tmi Academy

Principles of Corporate Treasury

Executive Summary

Primary duty

A treasurer's primary duty, or responsibility, to ensure that the company can meet its financial obligations as they fall due, including payments to suppliers, employees, tax authorities, shareholders, banks and bond holders. Financial obligations can be in a variety of currencies, so cash needs to be available at the right time, in the right place, and in the right currency.

The timing mismatch

Fulfilling this obligation can be challenging due to the difference in timing between payment obligations to the stakeholders we have just listed, and collections received from customers. Treasurers need to be proactive in managing cash and liquidity to minimise the amount of external borrowing that is required, and reduce the amount of working capital that is required as far as possible.

Major treasury responsibilities

Treasury functions have diverse responsibilities, but cash management, borrowing, investment, FX and bank relationship management are typically core responsibilities of most treasuries.

Treasury policy

The treasury policy document provides the framework for treasury's activities, including responsibilities, permitted activities and performance measurement. The treasury policy should not be a static document but reviewed regularly in line with changes to the company's risk appetite and market conditions.

Treasury resources

A successful treasury requires the right balance of appropriately skilled people and efficient processes, effective controls, underpinned by modern, automated treasury technology and supported by banking partners that understand and support treasury's requirements.

Degrees of treasury centralisation

While most companies will seek to centralise their treasury activities into a global or regional treasury structure, this can be difficult to achieve in practice. Treasury technology and a focus on consistent policies and procedures can help to address some of the potential disadvantages of a decentralised treasury organisation.

> **Financial obligations can be in a variety of currencies, so cash needs to be available at the right time, in the right place, and in the right currency.**

What is Corporate Treasury?

This article provides an overview of corporate treasury, firstly defining exactly what it is and what are its key activities, assessing the resources needed by today's treasuries in order to carry out these activities effectively and then looking at the different ways in which a treasury can be organised.

Treasury is a relatively new profession that first emerged during the 1970s as corporations became increasingly international, and therefore their liquidity and risk management challenges became more complex. There are two useful definitions of what treasury is and what it does, one from the UK Association of Corporate Treasurers (ACT) and one from its equivalent body in the US, the Association of Finance professionals (AFP).

"In essence treasury management is all about handling the banking requirements, the funding for the business and management financial risk. It therefore incorporates raising and managing money, currency, commodity and interest rate risk management and dealing, and in some organisations, the related areas of insurance, pensions, property and taxation"
(Association of Corporate Treasurers, UK)

"The Treasurer is primarily responsible for:
- Managing overall financial risks
- Arranging external financing
- Managing relationships with banks and other financial institutions
- Overseeing day to day liquidity and cash management
- Investing for the short term and long term
- Developing and implementing treasury policies and procedures "

(Essentials of Treasury Management, Third Edition, Association of Financial Professionals, USA)

Although the wording of the two definitions is different, there are certain common features. These include the focus on financial risk, financing the business, managing banking requirements, and managing money (otherwise known as cash management or liquidity management).

Some of the key tasks for treasuries are therefore:
- Managing financial risk: that is, the impact of fluctuations in exchange rates, interest rates and in some cases, commodity prices
- Managing the company's relationships with its banks and obtaining the necessary funding for the business
- Managing the cash flows and balances arising from the company's business activities.

Each of these three is a complex task when a business operates internationally, and it is important for treasurers to prioritise their tasks in order to operate most effectively.

The primary duty of the corporate treasurer

While the treasurer's role comprises a number of different elements, he or she has one overriding objective, often described as treasury's 'primary duty'. Essentially, a company needs to be able to meet its financial obligations as they fall due i.e., to pay employees, suppliers, lenders and shareholders.

This can also be defined as the need to maintain liquidity, or solvency of the company: a company needs to have the funds available that will enable it to stay in business.

Companies have a number of financial obligations:

- Pay suppliers that provide goods and services to the company;
- Pay salaries to employees, make employer pension contributions and reimburse expenses
- Pay taxes due to statutory bodies;
- Pay for capital items. These could be purchased, leased or rented;
- Pay banks and bond holders that have lent to, or

invested in the company, in the form of interest payments and repayment of loans or bonds;

- Pay dividends to shareholders.

That leads to a vital issue: shouldn't the money received from customers cover these obligations and allow the company to make a profit to fund future growth?

The timing gap

The problem is not necessarily that the amount paid by customers is insufficient to meet the company's financial obligations; more typically, the issue is the timing mismatch between incoming collections and outgoing payments.

Figure 1 shows a generic analysis of a business. It makes an upfront investment in facilities (such as factories, production lines etc.). It then has to buy raw materials required for production, and purchase the labour to sell, produce and support the goods and services the company provides.

Only when the production of goods or services is complete, and these have been sold and shipped can the company bill its customers. There may also be a lengthy invoice period before the customer actually pays. While the model will differ between businesses and industries, there are only a few companies that can seek payment for goods and services before production or delivery.

The significant factor therefore is the gap between having to pay suppliers, employees etc. and the receipt of funds from customers. The amount of cash required to cover the mismatch in amount and timing of incoming and outgoing cash flows is referred to as working capital.

Working capital needs to be financed in some way, either by using internal funds from other parts of the business or through external funding; for example, bank borrowing. However, funding requirements can be minimised by effective cash management. If the company is fortunate enough to generate surplus funds, these can be deployed by effective liquidity and investment management.

Major responsibilities (found in most treasuries)

To summarise briefly; the major responsibilities of treasury include the following, depicted in figure 2.

