

FOCUSING ON THE ISSUES



LAST YEAR THE ACT AND ERNST & YOUNG TEAMED UP TO PRODUCE THE FIRST TREASURY OPERATIONS SURVEY. THIS YEAR WE ARE DOING THE SAME AGAIN – BUT WITH A GREATER FOCUS ON SOME OF THE KEY ISSUES. **RICHARD DREW** OF ERNST & YOUNG EXPLAINS.

FIGURE 1
Understanding of risk & exposures

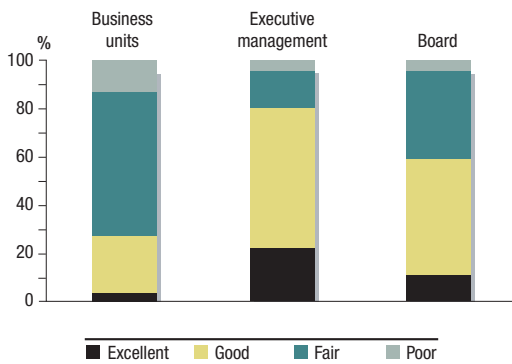
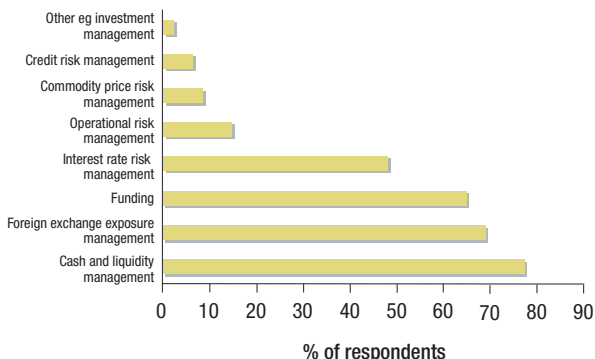


FIGURE 3
Most important financial risk management function



The survey that Ernst & Young carried out last year in association with the ACT examined various aspects of treasury operations. Some of the most interesting findings concerned the position of the treasury within organisations.

For example, despite the recent high profile of risk management, treasury activity was monitored by the board in less than half of the organisations surveyed. The performance of treasury, meanwhile, was regularly measured in only a third of the organisations.

Treasurers almost unanimously expressed concern about the timeliness and accuracy of the information they received from the business units and their level of understanding of the business risks. This contrasted with the executive management’s understanding of these risks which was felt to be good.

In terms of structure and staffing, there was a distinct contrast between smaller and larger treasury operations with the former expecting to grow in size and the latter expecting to decrease.

The survey revealed that one third of the respondents had already outsourced some of their operations and 40 per cent were considering doing so. Interestingly, 30 per cent of treasuries still relied on spreadsheets or manual methods of record-keeping rather than utilising a specialist treasury management system.

Three-quarters of the respondents characterised their operations as cautious or very cautious. Their primary objective was to minimise the cost of financing and eliminate risks rather than contributing actively to the organisation’s profitability. Cash and liquidity management was seen as the most important risk management function, followed by foreign exchange, funding and interest rate risk.

Hedging of interest and foreign exchange risk was predominantly undertaken with the aim of limiting rather than eliminating risk.

The number of organisations that used hedging to remove all risks was lower than those that did not hedge at all. Interest rate risk was typically managed by means of a targeted fixed/floating debt ratio, most commonly in the 40-60 per cent range. 80 per cent of respondents managed their foreign exchange translation risk – most by matching assets with liabilities. Foreign exchange transaction risk was typically hedged over a 12-month timeframe.

CHANGING THE EMPHASIS. This year we are changing the survey’s emphasis by exploring two of the aspects of treasury operations that we looked at last year in slightly greater depth. They are:

- responsibilities, structure, staffing and reporting;
- risk management.

In addition we have chosen to focus on one particular issue that is of current concern to a large number of treasurers, namely the impact of IAS 39. This we hope will have a dual benefit. It will allow members to express their views on these issues and enable the ACT to represent them more effectively when lobbying on their behalf, particularly as the convergence of UK GAAP to IAS begins. It will also enable members to know where they stand in terms of best practice.

