Seeing the wood from the trees

Executive summary

- Finance departments are facing tough times and an over-arching control framework is needed that allows businesses to see the wood from the trees. The integrity of the balance sheet is likely to be fundamental in that assessment as it captures the future cash generation and funding requirements for the business. But how is that integrity achieved?

Treasurers have always been in the business of managing financial risk for the benefit of their employers. More recently, that focus has expanded to cover holistic risk management across the organisation, including liquidity, operational and country risk – all of which have a bearing on the modern treasury department.

Market conditions are giving the wider finance team a renewed impetus towards cost management and the treasury is a vital part of the picture. In a geographically diverse business, centralising both operational and technical specialist processes can clearly deliver on that objective. However, neither should be attempted without an assessment of the risk implications of the proposed changes. But suppose the finance director is discussing the intended change of programme with you and suggests taking the treasury operations team offshore, co-locating them with the finance "production" team. What are your key concerns?

THE ISSUES There are clearly a number of concerns that could be raised. Probably the biggest one of all is how do you maintain the sound control environment that you have established by supervising directly and ensuring segregation of duties through a standard workflow, with timely, secure communication of issues as they arise? Beyond that, where should the focus be? The integrity of the balance sheet is likely to be fundamental in that assessment, as it captures the future cash generation and funding requirements for the business.

In terms of detailed numbers generation, treasurers generally focus on the cash. They also look to their mainstream finance colleagues to provide the consolidated accounting numbers investors rely on, as well as a view of the cash generation implicit in the balance sheet. That's a fair segregation of duties but clearly Enron, Parmalat and plenty of other organisations over the years found, belatedly, that their balance sheet wasn't as robust as they believed.

THE BALANCE SHEET SAGA Let's role-play for just a few minutes – bear with me, I know it's a little far fetched but, like all good dramas, you've got to let your mind go a little. Imagine that you're reading the latest financial thriller about a corporate meltdown and this is the opening chapter…

A senior manager within Global plc, a well-known public company, is sitting at his desk late into the night with the responsibility of signing off the balance sheet. This monthly rollercoaster is the bane of the manager's life but this month it's even worse because it is year-end.

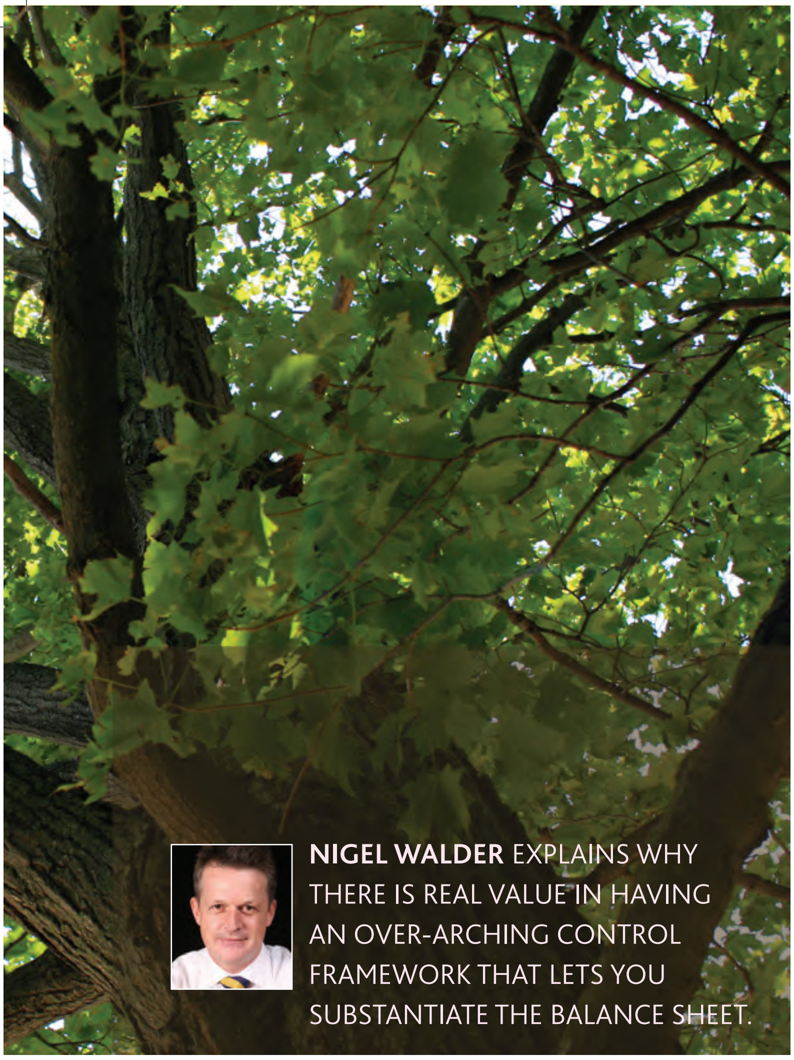
The balance sheet of Global plc consists of literally thousands of accounts hit by millions of transactions resulting in assets and liabilities which run into the billions. Some of the assets the manager is reviewing are highly customised transactions with clients and it's difficult to agree a mark-to-market because, well, there is no market. The only people who seem to enjoy this conundrum are Global plc's auditors, whose charge-out clock is ticking while they all try to agree fair value.