- Cash management and the management of associated liquidity; that is, the positive and negative balances that accumulate on the bank accounts

Figure 1 – The timing gap

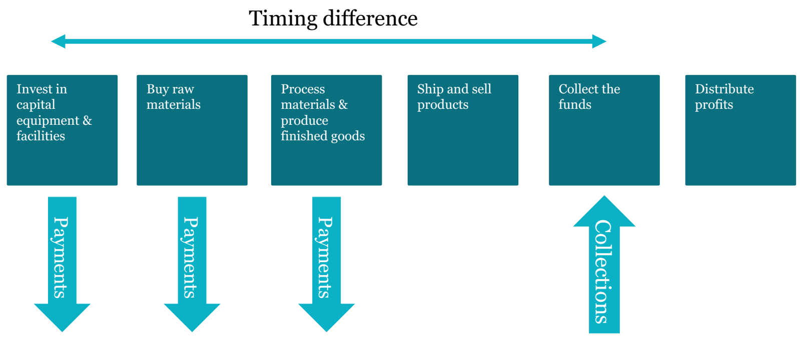
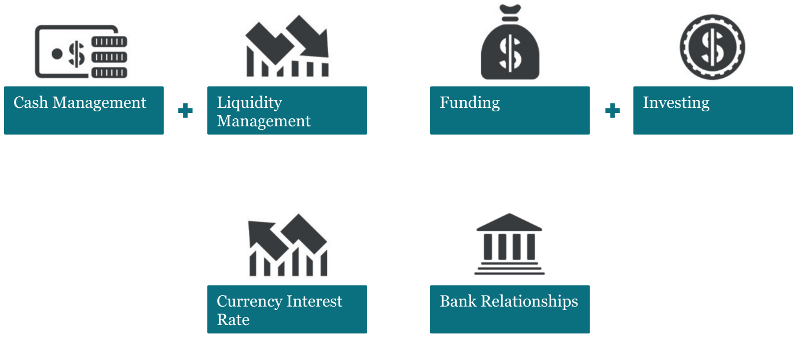
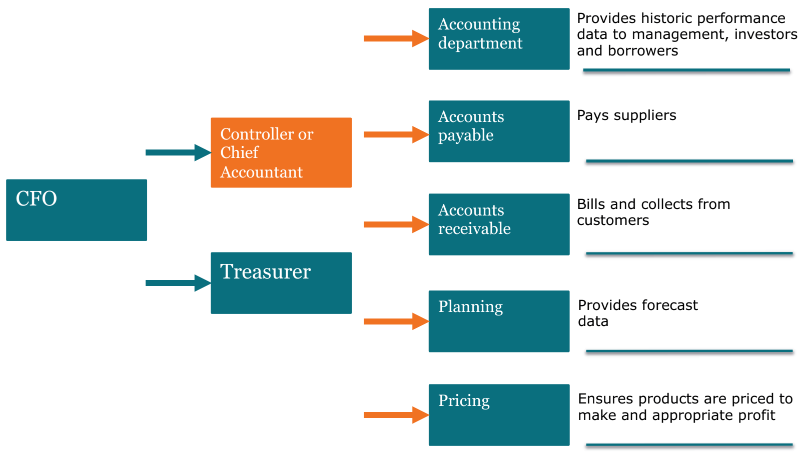


Figure 2 – Major responsibilities of most treasuries



The problem is not necessarily that the amount paid by customers is insufficient to meet the company's financial obligations; the issue is the timing

Figure 3 – Where does treasury fit into the organisation?



- Funding the company by borrowing money when necessary and vice versa, investing any cash surpluses that the company might generate
- Managing the effects and associated risks of fluctuations in currency and interest rates
- Managing relationships with the banks that provide the products and services needed to support these activities

A question that is frequently asked is: 'What is the difference between cash and liquidity management – or are they the same thing?'

Generally speaking, 'cash management' relates to the management of transactions and the bank accounts across which these transactions flow.

'Liquidity management' describes how balances on these accounts are managed. As these arise from the mismatches between transactions that flow into and out of accounts, cash and liquidity management are so closely related that they can be regarded as a single topic.

> **'What is the difference between cash and liquidity management – or are they the same thing?'**

Other responsibilities (found in some treasuries)

Treasury is a support function to the business as a whole, so it is likely to have additional responsibilities according to the specific needs and organisational structure of the business. These may include:

- **Commercial Credit Risk** – that is, calculating, monitoring and managing risk to commercial customers (in addition to credit risk to financial counterparties, which is typically a treasury responsibility)
- **Property** – large property transactions such as capital investment and leasing has a major balance sheet impact so it is often managed by treasury
- **Commodity Price Risk** - for companies with a large exposure to commodity prices, such as energy, fuel or raw materials, commodity risk is a major issue. It is managed in a similar way to currency risk, so treasury is often a natural owner of this activity
- **Insurance** – insurance is one aspect of risk management, so it often makes sense for treasury to manage this in order to take an integrated view of risk
- **Working Capital Management** – while treasury is typically responsible for managing balances on accounts, an increasing number of companies are involving treasury in the factors that influence working capital (such as payments and collections)
- **Pensions** – treasury may be involved in managing the company pension fund because of the need to invest assets in a prudent and effective manner, so that the fund can pay staff pensions in the future. In addition, many of the services required by pension funds are provided by financial institutions, including banks and their subsidiaries. As these relationships are managed by treasury, and treasury brings skills in investment management, it is logical for treasury to play a role in pension fund investment management
- **Trade Finance** – buying and selling goods and services overseas brings a variety of risk, not least the risk of counterparty default. Companies work with their banks as intermediaries for financing sales and purchases to reduce counterparty risk. In the past, trade finance was typically managed outside treasury, but as it can have a significant impact on working capital and the accuracy of cash flow forecasting, treasury departments are increasingly taking responsibility for trade finance.

