

Best Practices in a Changing Economic Environment



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Over the past year, treasurers in both the private and public sectors have been struggling to help their organizations navigate the most brutal financial market conditions the United States has experienced in decades. In addition to responding to unprecedented market events—the collapse of Bear Stearns, the bankruptcy of Lehman Brothers, unmatched volatility in the public and private markets, and a global recession—treasurers are seeing markedly increased demand for information and oversight not only from external stakeholders, but also from their



Meeting the Challenges of Timeliness and Transparency

own internal constituents, in particular, their executive management teams, and auditors. These factors have all contributed to highlighting risk awareness with more organizations recognizing they must have a consistent approach to risk management—for their practices are all receiving greatly increased scrutiny.

Above all, the extraordinary financial environment of the past several months has brought the issues of timeliness and transparency to the fore. Demand for accurate and timely data on financial positions has increased, but information is not readily available as assets are often held in multiple accounts and locations; recorded on separate and non-compatible reporting systems; accounted for using multiple methodologies; and captured using disparate manual processes.

At Citi, we work with corporate and institutional clients from around the world. Based on our experience listening to clients


and helping them find solutions to some of the top challenges they face, we invite you to take a look at a number of best-practice solutions that they have implemented to address their concerns.

Timely information is key

By far, the principal challenge for treasurers is having access to timely information. The depth and extent of market events often outpace the frequency investment information is updated and available across treasury groups for prudent risk management. For example, the increased incidences of credit ratings changes has made keeping current even more difficult. In turn, these rating changes can also delay downstream processes, such as the production of timely accounting reports.

Actionable best practices:

- Establish procedures to update firm-wide cash and investment portfolio information and ensure it happens more frequently than during monthly or quarterly accounting cycles. A best practice would be for more than 95 percent of all holdings to be updated on a daily basis, or on a weekly basis at a minimum.



By implementing these best practices, treasurers will be empowered to achieve their overriding goal: a comprehensive, accurate and up-to-date view of current and future organizational cash flows and be better positioned to drive efficiencies.

Comprehensive cash visibility

Today, cash is typically held in disparate locations and the organization's financial records are often stored in myriad internal and bank-provided systems. Data needs to be compiled, rationalized and analyzed from many different sources. As a result, treasurers often lack complete visibility over cash positions. It is difficult to aggregate the information in a timely fashion so that effective daily cash positioning, deal determination and execution can take place efficiently.

Actionable best practices:

- Warehouse all cash and investment information in a centrally accessible system location
- Use automated interfaces to pass information in a timely manner into the central warehouse where multiple systems exist and must be retained
- Extend daily information capture to all bank balances, investment positions, and debt positions
- Use automation to gain consolidated views of information in a consistent and defined method. Data should be visible at the single account level, in aggregate across each business unit or by geographic region, and across the entire organization.

Cash flow forecasting a priority

Besides current cash positions, treasurers need to have an understanding of anticipated future cash flows for proper planning. The risk of poor cash flow forecasting practices is greater today, given the higher cost of, and lowered access to, liquidity.

To obtain a complete picture of organizational cash flow requires gathering and consolidating information from commercial operating activity (e.g., cash flows from anticipated receivables and payables); from treasury deals (e.g., maturing foreign exchange and money market activity); and from corporate investment and financing activity (e.g., cash flows related to long term investments, capital purchases, and dividends). This data is often not readily available for a variety of reasons: treasury departments are chronically understaffed; forecasting is typically not an organizational priority outside treasury; and, the raw data needed to develop forecasts resides in many different systems.

Actionable best practices:

- Ensure forecasting becomes a priority for the organization by gaining CFO-level attention and support; and, by educating key partners in other financial business units, e.g., the accounts receivable and the accounts payable functions
- Move the automated capture and transfer of information from the company's Enterprise Resource Planning (ERP) systems into a centralized corporate treasury management system. Realistically, many companies will be some distance away from being able to deploy such a fully integrated approach. In that case, the short-term focus should be on streamlining information capture and communication across the organization by deploying online, real-time workflow solutions
- Once the information is captured, deploy analytics to identify buckets of cash (working capital and strategic cash reserves) that can be positioned to take advantage of movements in the yield curve.

Streamlining accounting practices

Duplication of information entry, which can be enormously time consuming and resource-draining, is often required to ensure that the proper financial information is present in all the required systems (i.e., general ledger entries). In addition, any restatement of accounting documents due to errors or misstatements can be very costly, and multiple data sources providing disparate accounting calculation methods can make consistent accounting practices difficult.

Actionable best practices:

- Clearly define a single set of documented, consistent accounting assumptions to be used across all accounts
- Create account consolidations across multiple accounts and account locations, to more efficiently apply consistent accounting assumptions
- Reconcile information on a frequent basis (i.e., daily) to ensure issues are quickly identified and resolved before manifesting themselves as errors in financial statements at period-end
- Develop automated feeds of financial data to underlying systems (i.e., general ledger).

