

Reuters Kondor Trade Processing – a strategy for IAS 39

Rising to the challenge of IAS 39

IAS 39 is an accounting standard applicable to any entity holding financial instruments, both cash and derivative products. It is a response to the increased prevalence and complexity of financial instruments in operations and risk management.

Every enterprise has to manage financial instruments - perhaps just cash, receivables and payables, but frequently investments, long-term debt, derivatives, as well as structured products. For many companies, financial instruments are the majority of their balance sheet - and this is true not only for banks, insurance and leasing companies but also for many service and commercial enterprises and holding companies.

The introduction of IAS 39 will represent a radical change in operational workflow management and accounting procedures for many companies as it:

- Calls for mark-to-market for many financial instruments
- Puts all derivatives on the balance sheet and requires fair evaluations
- Distinguishes between a transfer of financial assets as a sale or just a collateralised borrowing
- Demands discipline in hedge accounting

The European Commission has proposed that all EU listed companies should prepare their financial statements using IAS 39 by the beginning of 2005. Reuters has been actively working with industry partners including clients and accounting firms to ensure our back-office system, Reuters Kondor Trade Processing, can assist clients to meet the far reaching and complex demands of IAS 39 and yet retains its built-in flexibility.

Reuters Kondor Trade Processing

Reuters Kondor Trade Processing is designed to provide the back office with a full range of tools for workflow management, delivery, confirmations, payments, collateralisation and accounting across all instruments including derivatives and structured products - enabling you to reap the rewards of increased automation and reduced operational risk through-out the enterprise.

Additional tools for messaging, cash management, reporting and tailored processing of transactions ensure the smooth running of back office processes. Reuters Kondor Trade Processing can be fully customised to meet individual requirements and easily upgraded to enable future expansion of functionality for new users, types of instruments and modules.

Initial recognition and measurement

IAS 39 requires that all financial assets and liabilities must be recognised on the balance sheet, including derivatives, despite the fact that they may have no initial cost. It also requires that the initial contracting of each broad category of assets be accounted for consistently using either trade or settlement date accounting. Financial assets and liabilities are to be initially measured at cost - meaning the fair value of the cost to acquire. This includes transaction costs like commissions, taxes, exchange levies etc.

Reuters Kondor Trade Processing's flexible accounting structure allows for all types of transactions to be reported according to IAS or local requirements. In order to comply with a double accounting scheme, the system allows for two trade purposes to be managed at folder and transaction levels. For example a transaction could be set as Available For Sale for IAS and as Trading for the local norm.

Subsequent measurement

IAS 39 distinguishes between four categories of assets:

- Originated loans and receivables measured at amortised cost on the basis of effective rate
- Financial assets held for trading measured at fair value
- Available-for-sale financial assets measured at fair value. Discount/premium is amortised actuarially using the effective rate
- Held-to-maturity investments measured at amortised cost. Discount/premium is amortised actuarially using effective rate

and two categories of liabilities:

- Trading (for example derivatives with negative market value) measured at fair value
- Other liabilities measured at amortised cost

Reuters Kondor Trade Processing allows for different trade purposes for IAS 39 (available for sale, trading, held to maturity) or local norms to be configured at the folder level. The behaviours of the transactions in the different accounting processes are managed according to the trade purpose and valuation methods (fair value, amortised cost...) are configured accordingly.

In the forthcoming version of Reuters Kondor Trade Processing amortised costs for "held to maturity" transactions incorporate fees and brokerages at the effective rate.

Additionally, an extension of the fair value calculations for Mark to Market methods (from NumeriX) are being integrated and there is the facility to import external valuations.

Hedge Accounting

According to IAS 39, derivative (and non-derivative FX) instruments may be designated as hedge instruments. Designation must be in writing, up front and consistent with established risk management strategy. Hedge accounting is permitted under IAS 39 provided that the relationship is:

- Clearly defined
- Measurable
- Actually effective (to be tested periodically)

IAS 39 recognises three types of hedges:

- Fair value hedge
- Cash flow hedge
- Hedge of a net investment in a foreign entity

The strategy module in Reuters Kondor Trade Processing defines the relationship between underlying and hedge instruments. Hedge efficiency is calculated according to rules configured at the strategy level (cashflow hedge, fair value hedge, efficiency range...). In the case of hedging, accounting rules can be configured according to the trade purpose of the transaction and the calculation rules of the strategy. When capturing a deal, you can assign it to an IAS strategy on a percentage basis.

Disclosure and presentation of financial instruments

IAS 39 supplements the already comprehensive disclosure requirements of IAS 32. Several of these complex requirements demand some manual intervention – for example the reasons for reclassifications of a financial instruments from amortised to fair value. In order to facilitate this type of reporting all data related to transactions and accounting entries can be easily extracted from the Reuters Kondor Trade Processing database and presented using the flexible report writer.

The Reuters Kondor suite of risk and trade management solutions

Building on more than 20 years experience in the risk industry the Reuters Kondor suite is a highly sophisticated, modular solution designed to provide a best fit with your business requirements. Used by more than 50% of the world's top 25 banks, more than 11,000 users rely on Reuters Kondor risk and trade management solutions.

Integrated front to back office

Together, Reuters Kondor+ and Reuters Kondor Trade Processing offer a seamless, bi-directional and interactive front to back office solution. Alternatively, by using standard integration and middleware tools, Reuters Kondor Trade Processing can be connected with other in-house or third-party applications, using open APIs or industry-standard middleware adapters to import and export transactions and other data.

For more information on Reuters risk and trade management solutions visit www.reuters.com/risk or email risk@reuters.com

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