Where does treasury fit into the organisation?

Just as the range of activities for which treasury is responsible can differ between companies, so too can the organisational structure of which treasury is a part. Usually, treasury will be a part of the finance function, but it may be geographically or functionally distinct, with separate management reporting to the Chief Financial Officer (CFO). See figure 3.

The CFO is in overall charge of the finance function

Typically the CFO will have an individual reporting to him/her designated as controller or possibly chief accountant. That individual in turn will have a series of accounting and other departments reporting to him/her, including:

- **A General Accounting department**, responsible for reporting historic financial performance to internal management and external stakeholders.
- **Accounts Payable**, responsible for settling supplier invoices and other payments. This may be a centralised function (in-country, regionally or in some cases globally) or decentralised with each business unit taking responsibility for payments.
- **Accounts Receivable**, responsible for credit control, billing and collection of cash by customers. As with Accounts Payable, this may be a centralised or decentralised function. In many companies, it is more difficult to centralise Accounts Receivable because of the commercial sensitivities of customer relationships, so these activities are often conducted by, or in close proximity to sales teams.

There may also be a Planning group or department, that provides forecast data to management.

In some cases too, a central Pricing function is responsible for ensuring that products and services are priced correctly to maintain profitability and competitiveness, but this will depend on the industry, business organisation and culture.

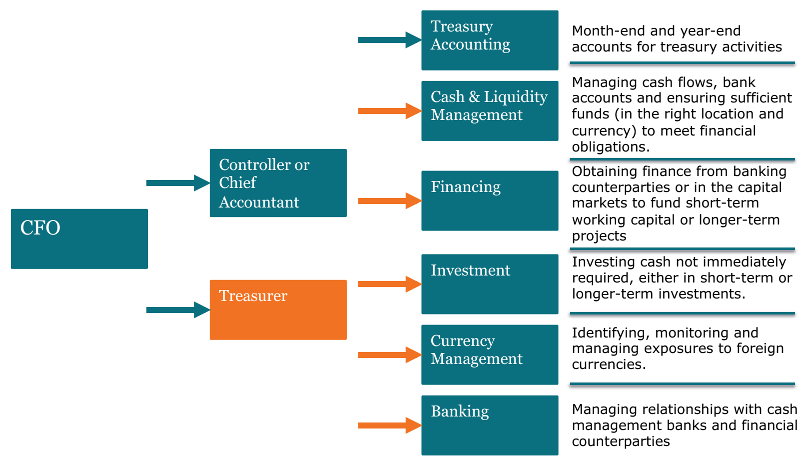
These traditional definitions are well understood in most organisations, but specific responsibilities may differ. For example, in some cases, treasury is responsible for centralised payments and/or collections (often called a ‘payments factory’ or ‘collections factory’), or takes on an oversight role, in order to be in a position to influence working capital as well as operational efficiency.

These functions may be combined in smaller companies. However in larger companies, treasury is a distinct business function that reports to the CFO.

Figure 4 provides a ‘close-up’ of the position of the treasury within the organisation.

The treasurer is normally a senior financial officer of

Figure 4 – Where does treasury fit into the organisation?



the company, often regarded as joint second or third in the finance function hierarchy after the CFO and Controller. The way in which the treasury team is organised will depend on the scale and complexity of the organisation. There may also be treasury teams in different locations, managing treasury in different regions. These regional treasury centres will usually be part of, and report into Group Treasury. Some of the major functions, include the following:

- **Treasury accounting**. Treasury produces month-end and year-end accounts for treasury activities. These are then passed to the Accounts function for group-wide consolidation, and to add a level of control.
- **Cash and liquidity management**. Treasury manages cash flows, bank accounts and ensures that sufficient funds (in the right location and currency) are available to meet the company’s financial obligations.

Obtaining finance from banking counterparties through credit facilities or overdrafts, or in the capital markets such as issuing bonds. Short-term borrowing may be used to fund short-term working capital requirements while bonds and drawdowns on credit facilities are typically used for longer-term projects.

Cash that is not immediately required may be invested in short-term instruments, such as deposits and money market funds (MMFs) so that it is available when financial liabilities fall due. Cash may also be invested in longer-term instruments when it will be required at some future date, such as to fund mergers and acquisitions.

Treasury identifies, monitors and manages exposures to foreign currencies, and converts these either to the company's base currency, or another currency required by group companies. Some currencies are restricted, such as Chinese RMB, which limits a company's ability to move funds out of a country.

Managing relationships with cash management banks and financial counterparties.

In smaller companies, some of these activities will be combined and/or managed by the same individuals.

Activities such as back-office processing and cash management may take place in a financial shared service centre (SSC) to take advantage of economies of scale and a central system infrastructure, but will still be within treasury's remit.

Distinct characteristics of treasury

There are several distinctive features of the responsibilities undertaken by a treasury which require it to be a separate function.

Firstly, other parts of the finance function value physical assets and liabilities such as inventory and fixed assets. While treasury also deals with assets and liabilities, these are financial rather than physical, such as loans, investments and future cash flows. Managing financial assets and liabilities requires specialist skills, calculations and systems, so it makes sense for these to be managed by a separate, specialist team.

Secondly, while other parts of the company deal with business risks, treasury deals specifically with financial risks; for instance, the risk that an investment counterparty may not repay a deposit, or the risk that a future customer collection in a foreign currency may have a lower value to the business than expected as a result of changes in the value of the currency. Treasurers consider how to measure and evaluate that risk and if necessary to hedge (or insure) it using specialist financial instruments.

Thirdly, the risks in question can be very large, and significant enough to have an effect on business results, so they require dedicated management

Finally, the transactions associated with these activities are often very large, so treasury deals with high monetary amounts with time-critical value dates in its day-to-day operations, while other departments such as Accounts Payable may deal with a higher volume of smaller cash flows.

