Pressure to perform

THE ANNUAL TREASURY OPERATION SURVEY REVEALS A GROWING EMPHASIS ON THE NEED TO MEASURE THE TREASURY PERFORMANCE. JEFFREY TEAGUE EXPLAINS.

The results of the 2005 Treasury Operations Survey are now available. For the third year in a row the survey was conducted by Ernst & Young's Financial Services Risk Management practice in conjunction with the Association of Corporate Treasurers (ACT).

This survey is conducted annually and is based on data from organisations who respond through the ACT website. The survey provides a means for treasurers to benchmark themselves against other treasuries and to gain an insight into the impact regulatory change is having on organisations such as International Financial Reporting Standards (IFRS) – including IAS 39 *Financial Instruments: Recognition and Measurement* – and other regulatory change is having on organisations. Despite the range of respondents and the variety of issues affecting treasurers, there were some interesting themes and trends highlighted by the survey.

KEY FINDINGS

REPORTING

Increasing use of performance measurement Over the last three years of the survey we have observed an increasing proportion of respondents measuring treasury performance (see *Figure 1*). Increasingly, performance measurement is seen as a means for an organisation to evaluate the effectiveness of its treasury. We see this as beneficial to organisations, treasury staff and the profession as a whole.

Executive summary

- Increased emphasis on performance measurements.
- However there is an increasing dissatisfaction with the performance measures available.
- Use of spreadsheets continuing to decline.
- Most treasurers now have documented policies.
- The risk approach is cautious.
- Cash and liquidity management remains most important function.

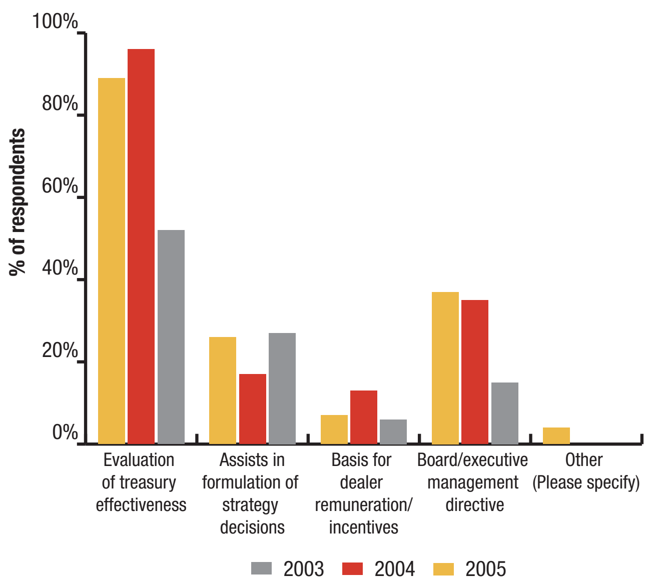
Without being able to demonstrate the value added by a corporate treasury, the function is often simply seen as overhead and, as the last couple of decades have shown, cost cutting and efficiency pressures on organisations have led to the downsizing of treasuries and a general contraction of opportunities within the corporate treasury profession. We consider the growing use of performance measures as a positive step in increasing the value of treasury activities by senior management.

But satisfaction with measures is decreasing A downside to the growth in performance measurement has been the growing dissatisfaction with the measures being used. Our survey indicates that measures have simply become too complicated and difficult to develop. Much management time has been taken up of late by IFRS and Sarbanes-Oxley (SOX) requirements that have probably hindered the ability of treasurers to develop more appropriate measurement tools. We would hope as these pressures diminish that addressing the quality of treasury performance measures will be given a high priority.

Other highlights

- Most treasuries use market rates as a benchmark for funding performance, though benchmarking against risk neutral positions is increasing.
- Budget rates are now the most popular tool, replacing market rates, for measuring foreign exchange risk management, with risk neutral position benchmarking gaining popularity.
- Market rates remain the most used measurement tool for interest rate risk management performance.
- The use of budget rates in commodity price risk management has increased substantially.
- Credit risk management is measured primarily by the use of risk neutral positions, with the remainder of treasuries using market rate benchmarks.
- Treasury system use continues to grow, particularly in large organisations, and the reliance on spreadsheets continues to fall (see *Figure 2*).

Figure 1. Main Reason for Measuring Treasury Performance



What is the main reason(s) for measuring performance?

Source: Ernst & Young

Box 1. Background: Sample and demographics

The number of responses to the 2005 survey was 51, similar to previous surveys. Since the last survey there has been an increase in the proportion of UK treasuries reporting to overseas head offices. Much of this can be attributed to a change in the respondent mix. However, the general profile of respondents, their size and volume of treasury activities, remains generally consistent with previous surveys.

We'd like to thank all participants who responded to the survey, without whose valuable time and effort we could not have produced this research.

We see the declining use of spreadsheets as a welcome development given the increasing complexity of managing a modern treasury and the very large inherent risks that arise from reliance on manual data input and risk of error when using self-developed spreadsheets. The cost of treasury systems remains a significant barrier but as prices slowly fall, take up should continue to improve.

RISK MANAGEMENT Treasury policy and procedure use is improving.

All of our respondents have a treasury policy in place, the overwhelming majority of those being formal documents. We feel this is an excellent result which reflects the importance placed on governance within modern treasury operations.

The use of treasury procedures manuals has also increased with procedural coverage of all areas increasing significantly. It is also heartening to note that most procedures manuals are being updated annually or bi-annually. The onset of Sarbanes-Oxley requirements is likely to be a driver of this trend but the benefit to treasury staff is likely to make the efforts undertaken worthwhile.

Risk appetite remains cautious The proportion of respondents describing their treasury's risk appetite as cautious or very cautious has increased relative to previous years. It is apparent that the days of aggressive, profit centre corporate treasuries have long disappeared.

