivity and performance in the workplace'. The ISPI web site includes a wealth of information, including the full text of its on-line magazine 'PerformanceXpress' and a useful on-line bookstore focusing on specialist titles in this area. A selection of useful articles from *Performance Improvement Journal* and *Performance Improvement Quarterly* are also available in PDF format on their Suggested Reading page.
www.ispi.org

Performance Prism – information on the performance prism, a performance measurement and management framework. It includes an interview with the authors of *The Performance Prism: The Scorecard for Measuring and Managing Business Success* published by FT/Prentice-Hall with the option to download the first chapter, 'Measuring and Managing Performance in the 21st Century' (PDF format, 14 pages).
www.som.cranfield.ac.uk/som/cbp/prism.htm

Making performance management work (Improvement & Development Agency) – discussion note released by the Improvement & Development Agency, with the full text available for download in PDF format. In addition, an on-line discussion forum (IDeA Discussions) includes further debate on that topic.
www.idea.gov.uk/bestvalue/notes/performance.htm

Performance Measurement Association – official web site of the association for practitioners in the field of performance measurement and management with a wealth of information on the subject. The site includes a useful selection of links, directory of experts, information on PMA discussion forums, details of conferences and an archive of the association's newsletter, entitled *Perspectives on Performance*.
www.performanceportal.org

Public Management Foundation – research centre established in 1990 focused on the provision of public services. The web site includes the full text of their journal *Stakeholder Magazine* which features a number of articles on performance management.
www.pmfoundation.org.uk

JULY 2002 Issue 89

Comments and suggestions should be addressed to Chris Jackson BA FCA, Head of the Faculty (see left).

The Faculty of Finance and Management ICAEW, Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ

FINANCE & MANAGEMENT is edited and produced on behalf of the Faculty by Silverdart Ltd, Unit 211, Linton House, 164-180 Union Street, London SE1 0LH. Tel: 020 7928 7770; fax: 020 7928 7780; contact: Alex Murray, Gabrielle Liggett or Helen Fearnley.

More links on performance measurement/management and many other subjects are available from the award-winning ICAEW web site's links pages at: www.icaew.co.uk/library

The DTI's 'value added scoreboard'

The Department of Trade and Industry has published the first ever 'value added scoreboard'. Using 'sales less the cost of bought-in materials' as the measure of value, the scoreboard shows the wealth created by each of the top 500 UK and top 300 European companies by value added. (The scoreboard does not include US and Japanese companies, which do not provide sufficient information – for example, they do not quote employee costs.)
This scoreboard can be obtained as a hard copy publication, or can be accessed through the DTI's web site. The latter allows a search by company or sector, for the value added during 2000/2001, the information being provided in a printable PDF format.

To order a hard copy of the scoreboard call 0870 1502 500.
To download relevant information, visit
www.innovation.gov.uk/projects/value_added/download.html

Performance and public services

In his Faculty lecture, **Tony Dart**, business controller of the Highways Agency, discussed the future of the finance function in a large organisation, and explained the changes he has made to the planning and implementation system at the agency. Helen Fearnley reports.

Tony Dart, a former technical director at the Chartered Institute of Management Accountants, began by addressing the public sector challenges for financial managers.

Today's British public sector delivers 40% of GDP, providing diverse services under a variety of funding, control and performance regimes, he said. Government policies emphasise delivery of service and best value to the public customer. In turn, these demands pose many challenges for financial managers.

If public resources are being consumed to produce outputs, how can a financial manager ensure that he provides public value by achieving and sustaining the potential benefit – the outcomes? And how can he ensure an organisational commitment to all-round excellence, by embedding those beneficial outcomes in the planning and management cycle, and by applying sound business principles to internal operations?

Dart proceeded to address some of the cultural problems associated with taking that final step, and also discussed the innovations the Highways Agency has made in planning and implementation.

Organisational culture and accounting

The culture of an organisation, he said, determines achievement – and the style of financial management critically influences that culture. Two extremes, both found in the public sector, are the administrative (or bureaucratic) culture and the managerial culture, each characterised as:

- *administrative* – rules bounded; works to the letter of the law; does only what must be done; and
- *managerial* – performance bounded; works to the spirit of the law; is about doing all that can be done.

It is possible to get away with an administrative-only culture indefinitely, provided there is no competition and no need to anticipate change. But, that is a dinosaur mentality...

The analogous accounting styles are financial and management. Their characteristics are:

- *financial accounting* – audit and reporting oriented (ie backward facing); is about what's right; relates to administrative culture; but is at least 80% compulsory – you must have it; and
- *management accounting* – information and result oriented (that is, forward facing); is about what's best; relates to managerial culture; but is at least 80% optional – so, must earn its keep.

Dart pointed out that these styles are not alternatives, but that finance managers should be aware that adopting management accounting causes cultural change.

Using management information for results

There are four key lessons concerning management information and its influence on results:

1. information of itself has no value;
2. value is delivered by effective action only;
3. action will not be effective in delivering benefits unless it is appropriate, measured and controlled; and
4. the benefits delivered by that effective action will not be sustained unless the action is embedded in the organisation's planning, control and delivery cycle.

So while any review may identify potential benefits, that information is valueless without action. To turn those theoretical outcomes into reality will need some form of investment – staff time, consultancy, capital, or any combination – and it will all have a cost. What action is needed to gain, and keep, top management commitment by controlling outcomes?

Predominant critical failure factor

Critical success factors (CSFs) are familiar, but critical failure factors (CFFs) can be even more important, Dart suggested. On everybody's list for every project, he said, the predominant CFF is always 'lack of top management commitment'. To gain and keep that commitment, it is essential to identify and justify improvement projects. One must define the management information to monitor progress; gain financial approval; incorporate projects and information in an action-based management plan; and close the loop through an 'implementation group' at board level.

In making a case to justify a project, he added, there is no substitute for a full appraisal. That appraisal must identify incremental cash costs and benefits, including a tabulation of all options from do-nothing to the proposed, or 'best value', option. Options must be reviewed objectively. Increments of benefits must also match increments of expenditure.

Failure to do this analysis is a major cause of misinvestment in IT projects, where 80% of benefits may come from reorganisation of existing working methods, and only 20% from the new technology – while the expenditure increments are the other way round.