RESPONSIBILITIES, STRUCTURE, STAFFING AND REPORTING. The questions that we have added to this section are intended to throw light on issues such as:

- what do treasurers think that they should be responsible for (as opposed to what they actually are responsible for)?
- how far has the trend towards the centralisation of treasury operations progressed?
- is there any evidence that more treasuries are expected to be profit rather than cost centres?

RISK MANAGEMENT. In this section we try to probe the approach that treasurers take to risk management in greater depth, with questions such as:

- to what extent do you factor your pension fund exposures into your interest rate risk management?
- do you hedge the earnings from your overseas subsidiaries?

IMPACT OF IAS 39. From 1 January 2005 EU listed companies will be required to report under International Accounting Standards in their consolidated accounts. This is one of the single biggest changes in accounting in recent times.

IAS 39 Financial Instruments: Recognition and Measurement has wide-ranging implications for the treasurer, and not just from an accounting perspective. It also gives guidance on the fair value of derivatives, asset and liability classification, effective interest rates, embedded derivatives, impairment and the recognition of assets and liabilities which need consideration. For example, requirements for rigorous documentation and effectiveness testing are introduced for hedge accounting which, if not met, could introduce increased levels of profit and loss account volatility.

The aim of this section, therefore, is to enable respondents to benchmark their progress and the impact IAS 39 has on them in comparison to other members. There is also an opportunity for respondents to voice their opinions on the Accounting Standard Board's plans for the future.

Topics covered include:

- which aspects of IAS 39 are having the most impact on your operation?
- what impact do you expect it to have on your financial results?
- what policies and processes do you expect to have to change?
- how many of your existing hedges will qualify for hedge accounting?

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FIGURE 2

Type of treasury system used

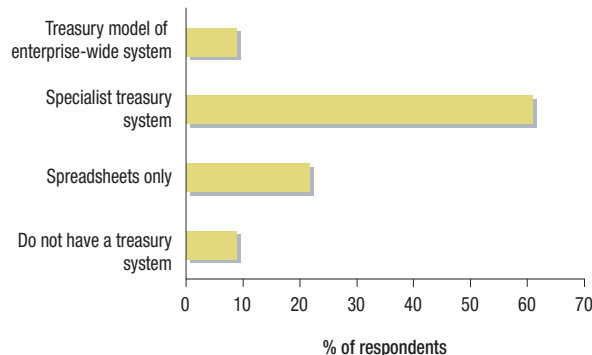
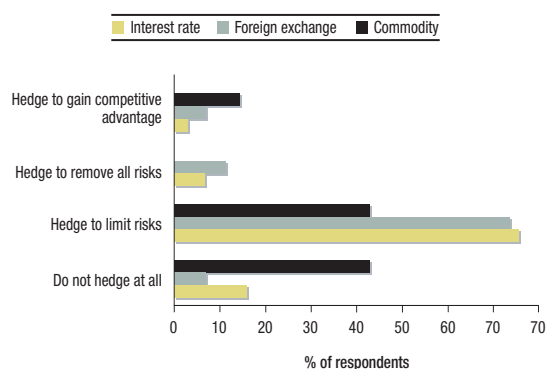


FIGURE 4

Risk management approach



How do I complete the survey?

The survey questionnaire can be found on the ACT website, www.treasurers.org, and the Ernst & Young website, www.ey.com/uk. The questionnaire should be printed off, completed manually and returned to Alistair Wright at Ernst & Young by Monday 14 June. Ernst & Young will analyse the responses and the report will be available from 16 August on both the ACT website and the Ernst & Young website. A hard copy version will be sent to all respondents and the results will also be summarised in *The Treasurer* in September. If you have queries, please contact: Richard Drew at Ernst & Young on 020 7951 4218 or Martin O'Donovan at the ACT on 020 7213 0715.