The combination of these four factors mean that treasury is typically regarded as a specialist area that requires specific skills, technology, policies and processes to deal correctly with areas of great sensitivity to the company.

> **Managing financial assets and liabilities requires specialist skills, calculations and systems.**

Governance and treasury

In addition to treasury's distinctive role and characteristics, it is clear that its activities are business-critical. It is therefore essential that there is a framework in place to ensure that the board of directors and CFO have visibility and control over the way in which treasury conducts these activities.

The board and CFO will ensure that there is an appropriate organisation in place and define its responsibilities in order that the company's cash and risk management objectives can be met. This includes appointing a treasurer with specialist skills and experience who can then recruit the resources required to do this. They will set a strategy or direction by which those objectives are to be achieved, and, and from a practical point of view, they will agree a policy and control framework which will act as guide and reference point for treasury's activities

Treasury's compliance with the policy and control framework, and specific activities such as borrowing, investment and exposure management are monitored by a Treasury Committee that often comprises some representatives of the board (including the CFO) and specialist finance executives from departments such as Internal Audit.

The importance of policy

Treasury policy therefore outlines what a treasurer and the treasury department may and may not do and defines its overall approach.

More specifically, it will inform treasury's objectives, and what powers and responsibilities it has been granted by executive management to achieve these objectives. It should also, if properly drafted, define how treasury's activities are to be measured and reported back to management.

Finally, policy should cover all the areas that may significantly impact the company's financial operations.

Treasury Resources

To achieve its objectives treasury needs many different resources, of which the four most important are:

- People (and how they are organised)
- Processes (and how these are controlled)
- Systems that people use to support or automate treasury processes
- Banks

People. Treasury is a specialist discipline and therefore treasury professionals require specialist skills and training or education. Many entrants to treasury are already accounting or finance professionals, although others may come from other disciplines, particularly banking.

It is often said that accounting is backward-looking and treasury forward-looking. This should not be considered a derogatory description, and it does illustrate the fact that treasurers have more time-critical responsibilities and need to be responsive to current and projected events in a different way from other finance professionals. In some cases, senior finance professionals are appointed to treasury for a limited period to gain exposure to treasury as part of their career development in finance.

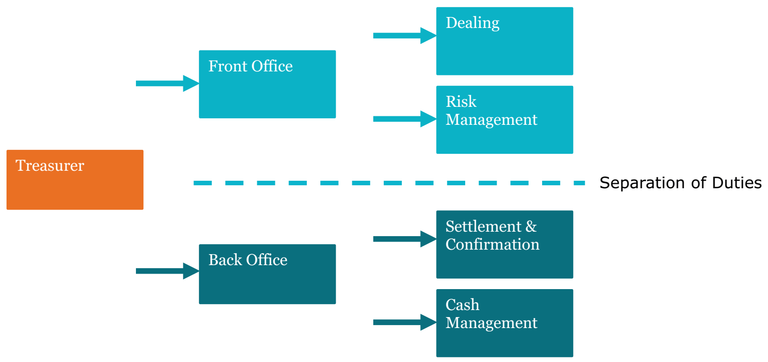
Treasury departments are often small (fewer than five people) except for the largest multinationals which may have 50 or 60 treasury employees across different locations, so treasury professionals often need to take on a varied spectrum of responsibilities.

Processes. Efficient processes for managing information and transactions are essential to a well-run treasury. For example, the first task for most treasury departments each morning is to retrieve bank statements to determine what the current bank balances are and reconcile the previous day's transactions against what was expected to happen. Then they create a cash position based on opening balances, and expected movements during the day and business unit funding, investment or foreign currency requirements on which daily decisions can be based. Each one of these tasks can be highly labour-intensive, and any mistake can have a significant financial impact. Therefore, not only do efficient processes mean that the best use is made of treasury professionals' expertise (as opposed to spending time on manual, bureaucratic tasks) but they also ensure that costly mistakes are minimised.

Treasury's activities are vulnerable to a range of risks, such as financial losses due to fraud, error, market or system failures. This is particularly the case due to the high value of transactions, its ability to make payments and the complexity of its activities.

Systems. Technology has an increasingly important role in treasury for automating processes, performing sophisticated calculations, communicating with internal and external partners and monitoring risk. The degree of technological sophistication in a treasury function will depend on its scale and complexity, but there are few treasury departments today that do not have specialist technology provided by their bank or banks, ERP provider or specialist treasury systems vendor. ERP stands for 'enterprise resource planning'. Systems such as SAP and Oracle are widely used by large corporations to integrate information and processes across different parts of the business, including finance and accounting, manufacturing, inventory, sales, service and customer relationship management. These systems may be used to provide treasury and cash management capabilities, or may be integrated with specialist treasury management systems for cash positioning, forecasting and accounting purposes.

Figure 5- Treasury organisation



The importance of treasury control was mentioned earlier. It is very difficult to achieve the right level of control without the appropriate systems in place. The specific types of technology in place in treasury departments, their purpose and how they are connected is covered briefly later in this article, and the term 'treasury management system' or TMS is used to refer both to specialist treasury systems or ERP systems that provide treasury management capabilities.

Treasury's relationships with its banks are key to achieving its objectives. Banks support treasury departments in a variety of ways, as we will discuss later in this module.

People

There are many different ways of organising a treasury department and defining individual roles, according the scale and complexity of the operation. It will also depend on the degree to which treasury is centralised or decentralised, a theme discussed below. However, assuming for now a single, centralised treasury department, some of the most commonly defined roles include the following:

The most senior treasury professional (Group Treasurer or Treasury Director) has overall responsibility for treasury activities, and may also have a deputy treasurer assisting in this. Below this, treasury is often divided into front office and back office. See figure 5.

