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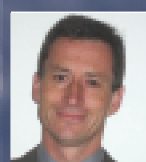
Executive summary

- The strategic dimensions, as well as operational aspects of treasury, must be considered if a treasury audit is to be effective. There are three main elements to the treasury audit programme: governance, infrastructure and strategic.



PAT LEAVY TAKES A LOOK AT WHAT ELEMENTS OF THE BUSINESS AND ITS PROCESSES AN INTERNAL TREASURY AUDIT SHOULD COVER.

An effective treasury audit is designed to provide the board of directors with comfort that treasury activities, which are sensitive and high-risk business areas, are properly controlled and effectively managed. This means that a treasury internal audit has to provide assurance that:

- treasury goals dovetail fully with the company's business and financial objectives;
- appropriate organisational arrangements are in place to manage and control treasury activities;
- decisions are sound and effectively implemented;
- the risks facing the company are properly identified, managed and controlled in line with the policies adopted by the board; and
- relevant information is identified, captured and communicated in a form and timeframe that lets individuals carry out their duties.

The traditional focus of internal audit has been on the internal control process, business process and the detection of errors, fraud and negligence, and compliance with regulations or internal policies and procedures. The introduction of the US Sarbanes Oxley Act in 2002 and stricter company legislation reinforced this concentration on internal control but only represents part of the picture. It doesn't make sense to be concerned about an unreconciled item if, for example, the strategy for managing a particular risk is inappropriate. For this reason the strategic dimensions, as well as operational aspects of treasury, must be considered if a treasury audit is to be effective.

AUDIT SCOPE There are three main elements to the treasury audit programme: governance, infrastructure and strategic (see *Figure 1*).
Governance The existence and effectiveness of a sound corporate governance framework (the main components of which include authority, decision-making, roles and responsibilities, management information, policy and strategy control, performance measurement and business ethics) is essential for sound treasury management. Internal audit establishes and tests whether this framework facilitates effective decision-making and if the structure works in practice.

Infrastructure This area covers many of the traditional control elements of a treasury internal audit: people, processes, systems and banking arrangements. In relation to people, internal audit needs to establish whether treasury has adequate resources to implement treasury policies effectively, and whether the requisite skills, training and experience for each level of treasury resource is aligned to the output expected from an employee at that level. In relation to banking (infrastructure), internal audit needs to assess whether banking arrangements, facilities and accounts are structured in an efficient way that meets operational requirements and facilitates the movement of cash in a cost-effective manner.

Policy and strategy To a great extent the previous two categories, governance and infrastructure, fall into the traditional control audit dimension mentioned earlier. The dimension of audit that is often excluded, and is indeed perhaps more significant from a risk perspective, is the area of treasury policy and strategy (the strategic dimension). The audit needs to assess whether treasury policy clearly articulates the position of the company and its board in relation to all aspects of treasury risk, whether this policy is appropriate to the nature of the business itself and aligned with achieving business and financial objectives, and that the strategies pursued are consistent with policy guidelines.

Policy and strategy needs to be considered for all treasury-related activities in the company: funding, cash, investments, liquidity and risk management (foreign currency, interest rate, commodity price, credit, market). Indeed, the audit should identify gaps in the development of policy and strategy in any of these areas.

A number of fundamental questions must be asked in relation to all aspects of the audit programme:

- Is this item aligned with the underlying business objective?
- Does this item make sense?
- Is it appropriate?

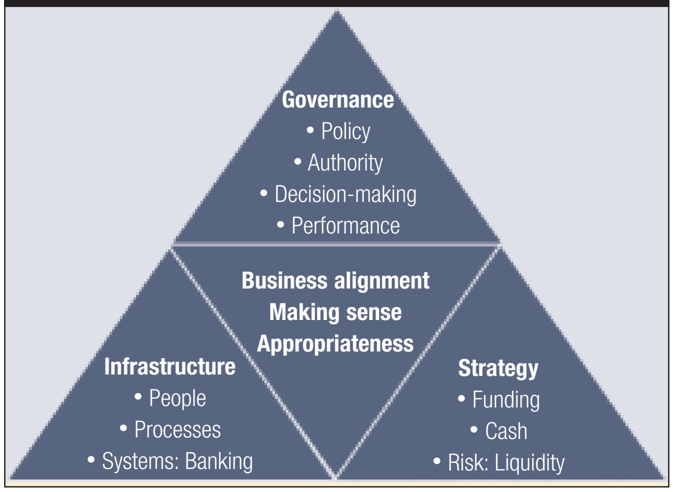
AUDIT APPROACH While the internal audit profession is unregulated, there are a number of international standard-setting bodies, such as the Institute of Internal Auditors (UK and Ireland), which have standards of professional practice for internal audits. These standards provide the bedrock for all internal audit assignments, and include:

- adopting a systematic and disciplined approach;
- evaluating significant exposures to risk; and
- aiming to add value to the company.

Some components of the systematic approach that should be adopted in undertaking a treasury audit include:

- an audit programme setting out in detail the control objective for all items in scope, the risk arising in relation to the item, and the tests to be undertaken for each component part;
- sampling of treasury transactions with a representative sample (in timing and value) of each transaction type across its full life cycle (rationale, decision, approval, instruction, execution, recording, checking, confirmation, settlement, reporting, accounting entry);
- walk-through of each of the processes in treasury, including transaction life cycles, banking configuration, routine tasks and the assignment of roles and responsibilities; and
- a process that communicates results with a focus on objectives, conclusions, recommendations and planned actions.

Figure 1: Treasury internal audit



The more complex area is the evaluation of the exposures to the treasury risks arising. This does not mean the acceptance of an explanation of the risks from the treasurer or treasury personnel, but requires an understanding of the underlying corporate business model and objectives so that the risks arising are independently identified and quantified. Thereafter, it is necessary to establish whether the treasury policy and strategies are appropriate and aligned with the original business objective. It is through this assessment that real value can be added to the company. To undertake this assessment effectively it is necessary to discuss the business model with senior management executives, which could include the chief executive officer or chief financial officer.

AUDIT SKILLS The internal audit profession recognises there is a challenge for in-house internal audit units to have the depth and breath of skills to undertake an in-depth audit of the many different business areas, of which treasury is only one. There is also a high level of awareness of the skills required for effective IT audit, and again a recognition that business areas such as treasury use different specialist applications and systems – treasury management systems, e-banking and online trading platforms – from other parts of an organisation.

This skills dilemma for internal audit almost suggests that a second treasurer is required to audit the first. In reality, it is impractical and uneconomical for internal audit to have the level of specialised skills it needs in-house. For this reason, there is an increase in the use of external service providers to support the internal audit process. In selecting a service partner, the company must ensure that the service provider has the competence and ability to deliver both the operational control and strategic dimensions of the audit programme.

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