Putting it into practice at the Highways Agency

The Highways Agency maintains, operates and improves 4% (5,850 miles) of the total motorway and trunk roads in England, said Dart, but carries two-thirds of the traffic. With assets of £60 billion, 1,800 staff and annual programme expenditure of £1.5 to £2.0 billion, the Agency is significant financially and strategically. It produces the following plans:

- *corporate* – covering three to five years, and agreed with its sponsoring department (Transport);
- *business* – covering one to three years, agreed at ministerial level and published externally; and
- *management* – a detailed internal document also covering one to three years, focused (before 2000/01) on the delivery of external (ministerial) targets implemented by operating divisions and managed via board level business and operations action groups.

From the 2001/02 planning round, the focus of the management plan was widened to encompass internal as well as external performance. Each division was asked to provide, as well as existing external performance indicators and targets, descriptive text answering the following:

- what do we do now? (description of roles and functions);
- where are we heading? (objectives);
- what are the internal and external constraints (CSFs) and how will we influence them?
- what are the main risks and how will we manage them? (Turnbull guideline information for corporate governance);

Controlling work in progress

Dart said that consistent planning and control require three elements – clear objectives, critical success factors (CSFs) and performance indicators (PIs) – in this analytical sequence:

1. define a consistent set of quantifiable objectives – where do you want to go?
2. for each objective, identify the CSFs – what do you influence or change to get there?
3. for each CSF, derive the formula for the PI to measure it – how do you work it out? and
4. for each PI, set the target values to be achieved at each period end – how do they compare with the current baseline values?

This ensures that all steps are defined and recorded. No numerical information appears until the final step. Performance indicators at step 3 must be set in pairs – one for outputs/outcomes achieved (representing effectiveness and equity) balancing one for resource inputs consumed (showing economy and efficiency). An example of providing management information is as follows:

- step 1 – *objective* – to speed up production of monthly management information (MI) by 2005, while reducing costs of the service;
- step 2 – *CSFs* – monthly reporting time; management information costs;
- step 3 – *PIs* – (1) reporting days as % working days; and (2) MI production costs as % total revenue budget; and
- step 4 – *target numerical values* –

	Current %	Year 1 %	Year 3 %
PI (1)	45	44	41
PI (2)	0.040	0.038	0.036

- what are our measures? (PIs); and
- who will act on them? (implementation group).

The objectives, CSFs, and PIs of each division, with their baseline and target numerical values, are summarised in tables with milestones for reference at meetings of the performance management action group (PMAG), which from April 2001 took over and expanded on the roles of the previous two action groups. (The objective-setting and monitoring process extends through team plans to individual personal development plans, ensuring that responsibility and accountability are devolved to all levels.)

The primary purpose of PMAG, of which all the agency's board are members, is to manage delivery of the objectives in the management plan, Dart explained. It does this by monitoring: the management of business resources (inputs); performance in maintenance, improvement and operation of the network (outputs/outcomes); and the planning framework prior to submission to the board (strategies). PMAG is directed to and focuses on action to achieve objectives. By these means, it completes the planning-monitoring-implementation cycle, ensuring best value is achieved both internally and externally.

The four pillars

Although there is still plenty to do, Dart admitted, the Highways Agency has now put into place four pillars of internal and external excellence:

1. *an action-oriented, performance-based management plan* – clear identification of inputs and outputs;
2. *integrated business management information* – measurement and feedback;
3. t*he board-level performance management action group* – a forum for ensuring corrective action where actual results begin to vary from the plan; and
4. finally, but most importantly of all, a commitment to excellence.

Tony Dart is business controller of the Highways Agency, and was formerly the technical director at CIMA.

If you would like an audio or video recording of this lecture, please see page 15.

A guide to professional integrity

As Samuel Johnson observed, 'Integrity without knowledge is weak and useless, and knowledge without integrity is dangerous and dreadful'. But what exactly constitutes 'integrity' in the business arena? In the following article **Caron Bradshaw**, the head of the ethics advisory services at the ICAEW, provides guidance on the nature of professional integrity, plus examples of how to maintain it in potentially tricky situations.

In November last year the International Federation of Accountants (IFAC) published its 'Code of Ethics for Professional Accountants'. Part A applies to all accountants and Part C deals with issues specifically relevant to employed accountants. It does not materially depart from the Institute's own guidance (see specifically Statement 1.220 of the Guide to Professional Ethics [GPE] and supplementary guidance, 1.401 – financial and accounting responsibilities and 1.402 – defaults or unlawful acts) but its publication offers a good opportunity to reacquaint yourself with the principles.

Integrity

It is impossible in a short article to cover everything, so let's concentrate on integrity. In both the GPE and the IFAC code the first fundamental principle is integrity. Integrity implies not only honesty but also fair dealing and truthfulness. Is there any difference between honest and truthful? I think so. To illustrate what I mean let me give you a fictional scenario.

Jane works in an office where she feels she is overworked and under-appreciated. So on a day when she knows she will be alone in the office for two hours she decides to attend an interview. Hence Jane takes those two hours out of the office and arrives back at 3.00 pm. As she rushes into the ladies, to change out of her interview clothes, Jane hears the telephone ringing. As she reaches her desk the caller rings off.

Unbeknown to Jane the caller was her boss, on his way back to the office, furious he could get no reply. When Jane's boss challenges her saying "I tried to call at just after 3.00 pm, I left the phone ringing for ages. Where were you?" Jane replies, "I am so sorry, I could hear the phone ringing but I was in the ladies. I did try to get to it in time but it stopped ringing just as I got back to my desk."

Jane's boss immediately gets a mental image of poor Jane stuck in the office on her own, not even being able to use the toilet without having to rush. Feeling guilty, he gives Jane the rest of the afternoon off!

The difference between honesty and

truthfulness – Jane was truthful but was she honest? Of course I am not suggesting that stretching the truth on this scale is a heinous crime for which a Chartered Accountant should be stripped of their membership! But there are times when not giving the complete picture or remaining silent instead of speaking up can demonstrate a lack of integrity that is not befitting of a Chartered Accountant.

Loyalties

When faced with a straightforward situation, for example observing a colleague drop his wallet in the car park, you would know how to act with integrity. You would recover and return the wallet without delving into it or removing the content, wouldn't you? But what about situations where it is less straightforward? What if you are not sure whether something is right, or you are under pressure from your boss? What if you acting with integrity causes your employer loss? Your loyalties might be torn so what is the position?

Your normal priority will be to uphold and support the organisation's legitimate ethical objectives. You cannot be legitimately required to break the law, breach the rules of your profession, lie or mislead the employer's auditors (including by keeping silent) or put your name to, or be associated with, a statement which materially misrepresents the facts. But what do you do if you are called upon to act at odds with your professional integrity? Let us consider a short case study based on several enquiries received.

