CGMA® SPECIAL REPORT

TREASURY & CASH MANAGEMENT ESSENTIALS

What Is Treasury and Cash Management?

Whether it knows it or not, almost every business of any size administers its financial assets and holdings, with the aim of optimising liquidity, ensuring the right investments are made, and reducing risk.

According to the CGMA Global Management Accounting Principles, treasury and cash management is defined as:

"The corporate handling of all financial matters, the generation of external and internal funds for business, incorporating the management of currency and interest rate risk, bank facilities, funding and cash management."

As guardians of organisations' assets, management accountants are responsible for stewarding liquidity, optimising capital structures, and supporting the execution of strategies that generate value for all stakeholders. Since the 2008 global financial crisis, however, the environment in which the treasury function has to generate value has become much more complex. Management accountants must therefore update their skills and competencies to cope with the new expectations.

This treasury resource has been written in partnership with the Association of Corporate Treasurers (ACT), the chartered body for treasury. It draws on the ACT's technical expertise, the CGMA Competency Framework, and the ACT Competency Framework. This special report will prove invaluable to management accountants who recognise the new challenges in treasury and wish to develop their capabilities to take advantage of arising opportunities.

POSITIONING TREASURY AND CASH MANAGEMENT

The key role of the treasury function is to advise the board and management on the business decisions and financial considerations that are fundamental to corporate strategy. Securing finance, maintaining funding, and managing risks are essential treasury skills that enable the execution of that strategy.

Every organisation deals with treasury issues, but many organisations do not have a distinct treasury function. Treasury may mean a discrete practice within an organisation or it may be among the responsibilities of a management accounting function. Similarly, the role of treasurer may be a discrete role or may be one responsibility within a broader role, such as financial controller or CFO.

At the strategic level, treasury is about advising on the appropriate choices, trade-offs, and compromises involved when financial decisions are made.

Three strategic and interrelated questions are fundamental to treasury decision-making:

1. What do we invest in?
2. How do we fund these investments?
3. How do we manage the risk of our choices?

It is impossible to make sound decisions about any one of these questions without influencing or being affected by the answers to the other two. In other words, they are interdependent. These questions are the foundations of business strategy development and are central to the financial criteria for investing. "Investing" refers to any use of resources for future benefit. It covers not only acquiring property, plant and equipment, M&A, and intangible assets such as patents, know-how, and brands, but also R&D, staff training, and marketing programmes.

Although management accountants address these questions on a routine basis, the very different financing considerations of different organisations (a utility company and a confectionery manufacturer, for example) will result in different answers.

The time horizons they have to consider and the risks they need to manage may be different too, whether because of the nature of the business or the type of financing chosen.

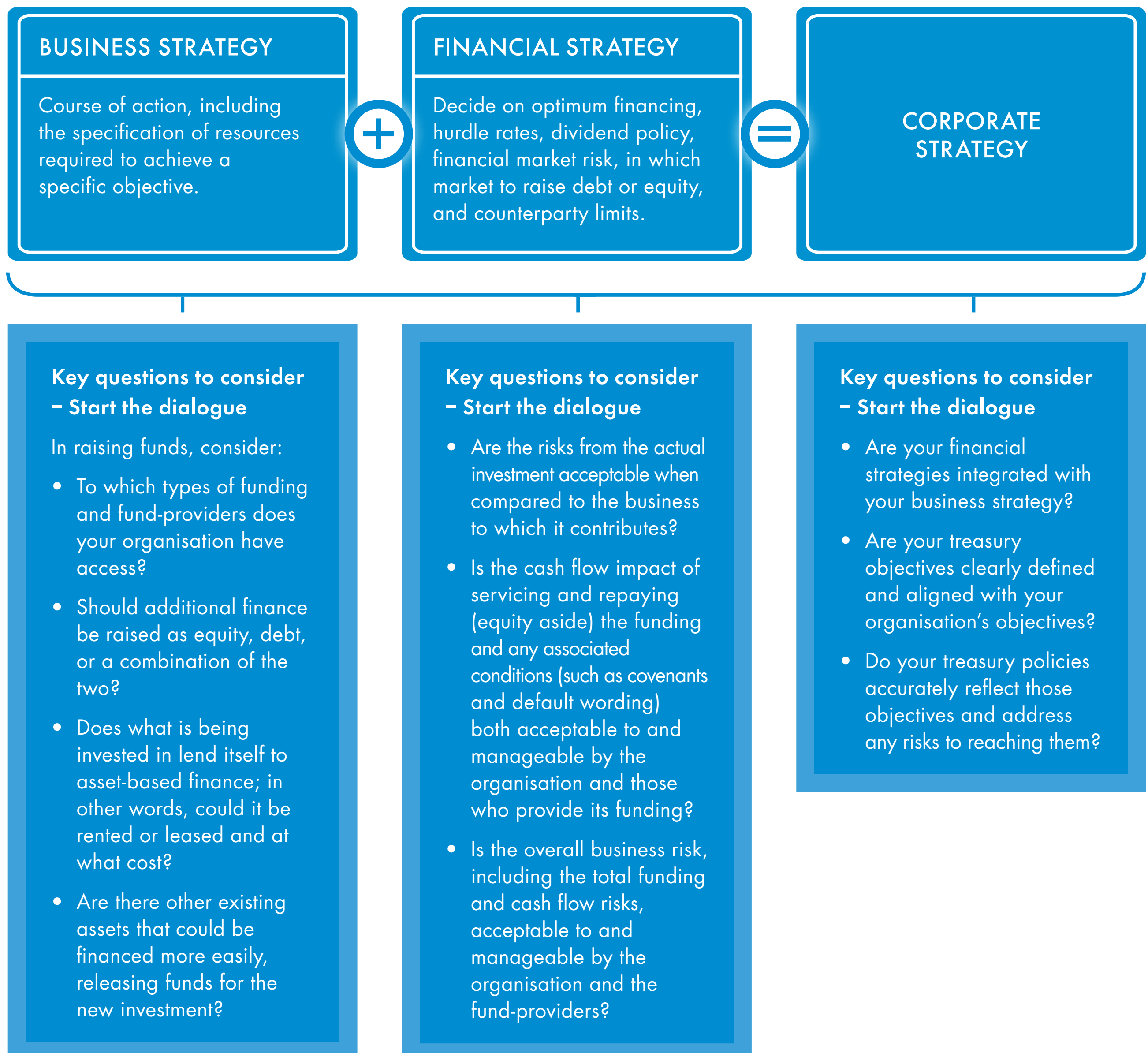
The answers to all three questions also depend on external factors, often interrelated, which can further increase uncertainty. Some strategic choices that may seem straightforward on the surface actually conceal unforeseeable consequences. Accordingly, judgement is constantly required – from the outset and as conditions change.