The terms 'front office' and 'back office' are derived from the banking sector, and in reality, only large multinationals will have the scale to warrant specific front- and back-office departments. However, even the smallest treasury needs to ensure segregation of duties, a point already noted, to ensure that no single individual is responsible for managing every stage in a transaction lifecycle.

Front office (often managed by Head of Front Office or Chief Dealer) is responsible for dealing with counterparty banks, such as loans, deposits and other investments, foreign currency and hedging instruments. The front office is often therefore responsible for risk management, although this could be a separate department.

Back office (often managed by the Treasury Manager, Head of Back Office or Treasury Controller) is responsible for administration and support of transactions conducted by the front office, including settlement, payment and confirmation with the banks. This function often also includes treasury accounting.

Cash management may be a separate function or part of back office, but this will depend on the organisation. Other responsibilities noted previously, such as Pensions, Insurance and Trade Finance, may also be separate, or split between front and back office.

Figure 6 – Example Process – Account reconciliation

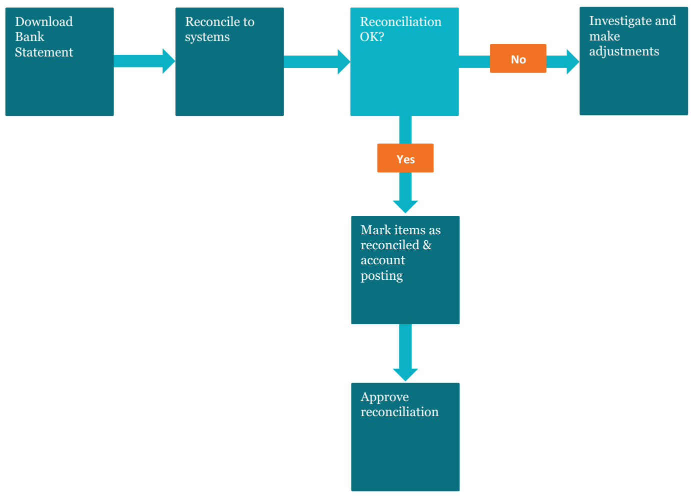
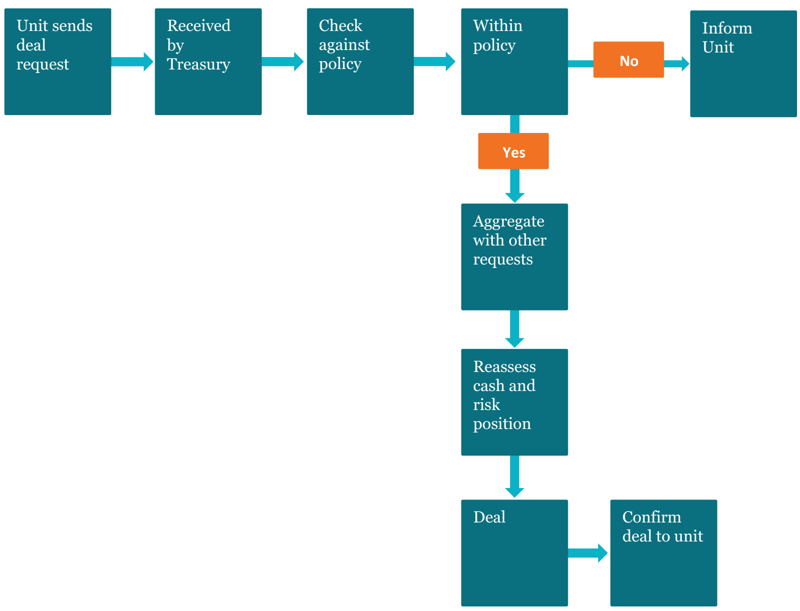


Figure 7 – Example Process – Business unit request



Processes

The critical role and function of treasury policy was emphasised earlier. However, treasury policy does not define the day-to-day processes that need to take place to achieve treasury's objectives. In particular, it does not lay out the sequence of individual tasks or the details of individual controls that we rely on for a robust process. Consequently, the policy document is often supplemented by a process document that outlines how each task should be performed. The advantage of a documented approach is that there is clarity and consistency as personnel change over time, processes can be audited by internal and external auditors, and treasury performance can be monitored and reported.

One of the first daily tasks in treasury is to reconcile the previous day bank account statement with the flows that were expected to take place. This process could be automated or manual, but the steps required are typically the same. An example is given in figure 6.

- The bank statement of all treasury accounts is downloaded from the bank's electronic banking system or a non-proprietary bank communication tool such as SWIFT.
- A report is downloaded from the TMS showing expected movements during the day

- A treasury analyst compares each item on the bank statement with items from the TMS report
- Amounts that match can be marked as reconciled in the TMS
- Amounts that do not reconcile may need to be followed up with the bank or the business unit involved. An adjustment may need to be posted in the relevant system
- The reconciliation process may need to be approved by a manager.