Summary

By implementing these best practices, treasurers will be empowered to achieve their overriding goal: a comprehensive, accurate and up-to-date view of current and future organizational cash flows and be better positioned to drive efficiencies, an objective that is increasingly a requirement in today's dynamic market. ■

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Furthering organizational best practices

The current economic environment is challenging and perhaps the most risky that firms have ever experienced, but it has only reinforced the need for establishing best practices throughout the organization, including the firm's investment managers. To more effectively manage assets, address fiduciary responsibilities and fulfill reporting requirements, most firms are more likely than not to have investment managers as part of the treasury team. Now, more than ever, they too need direct access to accurate and timely information and analytics on their firm-wide investment portfolios.

By working to understand the challenges; identifying best practices; and, using the latest technologies available in the marketplace, investment managers can increase efficiency and flexibility while also achieving the control and the oversight they need to manage investment portfolios. To help them achieve these goals, we have identified five best practices:

1. Monitor credit ratings of issues

Traditionally, credit ratings are tracked pre-trade, without frequent monitoring of post-trade credit ratings, which can fluctuate. Because of the credit crisis and the increasing frequency of ratings

changes, treasurers need to be more vigilant and be ready to respond to announcements of ratings agencies; i.e., upgrades, watches, downgrades, and outlooks. To complicate matters, credit ratings may be captured but fragmented across multiple accounts and asset locations, and multiple rating agencies may not issue consistent ratings of a single holding.

Actionable best practices:

- Automatically receive updates on ratings from multiple rating agencies (e.g., S&P, Moody's, and Fitch)
- Develop a clear procedure in the case of split ratings
- Track both ratings and rating agency watch information, preferably daily and, ideally, intraday
- Create a consolidated view of ratings across all investments, tracking them post-trade
- Maintain documented procedures to be followed if ratings fall below the acceptable level; maintain an auditable log

2. Factor duration into the risk equation

Historically, duration, the percentage change in a bond's price when interest rates move up or down, has been viewed in isolation and not in conjunction with other risk characteristics. Hence, duration may not be viewed consistently across multiple accounts and asset locations. With multiple data sources, different calculation methods may be used for duration, making valid comparisons between securities difficult.

Actionable best practices:

- Create a consolidated view of duration information across accounts with a consistent, defined calculation method used (e.g., effective duration)
- View duration in conjunction with credit rating information to show a consolidated picture of risk
- Maintain duration information both at single account and at aggregate account levels across all asset locations

With organizations merging or being acquired, changes in issuer exposure are occurring more frequently.

3. Manage issuer concentration

Issuer concentration has long been a standard consideration in an investment policy. Today, however, following the collapse of Lehman Brothers along with the failure of banks that had to be bailed out by the government, there is increased urgency to limit exposure to any single issuer and closely monitor ratings changes. Adding to the institutional portfolio managers' challenge, with organizations merging or being acquired, changes in issuer exposure are occurring more frequently. This activity leads to increasing risk inquiries from multiple constituents (e.g., board members, analysts, institutional investors) that must be considered. Finally, views of issuer concentration are fragmented across multiple accounts and asset locations, and, as a result, are difficult to track.

Actionable best practices:

- Use automated sources of information to track the ultimate issuer, rather than relying simply on the security description or the security identifier
- Create account consolidations across multiple accounts and account locations, enabling a holistic view across all assets
- Track issuer concentration, ideally, on a daily basis

4. Ensure investment policy compliance

While institutional managers are held responsible for ensuring compliance, they are often faced with investment policies that may contain contradictory guidelines, and policies that often span multiple control areas (e.g., risk, performance and accounting). Investments that exist across multiple accounts and asset locations are difficult to track in a consolidated manner, especially when monitoring is completed manually or only on a periodic basis, e.g., monthly or quarterly.

Additionally, investment managers are faced with demands for improved timeliness of information; demonstration of robust procedures to rapidly identify when policy violations occur and to implement appropriate responsive actions; and, even independent verification of compliance performance.

Actionable best practices:

- Review existing investment policies to ensure rules are clear and consistent and properly reflect current investment strategies
- Monitor investment policy rules, both at the individual account level and at an aggregate level across all accounts
- Monitor investment policy compliance daily on a post-trade basis and independently of any pre-trade compliance processes that exist
- Maintain a historical record of daily compliance violations, and the actions and time taken to resolve them in accordance with pre-approved internal guidelines

5. Benchmark investment results

Institutional investors must measure results—from both a performance and a risk perspective—against the appropriate benchmark. However, this seemingly straightforward responsibility is a challenge for several reasons: investment strategies may differ from account to account, requiring disparate comparisons; accounts are often managed by multiple managers, either internal or external, or both; performance must be determined independently of manager-provided return information; and increased visibility over historical performance is required at more discrete intervals (i.e., daily and monthly, in addition to quarterly or yearly).

Actionable best practices:

- Derive performance and risk information independently of investment managers, in many cases integrated with accounting information
- Clearly identify an industry benchmark, or a hybrid benchmark, for each account
- Monitor accounts per their benchmark on a daily basis to uncover deviations between the benchmark and the account both from a risk and performance perspective
- Maintain historical performance information alongside current performance numbers to identify trends