Strapped

John is a financial director of a medium sized company (Co A). The company finds itself increasingly strapped for cash. A major customer (Co B) approaches the managing director and offers two options for increasing income from current orders for no extra work. The first involves changing the invoices already presented and increasing the charge for goods yet to be invoiced. Co B will then bill the extra sum to its client and split the difference between itself and Co A. Co A would raise a credit note to Co B for the difference. The second suggestion is for a third party company to invoice Co A for non-existent 'marketing services'. Co A in turn raises a fictitious invoice for services to the Co B for a greater amount. John is uncomfortable with the suggestions but his MD has said he "can't see the problem and, anyway, everyone does it". If John acts in accordance with his professional obligations the company may lose out. What does John do?

Firstly he is right to raise an objection. Altering and/or raising fictitious invoices could amount to false accounting or other offences. Can his employer expect him to break the law? Can his employer expect him to turn a blind eye and ignore his professional ethics? No. My advice to John would be to raise the issue again with his MD. How he does this will very much depend on his relationship with his MD.

Concerns

His MD might feel extremely put out by receiving concerns in writing so a chat evidenced in writing might be better. John has the unenviable task of managing his future with the business against the need to do the right thing. The important points here are that John must raise his concerns, and be able to evidence this fact should he need to in the future (ie keep copies of items sent and/or notes of matters raised). If John's boss won't alter his request John must stick to his guns and not be involved. Ultimately he may need to resign.

There are other considerations. Is the business insolvent? Should he tell the third party or anyone else about the suggestion? Such issues rarely appear in isolation. There are usually a clutch of matters all presenting problems and all needing to be dealt with carefully and professionally.

Ethics in large part has evolved from, and reflects, what society considers acceptable. Sometimes, what is unacceptable to sections of society can confuse us when determining whether something is unethical. Let us look at another short case study to explain my point.

Susan is the financial director of an entertainment company. She discovers that one of the links on the company's web site goes through to what she describes as "women in discreet poses". She is pretty sure, having conducted her own investigations, that the web site is 'above board' and legal.

However she is concerned. Is her dilemma one of ethics or of morals? In my professional view, leaving aside moral judgements, there is nothing unethical about working within such an organisation, subject to the images being within the law. What Susan faces is a personal, not necessarily professional, question.

Both the IFAC and ICAEW codes encourage you to seek assistance when facing such dilemmas. That is where my department fits in. Calling our helpline for guidance in the early stages of a problem may prevent the situation getting out of hand. Sometimes knowing that you are acting reasonably gives you the strength to move forward in a constructive way rather than in a confrontational, career-shortening manner.

Caron Bradshaw is a barrister and the head of the ethics advisory services at the ICAEW.

Faculty members may be familiar with the services for members in business and practice under the acronyms 'IMACE' and 'CAASE'. These services have merged and now operate as the 'Ethics Advisory Services', providing free and confidential guidance on any ethical issues, however big or small. The advisors have many years' experience of ethical issues and are supported by a network of volunteer Chartered Accountants 'in the field'.

For guidance, advice or just reassurance. tel: 01908 248258; information is also available on the web site: www.icaew.co.uk/ethicsadvice; or email: ethics@icaew.co.uk.

Information about the New York-based International Federation of Accountants (IFAC) and its publications can be found at its web site: www.ifac.org

Bridging the generation gap in business

As author **Susan Annunzio** (*below*) explains in her book 'Evolutionary leadership', it is nowadays ill-advised to dismiss the 'younger' business generation – with its superior grasp of new technology – as having little to contribute. Helen Fearnley reports on Annunzio's theories about how the Baby Boomers and Generation X can pool their talents.

The workplace, like the family, can suffer from the unproductive, antagonistic 'what do they know?' attitude of one generation to another. Indeed one of the major challenges in running a successful business today, says Susan Annunzio, assistant adjunct professor of management at the University of Chicago Graduate School of Business, is the elimination of friction between the Baby Boomers (40 to 60 year-olds) and the incoming Generation X (20 to 30 year-olds).

A recognised authority on change management, adviser to senior corporate leaders around the world, and herself a Baby Boomer, Annunzio believes that 'her' generation has a particular problem. "Although young people joining companies have always thought they knew best how things should be done, today's 'upstarts' – particularly in the area of technical innovation – actually do know more about the future of business than those running the show."

Hence these 'know-it-alls' are essential to future success, even in organisations not directly involved in the internet economy, she claims. Yet, in most cases, instead of collaborating, Baby Boomers and their Generation X employees hold each other in mutual disregard. To Baby Boomers, Generation X is seen as cynical, rule-breaking, risk-taking and lacking in loyalty. In return, the Baby Boomers are deemed conservative, unadventurous, rule-bound and set in their ways.

In reality each side has its strengths. The Baby Boomer leaders have built major corporations to the size they are today, so they must be doing something right.

For its part, Generation X is not as alien as Baby Boomers might think. In interviews with dozens of recent graduates from Harvard, INSEAD, the LSE, and Stanford, Annunzio found that their real requirement of a working environment, was "the chance to be heard and make an impact".

However, their idealism has been tempered by the evidence of what has happened to relatives and parents, laid off from 'lifetime' jobs. They feel that loyalty no longer counts, and have developed a 'free agent' mentality focused on getting a job done rather than putting in the hours.

Therefore, for successful collaboration, Baby Boomer bosses need to create a different environment: one in which Generation X will want to work, and where its talents can shine. In short CEOs need to learn to bridge the gap between experience and enthusiasm.

Once it is standard for management to dismiss no new idea as 'too crazy' before further research, and for enthusiasts to accept that sometimes caution is more than a mere 'roadblock' by that management, the organisation can be propelled forward to a leading place within the techno-revolution.

This cannot be done overnight, though. Indeed, in Annunzio's view as a professor of the discipline, "Change management literature suggesting that results can be virtually instantaneous is hogwash. However, certain radical changes in attitude can drive a company rapidly forward in a matter of months, produce real results within three years, and bring transformation after five years."

The alternative – failing to adopt a more conciliatory attitude – will result in the organisation failing to progress.

The five-step plan

To transform an organisation into the ideal environment for Generation X to make its impact, Annunzio suggests the following five-step plan:

- adopt the 20/60/20 rule;
- ask the unaskable, speak the unspeakable;
- make loud statements;
- communicate irreverently; and
- celebrate heroes.

