TREASURY TRENDS

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Governance in Treasury

There is a great deal spoken of governance in treasury but, perhaps, less is actually done about setting up an appropriate structure to support good governance and, arguably, even less done about building robust reporting to ensure that.

Empirical research on governance and (enhanced) performance has tended to be centred on the investment industry. Whilst conclusions fall short of linking superior performance with strong governance, it would seem reasonable to expect well governed funds to experience better investment performance over time. Articles on governance tend to focus more on the poor examples than the good — as is the case with most things treasury. The more spectacular a failure or loss, the more likelihood the story will gain airtime. These stories often reflect a common theme — a breakdown in, or absence of, good governance is a contributing factor.

Key points

- Set up an appropriate structure and reporting package to support good governance.
- Cost is only one half of the equation. Decision making should focus on broader outcomes.
- To encourage stronger governance within treasury, ensure regular facetime with the Board or Council.
- Robust policies and procedures form the basis of good governance.
- Seek an independent appraisal of your treasury operation.

Sticking with the investment sector, David Swenson, Chief Investment Officer of Yale University's USD27 billion in Endowment assets, wrote "*discomfort represents a necessary, albeit not sufficient, condition of success.*" This is to be read in the context of needing to update and commit to a continuous programme of improvement in the Board or Council room, necessitating regular reviews of existing practices and undertaking gap analysis against best in class. Change is not always welcome but it is best to be leading the strategy rather than having to react to a series of adverse or unwanted outcomes — often the catalyst for change, but forced and too late.

Strategy to drive behaviours

Parallels with broader treasury exist because of the largely unique standing of the treasury function in most organisations; typically cutting across all aspects of a business given that treasury's end game is ultimately all about the management of cash. In this regard, education is key, and CFOs and Treasurers have a major role as strategic advisors within their respective businesses.

The 'out to in' philosophy, whereby information is sought from all stakeholders and a solutions found, is often more successful in building sound engagement than the alternative 'in to out' model, where business units are instructed what to do with little real appreciation of coalface issues.

Cost versus value

Governance structures need to support and encourage the CFO to assess opportunities for improvement on a value basis. There is a risk that a focus solely on cost rather than value leads to poorer decision making. According to the outgoing chairman of the Australian Securities and Investments Commission, the declining audit quality was a *"sleeper"* issue — ever lower fees charged for audits were lowering the quality of work and some of the results were *"appalling."* On a similar theme, New Zealand's Financial Market Authority recently raised issues around auditor independence and noted that directors should play a more active role to make sure audits are being done properly.

As advisors, we appreciate more than most the various measures of 'value' and the need to identify all of the relevant metrics. A cheaper per item price, while often getting the attention of the procurement team, can often miss the big picture and not deliver on the wider value measure. How do you assess a large up-front fee that nonetheless delivers significant and quantifiable long term savings?

Within the confines of treasury, missing relatively small points can lead to significant cost, not just financial. Fees cannot be ignored, clearly, but there needs to be a structure to assess value as opposed to simply working with the cheapest option — and then recognising and rewarding those for making better decisions.

Agency risk

The cost versus value discussion frequently makes up part of the mix, which is the potential conflict between management and shareholders, and their different aversion levels to risk.

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Governance structures need to support the processes to manage this risk, ensuring that management does not allow self interest to interfere with the primary duty of acting in the best interests of shareholders and stakeholders.

Education and communication are both key parts of governance. Notwithstanding the distinct responsibilities of each party, there must be a willingness of both management and those charged with ultimate control of the organisation to feed off each other, sharing thoughts as appropriate. Audit, Risk and Finance Committees (or combinations thereof) are prime structures to work in tandem — and there should not be any embarrassment around running internal or external training sessions to address areas of uncertainty. This is especially so when an organisation is going through material change (e.g. size, complexity, new markets).

Time with Board/Council

A relatively simple way to encourage stronger governance within treasury, and to elevate its standing within the organisation, is by seeking short, but regular facetime with the Board or Council. Typically, this would be working through the CFO but separately from the pure accounting focused reporting, with time dedicated to relevant areas such as capital structure, funding options, risk identification and management. Raising the interest and understanding of directors or councillors will lead to better quality questions, focused demands of time and so on.

Workshops offer an alternative route to the top table, running tailored sessions behind closed doors and, importantly, jargon free and centred on the specific areas of treasury focus. Outlining what are often quite complex issues can normally be broken into a series of logical steps. Confusion or misunderstanding risks the dumbing down of key points, missed opportunities or advancing along the path to wider problems. Good governance will flow from solid understanding of the risks at hand as well as having confidence in those tasked with the management of such risks.

Governance comes from within

Whilst many organisations work within the confines of regulation and legislation, much of good governance needs to be driven from within. Robust policies and procedures form the basis of this, with practical reporting and review processes in support. Naturally, reporting must present the 'right' information and, crucially, be forward looking — and thereby adding to the strategic recognition of treasury — as well as fulfilling an operational role. A regular assessment of performance will also go a long way towards ensuring that treasury is operating as effectively as possible.

We are often asked to undertake an independent appraisal of treasury operations and to review the success (or otherwise!) of the treasury policy. Does the policy framework sufficiently meet its key objectives? Are there areas where improvements and savings can be made? Those involved in the day-to-day running of the specific treasury function can often benefit from a 'big picture' healthcheck, if only to enjoy the positive reinforcement that risks are being appropriately identified and managed, and processes remain in line with best practice. Typically, our reviews identify opportunities for process improvements, risk reduction, or cost savings well in excess of our fees — another example of the 'value versus cost' proposition!

Through sound decision making, treasury has a real opportunity to add value to an organisation by first adopting best practices and then adding meaningful insights that impact strategy. A good governance framework, as represented by sound policy, processes, systems, and behaviours, remains at the heart of a high performance treasury function. Is it time to look at yours?

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