SIGNIFICANT BENEFITS CAN BE ACCRUED BY TREASURY OPERATIONS THAT INTRODUCE STRAIGHT-THROUGH PROCESSING (STP), PARTICULARLY WHEN IT COMES TO CASH FORECASTING, DEALING WORKFLOW AND HEDGE ACCOUNTING. **KEVIN GRANT** AND **KELVIN WALTON** REPORT.

Straight-talking treasury

Executive summary

- Many different levels of STP can be implemented in a pan-European corporate treasury. In each case, the project must fit in with the company's and treasury's priorities, and make financial sense.
- The deployment of STP can play a critical role in cash and working capital management, enabling a treasury to foresee any potential cash squeeze. Updated forecasts are pulled or pushed into the treasury system and dealers and risk managers are alerted of changes to a situation.
- Automating dealing workflow can also offer a quantum leap in efficiency. If interfaces with electronic dealing platforms, confirmation systems and payment systems are automated into a secure STP environment, transactions can flow straight through from initiation to payment and accounting.
- In the case of hedge accounting, a full STP solution will import relevant market rates, perform effectiveness testing and alert interested parties to any non-compliance. STP can also play a key role in ensuring effective SOX compliance.

Financial information is the lifeblood of most organisations. A company with a full order book which, at the same time, is straining its borrowing limit will eventually face serious consequences ranging from having to negotiate emergency, and potentially very expensive, financing to bankruptcy.

But if that company manages its cash and working capital efficiently, it will be able to foresee any potential cash squeeze, and should be able to navigate itself through this situation at low cost and with less risk. The deployment of straight-through processing (STP) could play a critical role in achieving this.

For European treasuries, events such as the adoption of the euro and squeezes on corporate profitability have directly, or indirectly, enhanced the importance of cash and working capital management at the highest levels of corporate management. This has led to increasing levels of automation. Treasurers have been able to justify technology investments that support more sophisticated cash forecasting tools, in-house banking and various forms of cash pooling by emphasising the benefits of enhanced interest income/expense performance.

This has coincided with exponential advances in technology with the establishment of the corporate intranet as a secure, high-volume, low-cost medium for communicating financial information within a corporation, and increasing use of the internet for critical external communications – primarily with banks. Technology has given treasury operations the means to expand beyond their traditional boundaries into the global enterprise and also to implement STP.

All these events have made real-time pan-European cash management both practical and affordable. They have served as the catalyst for the initial evaluation of STP benefits by corporates.

TECHNOLOGY DRIVERS. Today, there are two major forces driving treasury technology developments: hedge accounting and enhanced standards of corporate governance, influenced directly or indirectly by the Sarbanes-Oxley (SOX) Act (see *No shelter from the storm*, page 16, *The Treasurer*, October 2004). In Europe, IAS 39 has immediate bottom line implications for companies that do not have the means in place to perform the various disciplines of hedge accounting. Sarbanes-Oxley, meanwhile, has raised the bar for treasury governance, demanding transparent, auditable and demonstrably

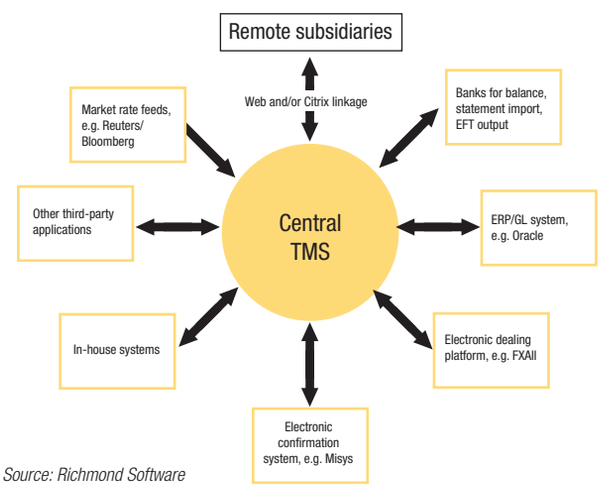
STP in financial services

Straight-through processing (STP), defined as the implementation and operation of streamlined and efficient business processes, has been a strategic operational goal for banks and other financial institutions for several years.

In financial services, it is seen as the key to enhanced efficiency and control in the processing of transactions. It can lead to the reduction and even elimination of clerical effort in a secure, robust and high-speed environment.

Banks, today, are generally achieving increasingly high levels of STP delivery in their internal operations, in bank-to-bank communications and in their interactions with their clients. This has occurred because the necessary technology is readily available. STP is commonly seen as industry best practice and so the commitment and drive to implement, evolve and finance STP solutions originate at board level. Bank shareholders and regulators are demanding ever-improving levels of efficiency, coupled with security and transparency, and these primary forces are continuing to stimulate STP roll-out.

Figure 1. Generalised treasury technology topology



Source: Richmond Software

secure processes. Even European companies that are not US listed are beginning to feel pressures from their auditors, shareholders and customers to implement a SOX-compliant treasury policy.