Few large multinationals adopt an entirely manual process for account reconciliation, so an automated process could be conducted as follows:

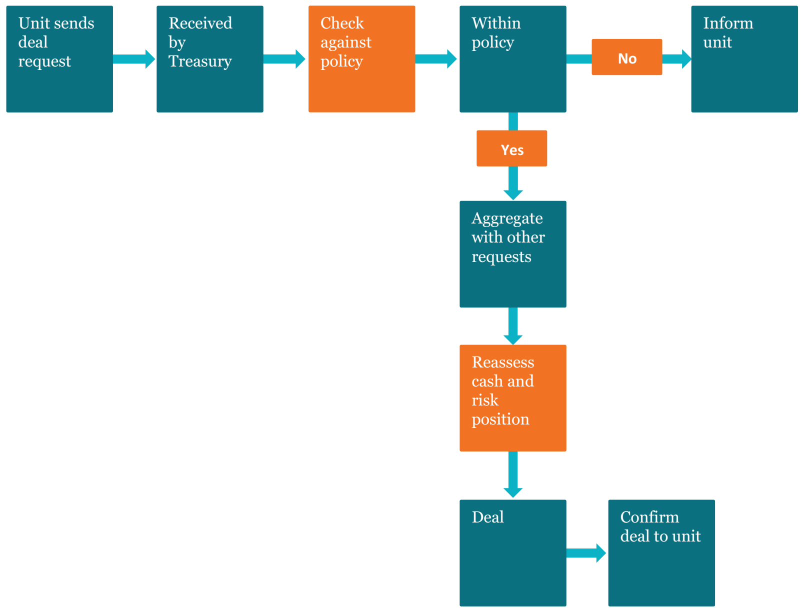
- The bank statement of all treasury accounts is downloaded from the bank's electronic banking system or a non-proprietary bank communication tool such as SWIFT, either as a manually initiated or automated/ scheduled event
- The bank statement is imported into the TMS (this could be 'pushed' from the bank communication system or 'pulled' from the TMS)
- Automatic reconciliation takes place based on the rules that have been defined in the system. For example, small rounding differences may have automatic account postings so that items can be marked as reconciled.
- Reconciled items are posted automatically on the account in the TMS, and unreconciled items are displayed to the user.
- Amounts that do not reconcile may need to be followed up with the bank or the business unit involved. An adjustment may need to be posted in the relevant system.
- The reconciliation process may need to be approved by a manager

Business unit request

In many cases, treasury will operate as an 'in-house bank' to the group as a whole. This means that business units (or group companies) can (or may be obliged to) deal with treasury as if it was a bank, as opposed to approaching banks themselves. The advantage of an in-house bank is that bank relationships are managed through treasury, treasury can aggregate financial requirements across the group and potentially net off surpluses and deficits to minimise the need for external financing. The total amount available for investment may be higher, and foreign exchange exposures netted. Figure 7 shows a simple internal deal request process.

Business units may request deals from treasury, either via phone, email or fax, or increasingly through an online process that is integrated directly with the TMS.

Figure 8 – Preventative control



In many cases, treasury will operate as an 'in-house bank' to the group as a whole.

Figure 9 - Detective control example

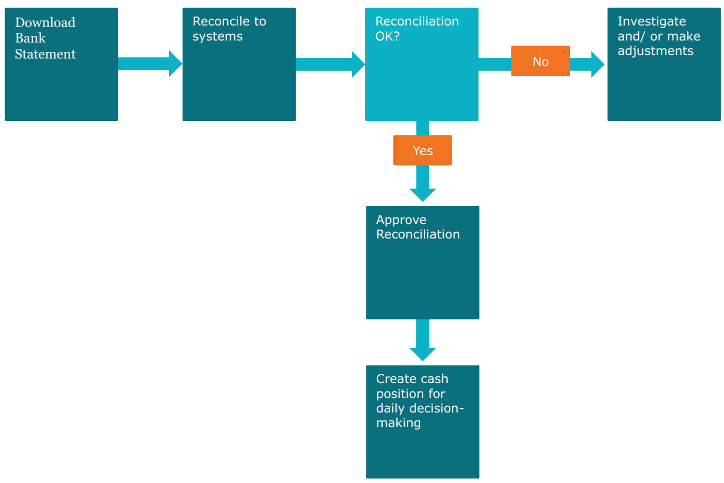


Figure 10 – Preventative and detective controls

Treasury action	Control type
Authorisation and approval of financial transactions	Preventative (before transaction) Detective (after transaction)
Segregation of duties	Preventative
Transaction checking	Detective
Access controls	Preventative
Reconciliation and confirmation of transactions	Detective
Treasury performance monitoring	Preventative/ detective
Reporting of exposures, positions, limits etc.	Preventative/ detective
Internal/ external audit checking	Preventative/ detective

On receiving a deal request, treasury will check this against the treasury policy to ensure that it is compliant. Again, this may be a manual or automatic process. If the request does not comply with policy guidelines, treasury will inform the business unit.

If a deal request is accepted, treasury may aggregate requests from different business units, and net off surpluses, deficits and foreign currency risk exposures to minimise the number of external transactions that need to be conducted. Again, this could be automated or manual.

Treasury will then determine what deals need to be transacted in the market and deal them manually or electronically. Having performed these transactions, treasury will post an internal deal with each relevant business unit.

Treasury controls

Almost every treasury task has an associated process to ensure consistency, efficiency and control. Efficiency is important to ensure the best use of resources and reduce the scope for error, while appropriate controls are essential to avoid financial losses as we discussed earlier.

Almost every treasury task has an associated process to ensure consistency, efficiency and control.

Controls can be either preventative or detective in nature. Preventative controls (see figure 8) are relatively self-explanatory, in that checks take place in advance to avoid a breach in policy, error or fraud.

In the example process of the business unit request, there are two preventative control points:

The first is to check that the request is in line with group policy and authorised internal limits.

The second is to make sure that the appropriate deals are being performed in order to keep the company's cash and risk position is in line with policy, and to ensure that external transactions are of a sensible size (that is, not too small or too large to achieve competitive rates).

In both these cases the control is preventative, in that it aims to prevent something happening which is either not approved or not efficient.