The 20/60/20 rule

The 20/60/20 rule is the key step, since it results in a clear view of which employees are driving the organisation forward, which are treading water, and which are being actively obstructive.

According to this rule, almost any organisation can be split roughly 20/60/20, by percentage of employees. The 'top' 20% Annunzio defines as "high potential, inner-directed people, who work for the thrill of solving a problem and getting a job done".

Unfortunately, there is a counterbalancing 'bottom' 20% made up of discontented "miserable whingers", who spend almost their entire time complaining. And whose complaints and quibbles take up roughly 90% of management's time reserves.

In between are the 60% of workers who are "'undercover', not complaining but doing the least they can do, without getting into trouble".

This rule requires first identifying the membership of the three groups (and they will not necessarily be in the proportions described – eg a company with a particularly unhappy culture may have more than a fifth of the workforce in its nominal 'bottom 20%'). Next, the top 20% must be acknowledged and praised, while the middle 60% are actively encouraged to take on the characteristics displayed by that top 20% (part of the 'celebrate heroes' step). Meanwhile, as graciously – but as quickly – as possible, the bottom 20% must be nudged towards leaving.

Annunzio insists that the removal of the bottom 20% is actually quite altruistic, in that it is unethical – and unkind – to waste company time and resources in trying to please those who would clearly be happier working elsewhere.

However, getting rid of the unwanted 20% is not necessarily without its difficulties, especially as they are not restricted to the lowliest ranks of the corporate structure. Annunzio admits to many a painful conversation with a CEO reluctant to fire an underperforming colleague, even though this misplaced loyalty is losing him the respect of his workforce.

Her answer? "Do (the colleague) a favour – let him find other work that really fulfils him."

Another hurdle is the conversion of the middle 60% to inner-directed, enthusiastic, problem-solving behaviour. Certainly not all of the middle 60% will readily learn to mimic the top 20%. But if only a quarter of them do so, that means that (in the average organisation) an extra 15% of the total workforce is working with the original top 20% to drive the company forward – and 35% will do it almost twice as fast.

Even the process of correctly identifying members of the three categories is not necessarily straightforward. Quite frequently a CEO will confuse his top 20% with his bottom 20%. It is an easy mistake given the similarities – both groups give leaders a hard time, both complain freely, both are frustrated by the system.

Only their motivations differ, with the top 20% complaining because they want to fix any problems and move on, while the bottom 20% complain in order to maintain the status quo, or go back to a more comfortable way of doing things.

However, there is one distinguishing factor. Someone in the top 20%, after being allowed to vent their grievances, will then happily engage in constructive discussion about a solution. A bottom 20%er has little interest in resolution.

The other steps all flow from the 20/60/20 rule, helping to bring positive change out of its findings.

Ask the unaskable

The 'ask the unaskable, speak the unspeakable' step is designed to make the organisation faster and more flexible by producing brutal honesty. It encourages everyone in the company to challenge the status quo, openly asking questions such as 'Why do we do it this way? Why does management say one thing and do another? What are the unwritten rules of our company?'

In this way, those who know the problems but have no authority to change things can make others aware of the need for remedial action. Conversely, where the top 20% are aware of problems and covertly acting to produce solutions, the rest of the employees perceive that the problems are not merely being ignored.

Make loud statements

Similarly, when changes are being made to improve the organisation's speed and flexibility, employees need to be given the information through what Annunzio calls "loud statements of change".

These can be anything from meetings to speeches to personal meetings, but the message must be public, from the top, and at the beginning of a change effort – to break the company's implicit rules.

These implicit rules, which exist in every organisation, dictate what behaviour is or is not acceptable. And in most organisations the gap between the explicit and implicit rules is vast. For example, the explicit rules may encourage employees to challenge management's ideas, take risks, and be innovative, while an implicit rule says the boss is always right. When employees have to spend time working out which message they should be following, time is lost which could better be spent adding value for the customer.

Hence it is important to show the company's behaviour matches its rhetoric. This is shown first by those at the top modelling the approved behaviours with their own words and actions. Secondly, there is the option of a big dramatic action or presentation which breaks the old rules in front of a large group of employees.

Communicate irreverently

Communication with the workforce is about more than meetings and memos, says Annunzio. Everything, from the office layout to the official dress code communicates something to employees. CEOs must take an inventory of all these messages, to make sure they are in line with the change strategy (eg a two-page instruction leaflet on dress code sits uneasily with a stated move towards encouraging independence and personal expression). You must, says Annunzio, slaughter sacred cows.

Celebrate heroes

And finally, while you are at it... kill the fatted calf. The last leg of the evolutionary leader's journey is the old-fashioned but necessary process of identifying, honouring, rewarding and creating 'heroes' – whether they be individuals, teams or departments.

By lauding these top performers, making them public heroes, three strategic tasks are accomplished:

- the best and brightest in the organisation will be inclined to stay, if their value is acknowledged;
- desired behaviours are reinforced throughout the organisation by creating real-life role models; and
- the process of finding successors for the top leadership team is initiated.

In short, the organisation is operating under evolutionary leadership.

Susan Annunzio is assistant adjunct professor of management at the University of Chicago Graduate School of Business, and is a frequent lecturer on leadership at INSEAD. Tel: 001 312 456 7919; email: sannunzio@segalco.com.

'Evolutionary Leadership' is published by Texere, price £17.99. Tel: 0200 7204 3644; web site: annunzio.etexere.co.uk.

Explaining the new anti-bribery legislation

The controversial Anti-terrorism, Crime and Security Act 2001 has recently extended the UK's existing law of corruption. Since 14 February this year it has been an offence for any UK national or company to commit an act of bribery overseas.

In this article, Clifford Chance LLP partner **Martin Saunders** explains the background.

The UK was one of the first countries to introduce laws against corruption, which are found in the common law offence of bribery and three long-standing statutes. To elaborate a little on each:

- *the common law offence of bribery* – it is an offence to bribe the holder of a public office. Similarly, it is an offence for any such office holder to receive a bribe;
- *corruption in public office* – under the Public Bodies Corrupt Practices Act 1889 it is an offence to corruptly give or receive any reward, gift or payment as an inducement to an officer, member or servant of a public body. The definition of 'public body' includes any body with public or statutory duties to perform, such as local authorities, councils and government agencies that perform statutory duties. However, before the new act came into force in February, the definition did not include public bodies outside the UK;
- *corruption of agents* – the Prevention of Corruption Act 1906 makes it an offence for any agent to corruptly accept a gift as an inducement or reward in relation to his principal's business. It is also an offence to offer such a gift to an agent. The definition of 'agent' is wide and includes agents and employees of both public bodies and private businesses; and
- *presumption of corruption* – under the Prevention of Corruption Act 1916 the courts will, in certain cases, presume that a payment or gift has been paid or given corruptly, unless the defence can prove otherwise. This presumption applies in proceedings brought under the 1889 or 1906 acts against employees of public bodies, who receive payments or gifts from persons holding or hoping to obtain a contract from the body concerned.

