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# TREASURY MANAGEMENT

**The Practitioner's Guide**

**STEVEN M. BRAGG**

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# Preface

A treasurer has a broad range of responsibilities in the modern corporation, ranging from cash management to risk management. Further, the treasurer is responsible for the proper movement of potentially large amounts of funds and the construction of hedges, which call for the integration of a comprehensive set of controls into a broad-based procedural framework. *Treasury Management: The Practitioner's Guide* shortens the treasurer's learning curve for all aspects of the position, with chapters clustered into the general categories of cash management, financing, risk management, and treasury systems.

The book is divided into four sections. In Part One, we address the various methods by which a company transfers cash, both on paper and by electronic means, and then show how to create a cash forecast and monitor its accuracy. We then cover several methods for aggregating cash from a multitude of locations, so that funds can be more effectively dispositioned. Finally, a separate chapter addresses the components of working capital and how they may be altered, thereby impacting cash flow planning.

In Part Two, we cover what the treasurer does to raise debt and equity, as well as how to invest funds. This includes a discussion of the various kinds of debt and key characteristics of each one, how to deal with credit rating agencies, and the intricacies of equity offerings. The coverage of investments includes investment criteria, types of available investments, and investment and risk reduction strategies.

Part Three addresses an increasingly important aspect of the treasurer's responsibilities, which is risk management. This includes the objectives and strategies of both interest rate and foreign exchange risk management, as well as the available risk mitigation tools that are available to the treasurer.

Finally, Part Four describes the technology that drives many treasury transactions. This includes an overview of the clearing and settlement systems used in the United States, the functions of a treasury management

system, and a discussion of how corporations can access the Society for Worldwide Interbank Financial Telecommunication (SWIFT) network.

These chapters are liberally sprinkled with examples to clarify concepts. Particular attention has also been paid to the specific accounting requirements of key treasury transactions, as well as related controls, policies, and procedures, with the intent of providing a treasurer with a complete framework for setting up and operating the treasury department.

The book answers a multitude of questions involved in running a treasury department, such as:

- How do I calculate the cost-effectiveness of a lockbox?
- How do I create a cash forecast?
- How do I set up a cross-border cash pool?
- How does notional pooling work?
- What policy changes can I implement to alter the investment in working capital?
- How can I securitize my accounts receivable?
- What types of exemptions are available from the stock registration rules?
- How do I set up a tranching cash flow strategy?
- How do I integrate risk mitigation into my investment strategy?
- How do I use forwards, futures, swaps, and options within my hedging strategy?
- How does the continuous link settlement system reduce settlement risk?
- What features should I look for in a treasury management system?

In short, *Treasury Management: The Practitioner's Guide* is the ideal sourcebook for the mechanics of how to run all aspects of the modern treasury department.

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# About the Author

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*Accounting Best Practices*

*Accounting Control Best Practices*

*Accounting Policies and Procedures Manual*

*Advanced Accounting Systems*

*Billing and Collections Best Practices*

*Business Ratios and Formulas*

*Controller's Guide to Costing*

*Controller's Guide to Planning and Controlling Operations*

*Controller's Guide: Roles and Responsibilities for the New Controller*

*Controllershship*

*Cost Accounting*

*Essentials of Payroll*

*Fast Close*

*Financial Analysis*

*GAAP Guide*

*GAAP Policies and Procedures Manual*

*GAAS Guide*

*Inventory Accounting*

*Inventory Best Practices*

*Investor Relations*

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**PART ONE**

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**CASH MANAGEMENT**



# 1

## Treasury Department

The treasury department is responsible for a company's liquidity. The treasurer must monitor current and projected cash flows and special funding needs, and use this information to correctly invest excess funds, as well as be prepared for additional borrowings or capital raises. The department must also safeguard existing assets, which calls for the prudent investment of funds, while guarding against excessive losses on interest rates and foreign exchange positions. The treasurer needs to monitor the internal processes and decisions that cause changes in working capital and profitability, while also maintaining key relationships with investors and lenders. This chapter explores these and other responsibilities of the treasury department, as well as such key issues as treasury centralization, bank relations, outsourcing, and performance metrics.

### ROLE OF THE TREASURY DEPARTMENT

Ultimately, the treasury department ensures that a company has sufficient cash available at all times to meet the needs of its primary business operations. However, its responsibilities range well beyond that single goal. It also has significant responsibilities in the following areas:

- *Cash forecasting.* The accounting staff generally handles the receipt and disbursement of cash, but the treasury staff needs to compile this information from all subsidiaries into short-range and long-range cash forecasts. These forecasts are needed for investment purposes, so the treasury staff can plan to use investment vehicles that are of the correct duration to match scheduled cash outflows. The staff also uses the forecasts to determine when more cash is needed, so that it can plan to acquire funds either through the

use of debt or equity. Cash forecasting is also needed at the individual currency level, which the treasury staff uses to plan its hedging operations. This topic is covered in Chapter 3, Cash Forecasting.