Figure 9 shows an example of a detective control, that is, it highlights problems that have already happened. This example was cited previously: the reconciliation of a bank statement with the cash flows that were anticipated. If an item on the bank statement can be reconciled, then it is marked as such and posted to the ledger. The reconciliation process may also be approved once completed as another level of detective control. If an item cannot be reconciled, meaning that there is a difference between what treasury expected to happen, and what actually happened, then further action needs to take place. It is clearly in treasury's interests to have as accurate a view of cash as possible to avoid surplus balances or overdrafts on an account.

Reconciliation exceptions can happen for a variety of reasons. For example, suppliers may not have paid on time, or the payment may have had incorrect or incomplete settlement instructions, delaying receipt. Payments may have been made after the cut-off time (i.e., the deadline for payment instructions) and therefore the value date is one day later than expected. If charges are deducted from a cash flow, or it has been converted from a foreign currency, there may be a rounding difference which makes it difficult to reconcile. In addition, the reconciliation process aims to pick up errors or fraud as quickly as possible.

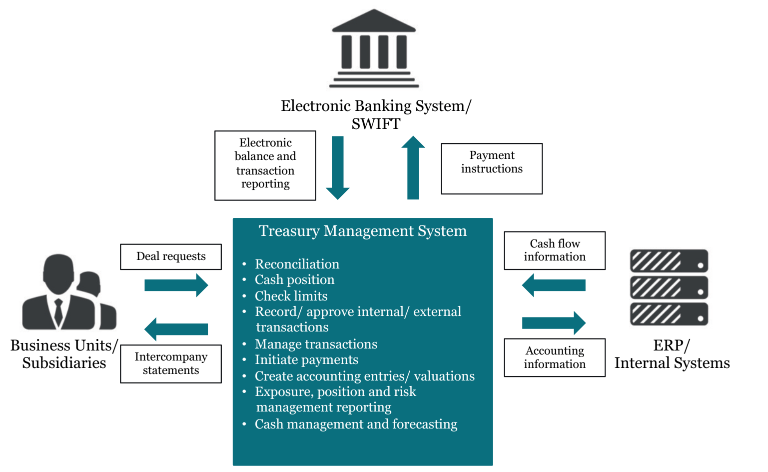
In the event of a reconciliation exception, treasury personnel take the action appropriate to the event. This could involve following up with the bank, contacting the internal business unit or central department involved, and adjusting the TMS so that the differences from expected cash flow activities are reflected in the cash position.

Preventative and detective controls

To summarise, controls can be preventative or detective. A well-managed treasury function will combine both types of control as part of its processes. Figure 10 illustrates some frequent controls, but treasury functions will have different systems and safeguards in place according to the specific nature of their responsibilities, technology infrastructure, processes and organisational structure.

- Authorisation and approval of financial transactions
- Segregation of duties, that is, ensuring that different individuals are responsible for each stage of a financial transaction, such as dealing, approval and settlement
- Checks on recording of transactions to ensure that none are omitted or duplicated
- Safeguards for access to systems or documents
- Reconciliation/checking of records, such as confirming transactions with counterparty banks
- Measurement of treasury performance, including the use of key performance indicators, known as KPIs
- Reporting of positions, exposures, transaction statements and limits
- Checks by internal (and external) audit

Figure 11 - Treasury Management System



Systems

One of the several factors that influence the processes and controls that each company has in place is the technology that underpins them. Treasury technology infrastructure can vary enormously between companies according to their size, complexity, degree of centralisation and a range of other factors, but the purpose of the systems used in treasury are the same: that is, to provide efficiency, control and transparency over processes and decision-making in treasury.

A treasury management system (TMS) can refer to both a specialist cash and treasury management system, or a module of an ERP. (See figure 11.) While systems differ in their functionality, which corporations may also choose to deploy in different ways, some of the most common capabilities of a TMS include the following:

- Import the bank statement from the bank, either through an electronic banking system provided by the bank, or a portal that provides information from multiple banks through a single channel such as SWIFT. The bank statement typically shows the previous day's activity, but intra-day statements are also available in some cases.
- Reconcile the bank statement to expected activities
- Import deal requests from business units and subsidiaries, such as requests for funding, surplus funds for investment, or foreign exchange (known as FX) requests. This capability is typically provided by the TMS itself, such as through a web browser made available to business unit users, or these requests could be imported from an external system
- Import cash flow information such as payables and receivables from an ERP or other internal systems.
- With this information, the TMS can then produce a cash position that will enable the front office to make dealing decisions, such as what funds are available for investment, what funds may need to be borrowed, and which amounts in various foreign currencies may need to be exchanged.
- Before dealing, the TMS will show what credit limits are available with authorised counterparty banks to facilitate the dealing process. Dealers may transact deals on the telephone or through an on-line dealing portal which may be integrated with the TMS.
- Once deals have been recorded in the TMS, the relevant approval tools will be made available to the relevant users
- Back-office users can then check transactions for settlement. The TMS allocates settlement instructions based on pre-defined rules. It also produces confirmations that can be sent to the counterparty bank manually or integrated with a confirmation matching system. Intercompany statements are transmitted to the relevant business units, or available for download
- Once the relevant approvals have been completed in the TMS, payment instructions and advices to receive are transmitted to the bank in the relevant format, again through the electronic banking system or SWIFT
- The TMS will typically also provide the accounting

entries and valuations for internal and external transactions. The monthly and year end accounting process may be completed in the TMS itself, or the accounting entries sent to a separate accounting system for month-end and year-end processing

- The TMS will provide a range of reporting and decision-support tools for risk management purposes, and may also support hedge accounting (that is, compliance with accounting regulations on the treatment of transactions used to manage financial exposures)
- The system will also support cash management and forecasting.