Breaches of any of these laws can lead to lengthy terms of imprisonment or fines. However, before the new act came into force, none of these statutes made any provision for acts of corruption overseas.

The impact of the OECD convention

In 1997 the UK government, with 33 other countries, signed up to the Organisation for Economic Co-operation and Development (OECD)

Convention on Bribery of Foreign Public Officials. This convention required signatory states to introduce laws against international corrupt business practices. The US government was strongly in favour of its adoption because US companies feared that, without it, the strict US anti-corruption legislation (The Foreign Corrupt Practices Act) put them at a disadvantage when competing overseas against non-US companies.

The government here believed that the existing UK law already complied with the convention requirements. However, a Law Commission report in 1998 and a white paper on corruption in June 2000 questioned whether existing UK law applied to corruption overseas and recommended a complete overhaul of UK corruption law.

After the events of 11 September, the government quickly enacted emergency anti-terrorist legislation in the form of the Anti-terrorism, Crime and Security Act. Most of the provisions in this statute are directed specifically against terrorism, but the government also decided to include some anti-corruption provisions.

The home secretary, David Blunkett, linked the issue of corruption to terrorism, saying: "Commercial bribery can encourage corrupt and bad government, which hinders international development programmes and provides fertile territory for terrorism. Although the vast majority of UK companies behave perfectly properly we need to ensure that none of our citizens or companies give any kind of assistance to corrupt government round the world."

The government has also indicated that it will undertake further reform of the law on corruption, to implement the wholesale changes recommended by the Law Commission report and white paper (although it has not committed itself to a timetable).

The changes in the new act

Part 12 of the act came into force on 14 February. It has extended the existing UK offences to cover acts of bribery by UK nationals and companies abroad. Such acts will now fall under the jurisdiction of our domestic courts with the same penalties as under existing legislation. However, prosecutions can only be made with the approval of the attorney general. The relevant provisions of the act are:

- *section 108* – this states that for the common law offence of bribery it is irrelevant if the person offered the reward has no connection with the UK; extends the 1906 act (which contains the offence of corrupt transactions with agents) to include agents and their principals whose functions and business have no connection with the UK; and also extends the definition of 'public body' in the 1889 and 1916 acts to include any equivalent body outside the UK;
- *section 109* – this extends the existing laws on corruption to include acts committed by UK nationals or companies when acting outside the UK and confers jurisdiction on the UK courts for such offences; and
- *section 110* – this states that the presumption of corruption will not apply to acts which are caught by sections 108 and 109.

The practical effect of these changes is that the UK's anti-corruption legislation now extends to bribes paid within the UK to employees or agents of companies or public bodies that have no connection with the UK, and to bribes paid overseas by UK nationals and companies. In such cases there will, however, be no presumption that a payment is made corruptly, even if it is paid to a public official.

The Chancellor has also moved to clampdown on tax provisions, announcing in the April Budget that any payments made overseas after 1 April, which would now constitute a criminal offence in the UK, will no longer be a tax deductible expense for UK companies.

These changes will be implemented as part of the Finance Bill, which is still being debated in Parliament. Although there is no date yet fixed for Royal Assent the bill is expected to become law by August this year.

Are facilitation payments prohibited?

Bribes can vary from multi-million pound demands down to payments of a few pounds. Small 'facilitation payments' are typically those made to foreign local officials as inducements to perform their functions, such as the issue of a licence or permit. BP and Unilever, reporting to MPs last year, admitted that whilst not encouraged, such facilitation payments are generally tolerated. There is no reason to believe that these companies are exceptional in this respect.

The US Foreign Corrupt Practices Act and the OECD convention both exclude facilitation payments from their general prohibitions against corrupt practices. However, the position under the new UK act is less certain. The act does not contain any exception for facilitation payments. The Confederation of British Industry, whilst generally supporting the new legislation, believes that the absence of an expressed exception may put UK businesses at a competitive disadvantage to their foreign rivals.

The government has said that in practice the attorney general is unlikely to take action against minor acts of bribery overseas. However, it has declined to formalise this opinion as a written guideline. In any event, the offences under UK law only apply to payments and gifts that are made 'corruptly', which the courts have interpreted as meaning acts of a nature 'tending to corrupt'. Such an interpretation does not add much certainty to the scope of the legislation. Nevertheless, a UK national or company prosecuted under the new legislation may be able to argue that if facilitation payments are part of local custom there is no such tendency to corrupt and, therefore, no offence under UK law.

Until the government or the courts provide further guidance, UK businesses will need to be cautious. In the meantime, the practical impact of the new legislation in the fight against global corruption remains to be seen.

Martin Saunders is a partner in international law firm Clifford Chance LLP, specialising in regulatory investigations and financial crime. Tel: 020 7006 8630; or e-mail: martin.saunders@cliffordchance.com. The firm's web site is at www.cliffordchance.com.

Why CFOs need to communicate

In a second extract from the booklet published recently by The International Federation of Accountants, entitled 'The Chief Financial Officer in the year 2010'*, accountancy writer Robert Bruce interviews **John Connors** *(left)*, CFO of Microsoft, about the prospects for the finance function in 2010.

**The booklet can be downloaded at no charge from IFAC's web site at www.ifac.org/store. Hard copies may be purchased for $25 plus shipping through the on-line bookstore.*

In the booklet, Bruce talks to 10 leading CFOs about their thoughts on the changes and challenges that they face over the next decade. The IFAC project was organised by an international team led by Chris Jackson, head of this Faculty.

As you might expect of the CFO of Microsoft, John Connors has a view on how the communication of data is going to influence the role of people like himself over the next 10 years. "The biggest difference from 10 years ago", he said, "is the real-time global distribution of data. We are going to just continue to see enormous increases in the use of all forms of communication and the costs of communication will drop precipitately."