- *Working capital management.* A key component of cash forecasting and cash availability is working capital, which involves changes in the levels of current assets and current liabilities in response to a company's general level of sales and various internal policies. The treasurer should be aware of working capital levels and trends, and advise management on the impact of proposed policy changes on working capital levels. This topic is addressed in Chapter 5, Working Capital Management.
- *Cash management.* The treasury staff uses the information it obtained from its cash forecasting and working capital management activities to ensure that sufficient cash is available for operational needs. The efficiency of this area is significantly improved by the use of cash pooling systems. This topic is addressed in Chapter 4, Cash Concentration.
- *Investment management.* The treasury staff is responsible for the proper investment of excess funds. The maximum return on investment of these funds is rarely the primary goal. Instead, it is much more important to not put funds at risk, and also to match the maturity dates of investments with a company's projected cash needs. This topic is addressed in Chapter 8, Investment Management.
- *Treasury risk management.* The interest rates that a company pays on its debt obligations may vary directly with market rates, which present a problem if market rates are rising. A company's foreign exchange positions could also be at risk if exchange rates suddenly worsen. In both cases, the treasury staff can create risk management strategies and implement hedging tactics to mitigate the company's risk. This topic is addressed in Chapter 9, Foreign Exchange Risk Management, and in Chapter 10, Interest Risk Management.
- *Management advice.* The treasury staff monitors market conditions constantly, and therefore is an excellent in-house resource for the management team should they want to know about interest rates that the company is likely to pay on new debt offerings, the availability of debt, and probable terms that equity investors will want in exchange for their investment in the company.
- *Credit rating agency relations.* When a company issues marketable debt, it is likely that a credit rating agency will review the company's financial condition and assign a credit rating to the debt. The treasury staff responds to information requests from the credit agency's

review team and provides it with additional information over time. This topic is addressed in Chapter 6, Debt Management.

- *Bank relationships.* The treasurer meets with the representatives of any bank that the company uses to discuss the company's financial condition, the bank's fee structure, any debt granted to the company by the bank, and other services such as foreign exchange transactions, hedges, wire transfers, custodial services, cash pooling, and so forth. A long-term and open relationship can lead to some degree of bank cooperation if a company is having financial difficulties, and may sometimes lead to modest reductions in bank fees. This topic is addressed further in the Bank Relations section of this chapter.
- *Fund raising.* A key function is for the treasurer to maintain excellent relations with the investment community for fund-raising purposes. This community is composed of the *sell side*, which are those brokers and investment bankers who sell the company's debt and equity offerings to the *buy side*, which are the investors, pension funds, and other sources of cash, who buy the company's debt and equity. While all funds ultimately come from the buy side, the sell side is invaluable for its contacts with the buy side, and therefore is frequently worth the cost of its substantial fees associated with fund raising. This topic is addressed in Chapter 6, Debt Management, and Chapter 7, Equity Management.
- *Credit granting.* The granting of credit to customers can lie within the purview of the treasury department, or may be handed off to the accounting staff. This task is useful for the treasury staff to manage, since it allows the treasurer some control over the amount of working capital locked up in accounts receivable. This topic is addressed in Chapter 5, Working Capital Management.
- *Other activities.* If a company engages in mergers and acquisitions on a regular basis, then the treasury staff should have expertise in integrating the treasury systems of acquirees into those of the company. For larger organizations, this may require a core team of acquisition integration experts. Another activity is the maintenance of all types of insurance on behalf of the company. This chore may be given to the treasury staff on the grounds that it already handles a considerable amount of risk management through its hedging activities, so this represents a further centralization of risk management activities.

Clearly, the original goal of maintaining cash availability has been expanded by the preceding points to encompass some types of asset management, risk management, working capital management, and the lead role



in dealing with banks and credit rating agencies. Thus, the treasury department occupies a central role in the finances of the modern corporation.

## TREASURY CONTROLS

Given the large sums of cash involved in many treasury transactions, it is important to have a broad set of controls that help to ensure that transactions are appropriate. The following chapters contain sections on controls related to those chapter topics. At a more general level, it is critical that duties be properly *segregated* among the treasury staff, so that anyone concluding a deal never controls or accounts for the resulting cash flows. For example, trading activities should be separated from confirmation activities, so that someone fraudulently conducting illicit trades cannot waylay the confirmation arriving from the counterparty. In addition, a senior-level treasury manager should approve all trades, yet another person (possibly in the accounting department, in order to be positioned out of the departmental chain of command) should reconcile and account for all transactions.

It is also useful for someone outside of the trading function to regularly compare brokerage fees or commissions to reported transactions, to see if there are any unauthorized and unrecorded trades for which the company is paying fees.

Treasury is also an excellent place to schedule internal audits, with the intent of matching actual transactions against company policies and procedures. Though these audits locate problems only after they have occurred, an adverse audit report frequently leads to procedural changes that keep similar problems from arising in the future.

In addition to segregation controls and internal auditing, the treasurer should impose *limit controls* on a variety of transactions. These limits can prohibit or severely restrict the treasury staff from investing in certain types of financial instruments (such as some types of financial derivatives) that present an unduly high risk of capital loss. Another limitation is on the amount of business a company chooses to do with a specific counterparty, which is designed to reduce company losses in the event of a counterparty failure. Limitations can also apply to certain currencies if there appears to be some risk that a country's leaders may impose currency controls in the near future. Finally, there should be monetary caps on the transaction totals to which anyone in the treasury department can commit the company. Even the treasurer should have such a limitation, with some major transactions requiring the approval of the company president or board of directors.

The controls noted here are only general concepts. For more detailed itemizations of specific controls, please refer to the Controls sections of each of the following chapters.