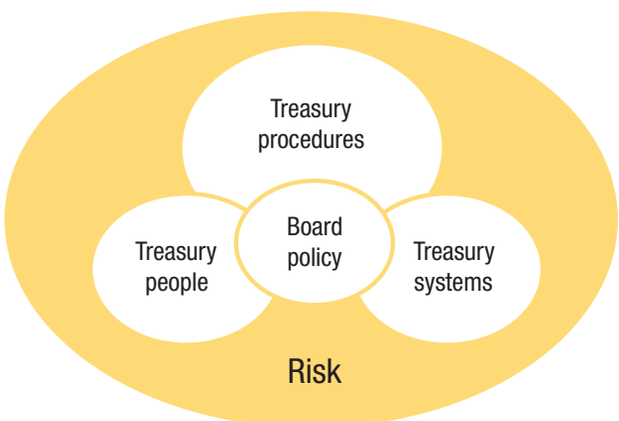
IMPLEMENTING STP. Many different levels of STP can be implemented in a pan-European corporate treasury. In each case, the STP project must fit in with the company's, and the treasury's priorities, and make financial sense for the investment to be justified. These boundaries have been extended by the dictates of hedge accounting and SOX because of the vast amounts of data that will need to be processed, and the logical and mathematical complexities of the processing itself.

It is quite feasible for a treasury operation today to spread itself into all the financial corners of a European – or even wider – organisation. However, each STP possibility should be evaluated on its own merits. If a given project relates to regulatory compliance, the consequences of non-compliance may be the compelling issue that justifies and fuels the STP project.

The growing role of treasury

The backdrop to any debate about the value of straight-through processing (STP) to a corporate treasury operation is based on the evolving perception of a treasury's role in an organisation.

Treasury's remit has developed steadily since the treasury profession began to differentiate itself from classical accounting in the 1970s. It began to focus on high-value, low-volume operations, and, in Europe, was highly concerned with FX risk management. The concomitant interest rate volatility similarly elevated the importance of strong risk management for corporate debt and investment.



Cash was the poor relation in this environment – something which may seem very alien to those who have entered the treasury profession within the last 10 years.

But the world started to change as a combination of political and economic events squeezed the volatility out of the market and ushered in the age of cash. This had profound effects on corporate treasury, especially as these changes roughly coincided with the availability of low-cost technology – and with a series of well-documented scandals in several areas of corporate financial governance.

***Figure 1* summarises the way that treasury and corporate management interact when setting treasury policies, identifying problems and resolving them through projects.**

It does not matter if a troublesome business issue was first recognised at board level, or within the treasury department; what follows is an interactive process of many steps, with iterative elements, in which the importance of the problem is evaluated, a range of solutions researched or designed, costs and benefits evaluated, budgeting secured and the project implemented.

Figure 1 is a topology diagram of the types of interfaces that may be implemented around a treasury management system. Any of these may in theory be developed into STP integrations if the benefits make sense.

STP IN CASH FORECASTING. More and more companies are now using browser-based functionality to integrate information, such as cash forecasts and FX and money market deal requests, gathered from a European network of operating companies.

The benefit of this approach is that subsidiary-specific templates may be designed, incorporating local language and information requirements. Such data entry is available on a 24x7 basis, so timezone and holiday calendar difficulties are eliminated and an accurate and timely forecast management system put in place.

This may be extended into a full STP, and even real-time, cash forecasting environment, with updated forecasts being pulled or pushed into the treasury system to alert dealers and risk managers of changes to a situation. This type of STP implementation frees professional treasurers' time so that they can focus on risk management without having to be concerned with the details of data processing.

BANK ACCOUNT MANAGEMENT STP. Another function that is often implemented using STP is bank statement retrieval and reconciliation. This is an entirely mechanical process which, once fully implemented, allows a European treasury's cash managers to arrive at work and use already-prepared reconciliation analysis to complete the process manually, and initiate any necessary research with banks. The benefits include the elimination of unproductive clerical effort. Dealers and risk managers can also obtain cash forecasts earlier. This provides them with more time and opportunity for market interventions.

TREASURY DEALING WORKFLOW STP. STP – if justified by dealing volumes – can also offer a quantum leap in efficiency if the dealing workflow is automated. If interfaces with electronic dealing platforms, confirmation systems and bank payment systems are automated into a secure STP environment, entire transactions can flow right through from initiation to authorisation, execution, confirmation, payment and accounting with minimal intervention. This type of STP requires company-specific configuration to accommodate special requirements such as authorisation processes. From a management perspective, it is crucial that the processes are 'locked-down' in a fully secure manner so that treasury can take advantage of a very high level of secure automation.

HEDGE ACCOUNTING STP. European treasuries are continuing to come to grips with the needs of IAS 39 compliance. Here, the value of an STP implementation will be proportionate to the volume and complexity of the exposure/hedge relationships that are being managed. In this area, the key judgement a treasurer must make relates to the amount of effort needed to monitor hedge effectiveness in such a way that it will be judged to be 'compliant.' A full STP solution will involve an automatic process that imports the relevant market rates, performs effectiveness testing, and then alerts all interested parties if any relationship is approaching non-compliance. In this case, the cost of STP implementation and operation might be seen as an insurance premium against the bottom-line consequences of IAS 39 compliance failure. This example makes the connection between STP risk management and impact on shareholder value graphically clear.

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