The world of the CFO in 2010 will, in that sense, be very different. "People will have access to information in a way they never had in the past", he said, "which means the premium on communicating financial information will be enormous." This not only changes the message. It also changes the messenger. "CFOs will have to become much more effective at framing their company's story consistent with the company's financial story." And there will be less time in which to do it. "There will", suggested Connors, "be little opportunity to explain detail or nuance."

Line organisations

This in turn means a change in the type of person who will be a CFO in the future. "I think we will see more and more CFOs come from line organisations rather than the traditional finance route", said Connors. He noted how the changes are happening. "Here in Seattle, Boeing hired a high-profile CFO who didn't stay long", he said. "Then they hired a guy from their aircraft line and he's doing a great job."

Having said that, Connors' views on the requirements of the CFO in 2010 are much more traditional than you might expect. From his position watching over the current American economy as well as the global economy he has learned some significant lessons in recent years. "If you look at the role of the CFO today there is probably much more similarity with the role of the CFO in 1990 than there is with the role of the CFO in 1998", he said. "There has been a return to business basics – to ensuring revenue forecasting and setting appropriate estimates of return to shareholders."

He sees the great dot.com crash as having had a searing effect. This will have a strong influence on what skills the CFO will need over the next decade. "I expect the economy to grow more slowly in the next 10 years", he said. "And so the CFO role will be one of increased importance as companies have to allocate resources more judiciously and be astute as to what areas will provide shareholder value and which will provide risk."

The way CFOs have traditionally viewed technology will also be affected. "The CFO will have to be much more focused on the role of technology to return real business value", he said, "instead of opposing technology because it is an increasing cost."

Truly global

Another of Connors' themes is the need for global companies to be truly global not just in their markets and their views but also in the people who work for them. This has an obvious effect on the role of the CFO and the finance function. "The CFO in 2010", said Connors, "will have to have a very open and clear perspective on diversity in the workforce. Any leader in finance will have to have an inclusive workforce or they will have a difficult time recruiting talent."

He sees the global economy as inexorable. "Almost every industry today is moving towards being global", he said. "For example there are BP petrol stations all over the USA. Twenty years ago that would have been unheard of – a non-American business in petroleum here." This will bring enormous change but also, he thought, a slow-down in global growth.

"There isn't an economy in the world which can afford to be protectionist", he said. "Japan feels real pressures today because it is facing competition for the first time in retail and distribution." The world is growing closer. "It is a very, very pervasive challenge", said Connors.

This has an upside and a downside. "It increases opportunities", he said, "and severely increases the stress of running the company. The stress of executing your decisions successfully and the increasing growth in anti-global sentiment." This is why he, unlike many CFOs, thinks that the importance of the finance function will increase rather than decrease. "In the short-term people are having to face the fact that if the top-line needs to be adjusted downward then to protect profits you've got to take costs out", he said. "It reminds the finance function of the brutal reality of the profit and loss account and increases the role of the fundamental finance function."

The result is straightforward. "Companies will need to have a very, very solid business plan and will need to have a more realistic sense of the risks than people have had in the last few years", he said. Understandably he sees some of this as being specifically related to the American economy. "The reversal in America's world-wide growth is being felt most severely in the USA and because of dot.com hyper-growth it feels like a recession."

Other economic trends will also impact the role of the CFO in the

CFO 2010

future. One of these will be energy policy. "Over 50% of all known oil reserves have been used", he pointed out. "The level of investment to increase energy to meet demand is huge. It touches every industrialised country", he said. "It is a drag on everybody's growth rate."

This is what he describes as the politics of energy. "It is virtually impossible to increase people's wealth if you have an energy-supply problem", he said. "We don't have a plan. Over the next 10 years energy prices will be much higher and that will have a big effect on growth. So there will be a slower growth rate and the role of the CFO will be much more like it was in the 1980s."

But globalisation will also bring other changes to the role of the CFO. "We will see a convergence to simple world-wide rules for accounting as investment capital moves more rapidly worldwide", he said. "People will increasingly expect a convergence to be forced between US GAAP and other standards." This will have an enormous impact on the role of the CFO. "It has a big effect on how finance students are taught, for example", he said. "It accelerates globalisation. Everyone will speak the same financial language."

Investor relations

This brings more change. "Financial information will spread so rapidly that the role of investor relations will become inseparable from corporate communications", he said.

"There will be a need to manage the investment community globally and in real-time. You will no longer be just talking to a handful of analysts." The same effect will change corporate governance. "It means that your constituencies are global in nature", he said. "The CFO will need to be much more aware of every country's practices but from within a global framework."

Connors has strong views on the way that the positions of CEO and CFO should be kept separate. "It is primarily the role of the CEO to create a vision and a strategic plan", he said. "When I hear a strategic plan has come out of the finance function, I know that that is a stock to avoid." His view is that "the financial function should be the ballast". And they also need to be the guardians. "Product people will always want more resource", he said. "Sales people will be overly optimistic. The role of the finance function is to validate and challenge those assumptions."

Wrestling match

The risks need to have been made known and the elements which will execute the plan provided for. "Strategic planning needs to be driven from the top by the CEO and the chairman", he said. "Then there has to be a wrestling match over resources and the fine-tuning of the plan. The finance function tries to be conservative and cautious in not letting the cart get ahead of the horse." For Connors there is a simple rule. "You need to deliver what you say you will deliver", he said. "The market likes that. It all starts with the finance function ballast beneath your strategic plan and not promising something you don't think you can deliver."

But Connors also believes that the stress of senior management will grow over the next decade. "Any company without a strong CEO in the next 10 years is going to have a major challenge", he said. "It is an almost inhuman role today. The CEO needs a strong team and the CFO has to be part of that. But people need to know where the buck stops. And that has to be the CEO."

John Connors, CFO of Microsoft Corp, is responsible for its IT organisation and manufacturing/licensing operations, as well as business operations. He joined Microsoft in January 1989. The company operates subsidiary offices in more than 60 countries and employs nearly 44,000 people.

TAX **UPDATE**

The Finance Bill – big, but is it clever?

The Finance Bill published on 23 April was 488 pages long, and by the time it finds its way to the Statute Book, seems certain to exceed 500 pages. It will be the second longest Finance Bill on record. **Frank Haskew** examines some of its key changes.

Frank Haskew is senior technical manager of the ICAEW's Faculty of Taxation.

It is impossible to get the full flavour of the tax, national insurance contributions (NIC) and related changes (tax credits for example) announced in this year's Budget merely by looking at the Finance Bill. The information that the rates of NIC will increase in 2003/04 is contained not in the Finance Bill but in the National Insurance Contributions Bill. For the changes to the tax credits rules you need the Tax Credits Bill, and VAT changes are introduced by way of regulations, not the Finance Bill.