THE CHANGING TREASURY AND CASH MANAGEMENT LANDSCAPE

The banking landscape is changing dramatically. Individual banks' capabilities are shrinking. Banks' balance sheets and corporate credit have become finite resources which have to be used as cost-effectively as possible. Increasing regulation will continue to add to the costs of funding and hedging. These changes are driving increased complexity and reshaping the key elements of the treasury function.

The following sections identify and describe the key constituents of the modern treasury function's role.

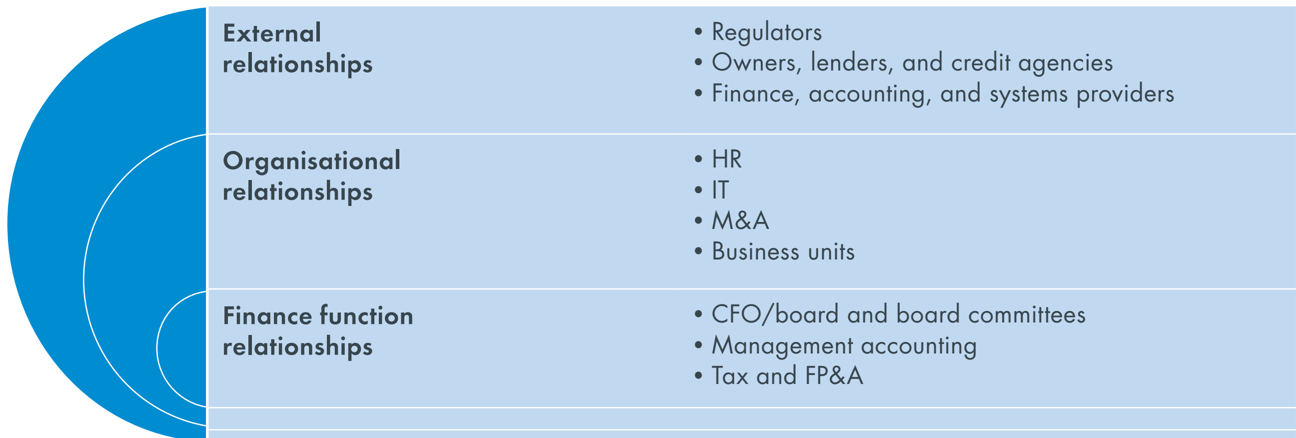
1. Treasury and corporate strategy



2. Business operations and stakeholder relationships

Effective treasury requires a thorough understanding of the organisation's business model and its industry.

Treasury interfaces with a range of business stakeholders, making it vital that the management accounting, tax, and treasury functions are all properly aligned and mutually supportive. To do its job effectively, treasury relies on building credibility and trust, throughout the business and externally.



3. Capital structure

Externally raised capital may be debt or equity, although hybrid structures can also be created.