Banks

Financial institutions (particularly banks) play a major part in helping treasury to achieve its objectives. Banks fulfil a variety of roles and support treasury in different ways.

Cash management banks
Every organisation will work with one or more bank(s) for cash management purposes.

Banks provide bank accounts, both in the company's domestic currency and foreign currencies. These may be interest-bearing or non-interest bearing according to the type of account, country and currency in which the account is held, and the policy of the bank. Banks may also provide overdraft facilities on certain accounts, which is often an important form of short-term borrowing for many companies. Most banks provide electronic banking systems to provide statements detailing balances and transactions on accounts.

Banks provide payment and collections services, both domestic (within the same country) or cross-border (to or from counterparties in other countries, and potentially in other currencies). In countries where electronic payments are prevalent, these most commonly made through the bank's electronic banking system.

With many companies holding a large number of bank accounts, cash can become fragmented and difficult to access. Therefore, an essential service provided by key cash management banks is to provide liquidity management solutions to enable treasury to have full visibility and control over the company's cash. One such technique is cash pooling or cash concentration, which is the transfer of funds from a number of accounts into a single header account. A cash pool may be within one country, include accounts from different countries, and in some cases, can involve different currencies.

Counterparty banks
Banks are also counterparties to most financial transactions that treasury undertakes to fulfil its objectives.

- They provide credit facilities and overdrafts to provide funding
- They provide long-term finance for large-scale capital projects
- Companies can deposit cash with banks (that is, the bank is borrowing money from the company) and receive an agreed rate of interest in return. Banks also provide other types of instrument in which treasury can invest such as commercial paper
- They organise the issue of company debt such as bonds
- They provide foreign exchange services
- They provide hedging transactions for managing interest rate, currency and commodity risk
- They provide trade financing for imports and exports
- They provide a range of ancillary services such as commercial card programmes.

Bearing in mind the range of activities in which they are involved, successful bank relationship management is an essential requirement for treasury.

With many companies holding a large number of bank accounts, cash can become fragmented and difficult to access.

Treasury Structure

Treasury departments may be organised in different ways. This extends not only to the structure of the department, but also how treasury activities are distributed across the group.

Global treasury centre
The most straightforward treasury organisation is a global treasury centre. This conducts cash and treasury management activities through a single treasury function on behalf of the rest of the group. It can be difficult to manage the cash and treasury needs of a geographically diverse organisation through a single centre, not least due to differences in time zones. Therefore, it is often smaller companies or those with

the majority of their business in a single country or region that are most likely to have a single global treasury centre, but large, complex multinationals have also achieved this. When companies have a single, global treasury centre, treasury often acts as an in-house bank, where business units deal with treasury as if it were a bank, as opposed to approaching banks themselves. Treasury can aggregate financial requirements across the group and potentially net off surpluses and deficits to minimise the need for external financing. The total amount available for investment may be higher, and foreign exchange exposures netted.

Regional treasury centres

For companies that wish to manage their cash and treasury management activities centrally, but need to transact business across a number of time zones, a regional treasury structure is often the most appropriate. Regional treasury centres, or RTCs as they are commonly known, represent Group Treasury by providing treasury services to the group in a particular area. RTCs usually operate according to policies and procedures determined by Group Treasury, and may share a common TMS. A company may have two or more RTCs depending on the business requirement. In some cases, back-office processing may take place centrally, such as through a shared service centre or SSC.

In some cases, an RTC may operate more independently from Group Treasury, for example, with different systems, policies and/or processes. For example, many companies with major operations in countries such as China that have restricted currencies and widely differing regulatory environments may have a separate treasury function in China, but reporting to Group Treasury.

Decentralised treasury

In a decentralised treasury, each country or business unit will conduct its own cash and treasury management activities, independently of the group. This is most likely to be the case where a group's business activities are quite diverse, and each business division or subsidiary operates in a largely autonomous way.

Group treasury can play a variety of roles in a decentralised treasury environment. For example, it may formulate treasury policies and procedures which local treasury operations should follow, and provide treasury advisory services. However, increasingly, companies are moving away from an entirely decentralised treasury structure, for a variety of reasons:

- It is difficult to monitor and manage credit risk to financial counterparties (e.g., banks) if each business unit maintains separate banking relationships, and bank charges may be higher if business units cannot leverage the purchasing power of the group
- It is difficult to gain visibility over the group cash position
- Treasury policies and processes cannot be enforced easily
- The cost of treasury technology and maintaining interfaces with each bank is replicated across each business unit
- Surplus cash in one business unit cannot be offset against deficits in another, leading to a high cost of borrowing (particularly as business units may have reduced borrowing capacity and less advantageous rates than Group Treasury would be able to achieve) and the interest obtained on surplus cash may be lower
- Foreign exchange risk may be considerable, and exchange costs high if each business units manages FX risk locally.

By centralising treasury into a global or regional treasury structure, companies can gain economies of scale with their banking partners and manage their risk more effectively. By gaining visibility and control over cash and risk, they can also offset FX exposures, surplus and deficit balances across the group. Ensuring compliance with internal and external regulations, and treasury policies and procedures is more straightforward, and companies can reduce technology costs through a single treasury technology infrastructure and standard interfaces to banking partners.

Despite the advantages of a global or regional treasury environment, however, some companies that have centralised their treasury activities in the past have devolved limited treasury responsibilities to local treasury centres, that effectively operate as satellites of group or regional treasury. In some countries, for example, borrowing or investment conditions may be more favourable than in the company's home jurisdiction. Furthermore, where a company is a market leader in a country, it may be beneficial to establish local banking relationships and play a part in developing the country's financial infrastructure. ■

RTCs represent Group Treasury by providing treasury services to the group in a particular area.

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