This Finance Bill has its share of nasty surprises, not least clause 132 'mandatory e-filing'. This clause has its origins in Patrick Carter's review of 'Payroll Services', aimed at making it easier for employers to comply with their payroll obligations. The flawed conclusion was that IT was the answer to these problems and that the government should give employers handouts in return for compelling them to file payroll returns electronically. Worse, the Finance Bill clause turns out to be a wide-ranging enabling clause allowing the Treasury to direct that any tax return must be submitted electronically, on pain of a £3,000 fine. The government intends to introduce this requirement for larger businesses (those with more than 250 employees) with effect from 2004/05.

Corporation tax

A number of other issues are emerging from the Finance Bill. In particular, the reductions in the starting rate of corporation tax from 10% to 0% and the lower rate from 20% to 19% have brought to a head the key decision as to whether non-incorporated businesses should now incorporate.

There is already a school of thought that the case for incorporation is compelling. Indeed, there is some anecdotal evidence that the government is encouraging businesses to incorporate, presumably on the basis that they can be monitored more easily. However, unless profits are to be ploughed back into the business, the benefits of incorporation for smaller businesses may be marginal once the extra costs are taken into account. It will be essential to perform calculations of the net after tax and NIC effect of taking salary and/or dividends. It is also important to remember that, whilst it is relatively easy to incorporate a business without suffering a tax charge, it is often much more difficult to 'disincorporate' tax-free.

For larger businesses, the reform of the tax rules for intellectual property and the new exemption for gains from substantial shareholdings will make major changes to corporate thinking. Both apply with effect from 1 April 2002. In theory simple reliefs, these reforms are complicated in reality – together taking up about 100 pages of the Bill.

Intellectual property

In respect of intellectual property, the tax rules will now broadly follow the accounting treatment. This is good news for UK businesses, as tax relief is now available for write-offs of intangible assets (including goodwill) where none was available beforehand. In addition, where the asset has an indefinite life, you can still claim a special 4% write-off, one of many modifications from the broad 'the tax position will follow the accounts' rule. The downside is that any receipts will be treated as taxable trading income and not as a capital gain.

The new exemption for substantial shareholdings will apply to sales by companies of a shareholding where the company disposing of the shares owns more than 10% of the share capital of the company which it is selling. Both companies must be trading companies, broadly in the period of one year before the date of sale and immediately after the sale.

Anti-avoidance

This new relief is potentially very valuable and will encourage a group to structure its activities through subsidiaries so that individual companies could at some stage be sold off and any gain will be exempt. However, because the trading company test must be met for a year beforehand, it will be necessary to think ahead. There is also a worryingly widely-drafted anti-avoidance rule, though the Inland Revenue has promised to publish guidance on this shortly.

To make the most of these new reliefs, companies will need to think about tax issues at an early stage and hand-in-hand with corporate structuring and management issues.

TREASURY **UPDATE**

The market for credit risk

In his latest treasury update column, **Chris Mansell** looks at the huge growth of credit derivatives and at their implications for UK treasurers.

Chris Mansell is a former treasurer and is now a director of several companies.

To most finance managers, credit derivatives (CDs) mean (if anything) the latest gizmo invented by the rocket scientists who inhabit the murkier regions of the financial markets. Nowadays that's only partly true, if at all. Until recently the market was used mainly by banks wishing to enhance the quality of their assets, a device for modifying the level of basic capital which the bank regulators require for lower quality assets.

In effect credit derivatives offload some of the inherent risk. Over the last five years however insurance and reinsurance companies, asset managers of all sorts, mutual and hedge funds, companies and even straightforward investors have come into the market, giving it substantial growth and especially improved liquidity.

JP Morgan, which is one of the most important participants, estimates that by the end of last year the market had doubled in 12 months to some $2 trillion. This also represents a tenfold increase in four years.

The CD can be defined as a bilateral contract that isolates the credit risk of a particular third-party (known as the reference credit) and transfers that risk from one of the contracting parties to the other. The significance of the CD is that it separates the ownership and management of the credit risk from all the other aspects of investing in a financial asset. Until the development of this market, credit had remained a key component of business risk for which there were no specific antidotes other than diversification of the portfolio of assets.

There are two basic products:

- *credit default swaps (CDS)* – under this financial contract the first party (protection buyer) pays a periodic fee, expressed in basis points per annum on the notional amount to the second party (protection seller) in return for a payment by the protection seller which will become due if there is some kind of default (a credit event) by the third-party (reference entity); and
- *credit-linked notes* – these are more complex, but have the advantage of enabling investors in credit derivatives to enter the market through the medium of the investment banks. This in turn has generated volume and liquidity. For the technically minded, this structure embeds a credit default swap into a funded asset to create a synthetic investment that replicates the credit risk associated with a real bond or loan document issued by the reference entity.

As with most derivatives, CD structures have proliferated, especially in offering baskets of risk. Thus a 'First to default' basket transfers credit risk with respect to multiple reference entities.

Opportunities for corporates will come assuredly. Although not holding large debt portfolios, there will be balance sheet credit risk through items such as long-term contracts, accounts receivable and vendor financing. Transferring any portion of that risk has traditionally not been easy. The default swap market offers corporate treasurers the facility to separate management of the exposure and to lay it off in the market through the purchase of credit protection.

Directors' responsibility to hedge – the US position

'But then why should I?' I hear readers say. Maybe there will come a time in the future when the answer will be 'the courts will clobber me if I don't'!

A recent study of US case law is not entirely without relevance since we share (to the Europeans' irritation) an 'Anglo-Saxon' business environment. Courts there have found that directors and others with similar responsibilities have a legal duty to hedge exposures. There are two assumptions – that hedging is actually possible and that it is desirable. Even then, directors in the US have to demonstrate that they act on an informed basis, and show good faith and due care.

A clearly inappropriate hedging programme would in the US create a liability for directors, to the extent that it would move from hedging to speculation.

In the US at least the emphasis will shift from 'whether' to hedge to 'how' to hedge, implying a lot more understanding of financial markets round the board room table. Is the UK all that far behind this trend?

FORTHCOMING FACULTY EVENTS – 2002

To attend any Faculty event, please fill out the form which adjoins this page, remove it by tearing along the perforation, and mail it or fax it to Kirsten Fairhurst at the Faculty's address given on the bottom of the form. If you have any queries relating to these or other events, please contact Kirsten Fairhurst on 020 7920 8486.