To further complicate the matter, the senior manager has been told that the cut-off data is incomplete because there are some cancellations which have not fed their way through yet. This job is hard enough without having inaccurate data.

The CEO is breathing down the manager's neck because last month the trading statement told the City that everything was fine, there was a strong balance sheet and prospects were looking good for Global plc.

Edgy at the best of times, the CEO is like a cat on a hot tin roof. He's been working for the past three months on obtaining £100m of funding at the current share price levels and he's banking on a clean and good-looking set of accounts. The existing shareholders won't take a dilution at any lower levels even though the company seriously needs the funds.

The senior manager is concerned. There are a number of balances



NIGEL WALDER EXPLAINS WHY THERE IS REAL VALUE IN HAVING AN OVER-ARCHING CONTROL FRAMEWORK THAT LETS YOU SUBSTANTIATE THE BALANCE SHEET.

that don't look right but he can't put his finger on it. He's suspicious of the business guys who are responsible for the transactions which pass through these accounts. How can people get paid annual bonus on estimated P/L for transactions that stretch out 10 years plus? It's a huge cultural issue within Global plc; the business guys are paid significant bonuses on an annual basis and have zero interest in the long-term outcome for Global plc.

He leans back in his chair and rubs his eyes. If only the board knew the challenge he faced on signing off these accounts. He has more chance of predicting when his bags are going to arrive from T5 after his recent weekend trip to Rome. Maybe he should make his concerns apparent at tomorrow's board meeting, but his concerns are currently unsubstantiated. The only thing he can do is rely on his people, which was fine when he could walk up and talk to them, but now that 50% of his department is offshore, it's much more difficult and unnerving.

Fact or fiction? Did anything there resonate with you?

As treasurer of Global plc what should your role be? Do you sit on the financial management board and opine that the financial controller needs to deliver a robust control framework? Or do you adopt a collaborative style by working with the financial controller, understanding differences appearing between your bank statement balances and the accounts, and co-operating to resolve those issues? Do you need to agree the mark-to-market adjustments around the value of funding instruments and investments appearing in the accounts? And is there a medium where such issues can be raised by junior staff so that senior management will notice? In other words, your concern is with the substantiation of the balance sheet – an area fraught with challenges, and subsequently inefficiencies – in many finance departments.

RECENT SURVEY FINDINGS In a recent survey, commissioned by Business Control Solutions, the greatest issue facing finance departments was found to be managing the daily flow of data and information. Of the respondents, 94% claimed to find departmental workflow very challenging. This was closely followed by difficulties in achieving visibility and efficiency of controls, which 79% of respondents said they struggle with. The survey, which was carried out in February this year, also found that 76% of respondents are hampered by a multitude of manual processes, and 58% are also troubled with the proliferation of disparate systems.

Given these findings, it's no wonder balance sheet substantiation is tricky and time-consuming. Problems with multiple systems, which are used by different departments and account owners, increase the difficulty of obtaining a global view of financial positions. This, in turn, generates further manual processes in collating, aggregating and presenting financial, progress and management information reports.

The survey respondents (in this case financial institutions) recognise that their future success relies on making improvements by combining visibility, ownership and control. Further results revealed:

- 69% of respondents ranked making improvements to control and reporting processes their highest priority remedial activity for 2008;
- 55% of the survey respondents said that a lack of clear communication and its impact on visibility and control are the greatest risks when offshoring; and
- Of particular importance to the specialist treasury area, the resources and skills of offshore staff were also a cause for concern, with 28% of respondents citing this as high risk.

THE CURRENT ENVIRONMENT MAY BE AN OPPORTUNE TIME TO DEMONSTRATE VALUE MORE WIDELY ACROSS FINANCE AND ENSURE THAT TREASURY-SPECIFIC CONTROL REQUIREMENTS DO NOT GET OVERLOOKED IN THE DRIVE TO CONTAIN COSTS.

Finance departments are undoubtedly facing tough times. As a result they need to put in place an over-arching control framework that allows business owners to see the wood from the trees. For the treasurer in particular, having visibility of any uncertainties around the cash position, coupled with a clear business line split of the balance sheet giving direct understanding of who's using how much of the organisation's liquidity, is clearly beneficial.

Treasurers, with their explicit risk management expertise, are highly valued by their finance colleagues. During the recent years of expansion and growth, potentially the principal focus for treasurers has been on external opportunity. The current environment may be an opportune time to demonstrate value more widely across finance and ensure that control requirements specific to the treasury do not get overlooked in the drive to contain costs. There is real value in a substantiated balance sheet.

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