Treasury has a fundamental role to play in setting an organisation's financial strategy, using the following three factors to assess the optimal financing solution:

- **Ranking of capital:** The ease and cost of financing.
- **Leverage:** How to measure and monitor the ratio of debt to equity.
- **Markets:** The diversity of sources and the maturity of financing.

4. Cash and liquidity management

Liquidity means access to cash. Its management is the most fundamental element of treasury management. If it fails, the organisation cannot continue to function.

The key tools for managing liquidity are:

- **Cash management:** Using cash generated by business operations, cash surpluses retained in the business, and short-term liquid investments to ensure that payment obligations can be met.
- **Working capital management:** Managing supplier payments, receivables, and inventories to optimise the investment in working capital.
- **Organising and managing borrowing facilities:** Using cash flow forecasts, building in planned/required new funding and maturing funding that must be repaid or refinanced.

Cash management components

Component	Description
Day-to-day cash control (including intra-day where necessary)	This involves having the information to monitor bank account balances and the tools to manage liquidity so that the organisation has enough cash or near-cash resources to meet its immediate obligations.
Money at the bank	Building an efficient bank account structure that minimises overall borrowing costs, maximises overall interest earned, and facilitates liquidity management.
Receipts	This requires the maintenance of bank accounts that are optimised for collection streams and an efficient infrastructure for managing items during collection.
Payments control	This involves maintaining bank accounts that are optimised for making payments, whether routine or urgent, together with appropriate systems support.
Short-term investments	Optimising the use of surplus funds by making short-term investments.
Short-term borrowings	The use of borrowing facilities to cover immediate funding shortfalls.

5. Treasury operations and control

Treasury operations are exposed to particular risks such as fraud, error, and failures of markets and systems. They are particularly susceptible because of the large amounts of money involved, their ability to make payments, and the potential complexity surrounding their activities.

Segregation of duties is designed to prevent fraud and detect errors. It is an essential approach that means no transaction or payment, internal or external, is ever carried out without at least one other person knowing about it. This is a general principle in the treasury function, meaning those executing and recording transactions may not confirm or settle those transactions.

6. Treasury and financing risks

Treasury and financing transactions are subject to a number of risks and consequences that are important for management and boards to understand. These include:

- **Interest rate risk:** If interest rates rise, borrowers will pay more interest. If they fall, depositors will earn less. However, there are more facets than this to interest rate risk.
- **Economic foreign-exchange risk:** The risk of a change taking place in the value of an organisation due to varying exchange rates. The largest component is sometimes called “strategic foreign-exchange” risk, which arises from any consequential changes in the organisation’s competitive position.
- **Currency/commodity transaction risk:** Pre-transaction risk arises when an organisation has to commit to a price before actually entering into transactions or commercial agreements. Transaction risk is the risk that changes in FX rates may make committed cash flows in a foreign currency worth less or cost more than expected.
- **Foreign-exchange translation risk:** Results from exchange differences that arise when consolidating foreign currency assets and liabilities into the group financial statements. This is not a cash exposure but an accounting issue, and it is therefore often not hedged by the organisation.

7. Financial risk management and risk reporting

Corporate finance theory suggests that the value of an organisation can be increased if its risk (the uncertainty of returns) is reduced.

ISO standard 31000-2009 defines risk as the effect of uncertainty on objectives. Risk can present opportunities for or threats to objectives. An uncertainly that does not affect objectives cannot be a risk to those objectives.

Key questions to consider – Start the dialogue

Management accountants must be aware of the overall approach of the organisation to financial risk management and be able to answer the following questions:

- Has the organisation properly articulated its management approach to threats and opportunities?
- Hence, is there capacity to take certain risks?
- If so, is there an appetite?
- How much of this appetite can be delegated to the treasury function?

Responsibility for managing financial risk often resides with the treasury function. Treasury activities must be included in the organisation's management information as well as, where material, to the market.

8. Accounting standards

An important feature of accounting standards is how quickly they change – and they change faster in treasury than in almost any other area.

Changing standards can have a major effect on covenants in loan agreements. A change might alter how some ratios are calculated, and these changes might possibly cause a loan default. For this reason, the standards in place at the date of the loan agreement are used to calculate covenants (in a process known as "frozen GAAP"). Multiple sets of accounts may be required as a result, one to meet IFRS and the other(s) to comply with various loan agreements.

CONCLUSION

Nearly a decade on, the global financial crisis continues to have an impact on business everywhere, increasing the need for effective treasury practice. Financial markets are now more volatile as risks, such as financial counterparty risk, have increased and traditional funding sources are changing.

Not all boards and senior management fully understand what a treasury function should be doing. Management accountants, more than ever before, must proactively understand treasury requirements and be prepared to engage the treasury function. They are particularly suitable for this role. They have advanced analytical abilities. And they are well placed to identify and exploit those technology and market trends that support future best practice and meet emerging business needs.

Further resources

This report is based on our series exploring treasury and cash management. To find out more, visit **cgma.org/treasuryessentials.**