● 10 July
EVENING LECTURE
(Royal Commonwealth Society Club, London)

'BENEDICTINES AND BUSINESS – BEYOND THE OBVIOUS' – FATHER DERMOT TREDGET, DOUIA ABBEY
If 'people' are recognised as the key to business success, what besides material gain actually motivates people to make things happen? Father Tredget is a Benedictine monk who previously held senior management positions in the hotel and catering industry, and he has an MBA and a masters degree in applied theology. He will argue the virtues of sprituality in the workplace. Doors open 6.30pm; lecture 7.00pm; followed by drinks, buffet and networking. *This event is organised by the Association of MBAs.*

● 18 September
HALF-DAY CONFERENCE
(Chartered Accountants' Hall, London)

'MEASURING AND MANAGING INTANGIBLES' – VARIOUS SPEAKERS
This conference examines from several angles the growing interest in intangibles. David Phillips of PricewaterhouseCoopers discusses 'Finance'; Dr Robert Shaw of Marketing Best Practice Ltd, speaks about 'Marketing'; consultant Andrew Mayo looks at 'Human capital'; and Keith McMillan, professor at Henley Management College, speaks on 'Reputation'. Chairman of the conference is Tony Powell, director of Intellectual Capital Services. Registration is at 9.00am; the conference begins at 9.30am; summing up is at 12.45pm; and buffet lunch 1.00pm.

● 23 September
HALF-DAY SEMINAR
(SFEU, Castle Business Park, Stirling)

'BEYOND BUDGETING' – JEREMY HOPE, CAM-I BBRT
This seminar looks at the case for moving away from traditional budgeting, which can be a handicap in today's evolving and turbulent markets. Companies must move from forecasting to real-time responsiveness and from centralised decsion-making to devolved power and responsibility. Jeremy Hope, a BBRT programme director with CAM-I, explores this topic from various angles. Registration is at 9.00am; the seminar begins at 9.30am; and buffet lunch 1.00pm.

● 8 October
EVENING LECTURE
(Chartered Accountants' Hall, London)

'ENTERPRISE PLANNING (ERP) SYSTEMS – DO THEY MEASURE UP?' – DENNIS KEELING, BASDA
How does one measure the return on investment in enterprise planning systems. Dennis Keeling, business software analyst and chief executive of BASDA, the international software standards body, outlines the pros and cons of these systems, and looks at software industry trends, including those which improve productivity and reduce costs. Registration is at 5.45pm; the lecture begins at 6.00pm; followed by drinks and networking at 7.00pm.

RECORDINGS OF FACULTY LECTURES

The following lectures and conferences held by the Faculty in 2001 and 2002 are available, in both **audio** and **video** format.

To obtain a recording, please tick the audio and/or video box on the tear-off response form opposite.

There is a charge of £5.00 for audio recordings and £10.00 for video.

28 JAN **MANAGING THE CHANGE – PERFORMANCE MEASUREMENT IN THE PUBLIC SECTOR**
Tony Dart of the Highways Agency explains the changes he has made to the planning and implementation system at the agency, and looks at the future of the finance function.

18 FEB **VALUEREPORTING – A REVOLUTION?**
David Phillips of PricewaterhouseCoopers explains this new technique including how to manage for value and the benefits of greater transparency.

15 APR **STRATEGIC ENTERPRISE MANAGEMENT**
Martin Fahy of the National University of Ireland, Galway, discusses strategic management accounting decisions aimed at increasing shareholder value.

28 MAY **PAY FOR PERFORMANCE – DIRECTORS' REMUNERATION**
Ruth Bender of Cranfield school of Management discusses the structure of directors' remuneration in the context of creating value for shareholders.

FRS 17 – the debate continues

The article by past Faculty chairman John Edwards on FRS 17 ('The pensions conundrum' – *May, Issue 87*) elicited a response from Faculty member Jackie Cain, who is an internal audit manager. Here we publish her letter, together with a reply from the author.

Jackie Cain:

John Edwards gave a clear exposition of the risks involved in pension schemes today and a set of coherent actions that finance directors (FDs) should take to manage those risks.

As I read the article, I was struck by the thought that these risks are not new. It would have been a wise and responsible finance director who had acted on them before today. But most directors have been able to ignore them and to hide behind the simplistic valuations required by the financial statements.

It seems to me that FRS 17 is a catalyst, spurring finance professionals on to fulfil their responsibilities. In that case, FRS 17 is a very good thing indeed and the standards setting bodies can be proud of their work.

The only question left to ask is: what other responsibilities are being ignored because more demanding standards are not required?

John Edwards:

I entirely agree that FRS 17 should not be the reason for FDs addressing the underlying issues in final salary schemes. I'm not really sure whether most FDs failed to address these issues before FRS 17 or whether it is a convenient excuse for otherwise difficult or contentious decisions.

I'm not as enthusiastic as you about FRS 17, even if it has resulted in some FDs being forced to take their pension issues seriously. What worries me most is that the standard will influence companies' attitudes to their schemes' investment policies so that they will tend to conform to rather arbitrary and possibly inappropriate criteria.

For example, fixed interest investments are discounted at the return on AA-rated bonds. This means that companies whose funds hold AAAs or gilts are penalised even if such holdings are in the interest of scheme members.

The discredited minimum funding requirement (MFR) had similar distorting effects on the behaviour of trustees; as a pension trustee myself, I regret anything which forces on them, directly or indirectly, behaviour which may not be in the interest of scheme members.

In addition I have real difficulties with the capitalisation on a company's balance sheet of an asset to which it has no real access.

So I'm ambivalent towards FRS 17.

I suspect that there are no other issues of a size or equivalent complexity which are amenable to this kind of approach. But Enron raises two issues: Are we too complacent to say that this kind of thing couldn't happen under UK GAAP?

On the other hand US GAAP with its page after page of detailed and prescriptive rules certainly didn't protect Enron shareholders.

Feedback

If you have views about any article or issue, please contribute to the debate by writing to Chris Jackson at the Faculty (*see address below*), or email: CDJackson@icaew.co.uk

The Faculty of Finance and Management,
The Institute of Chartered Accountants
in England and Wales,
Chartered Accountants' Hall,
PO Box 433, Moorgate Place, London EC2P 2BJ
Telephone: 020 7920 8486
Fax: 020 7920 8784

The Faculty's web site address is – **www.icaew.co.uk/fmfac**