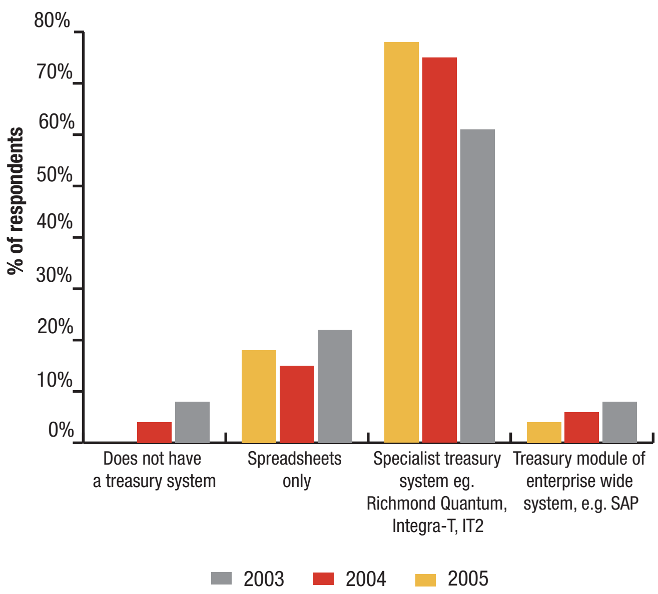
Cash and liquidity management remains most important function The top three risk management functions identified by our respondents were:

- cash and liquidity management.
- foreign exchange exposure management.
- funding.

Interest rate risk management was, however, not far behind (see *Figure 3*). This is similar to previous survey results. The most interesting development was the increase in prominence of operational risk management, an area not traditionally associated with corporate treasury, but utilising many of the same skills. All too often the role of treasury has been too narrowly defined, so taking on additional operational risk responsibilities should provide greater depth of skill within a treasury and increase its value to the organisation. It will be interesting to watch this trend in the future.

Sarbanes-Oxley progress continues The requirement for SOX reporting remained stable at around a third of respondents. An impressive number have now completed their initial requirements,

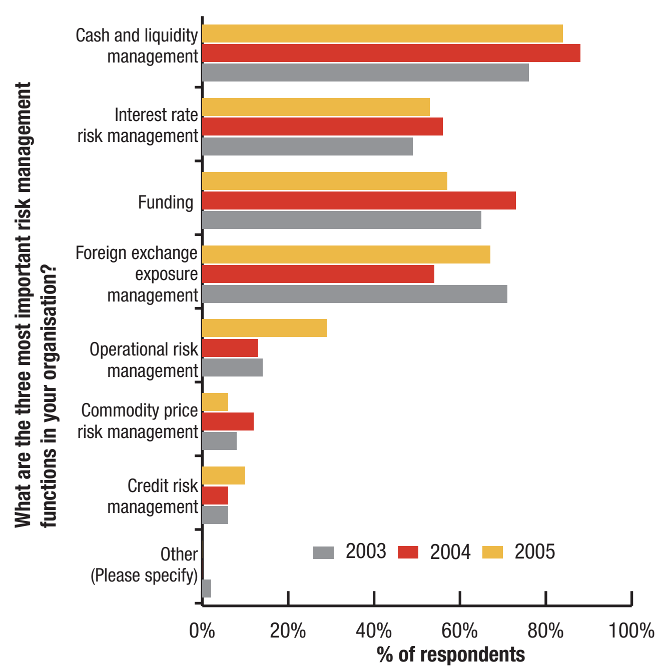
Figure 2. Current Treasury System Use



What type of treasury system does your organisation have now?

Source: Ernst & Young

Figure 3. Most Important Risk Management Functions



Source: Ernst & Young

which is encouraging considering the amount of resources that have been dedicated to achieving compliance in the previous year.

Cashflow forecasting remains sub-optimal Cashflow forecasting, the bane of many a treasurer, remains less than perfect. As expected the longer the forecast timeframe the less satisfied the respondents were with the quality of the forecast. An issue of concern is that a significant minority of organisations do not use cashflow forecasts to manage their liquidity.

Other highlights from the survey include

- Interest rate risk management is an issue to almost all respondents, though a worrying number of organisations have no policy to manage this risk.
- Most organisations use a five-year time horizon to manage interest rate risk and the majority still use derivatives to hedge the risks they face.
- A growing, though small (just 15%), number of respondents are viewing their pension fund obligations as an exposure to be managed like any other liability.
- Around half of respondents have a commodity price exposure and there is a growing trend for organisations that did not hedge this risk to now actively manage it.

IMPACT OF IAS 39 IAS 39 *Financial Instruments: Recognition and Measurement* appears to remain an important issue for many corporate treasurers. Whilst substantial progress has been made by almost all respondents and the level of knowledge and experience with the standard continues to grow, IAS 39 is still regarded fairly sceptically by a large proportion of respondents.

Highlights include:

- More respondents, particularly smaller organisations, agree that IAS 39 better reflects treasury risks than last year, but opinion is still strongly divided.
- Far fewer respondents than in 2004 felt that IAS 39 would have a material impact on their financial statements.
- More respondents are having to upgrade their systems to cope with the additional revaluation and recording requirements that IAS 39 compliance requires.
- Most respondents feel that earnings volatility will or is increasing due to IAS 39's impacts.
- A large proportion of treasurers are concerned that stakeholders will not fully understand the consequences of IFRS.
- Most organisations have been able to achieve hedge accounting through the establishment of hedging relationships and documentation for the majority of their hedging instruments.
- Effectiveness testing, however, has caused significant difficulties for a majority of respondents.

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