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What's a steam engine? Or: how digital is your treasury?

Corporate Treasury

Just as in the German movie "Feuerzangenbowle" (here's a link), these days, the often repeated question is: what is digitalization and what could it mean for treasury?

The answer is more important than initially suspected, as all the world seems to be talking of nothing else these days. Analysts ask CFOs what kind of digitalization projects might be in the pipeline and how this will affect the bottom line. Senior management is asked what blockchain could mean for the company or whether the company should be using cryptocurrencies. Employee representatives demand that bots cannot work 24/7 but only from Monday through Friday, 9-5. Now, if you don't know what a bot is, you are most likely in good company. However, you will find out at the latest when manual treasury activities are replaced by computer programs that more or less process repetitive tasks in an automated fashion, without any need for human intervention.

So here is a definition of digitalization in treasury that is fairly close to the generic definition of digitalization:
"Digitalization in treasury is the changing and optimization of processes and methods as well as the comprehensive use of data, which increasingly takes places with the help of computer-based user interfaces and software."

For the non-nerds (also known as digital immigrants to some) among you: a computer-based user interface is the point in a process or the action where a human interacts with the machine. On the simplest level, this could be your keyboard – it is neither human nor really part of the machine (in this case, your PC) but is an interface between the two. Another one could be the touchscreen on your smartphone or tablet or the intelligent assistants, such as Alexa, which are also computer-based interfaces. In the (far-off?) future, this could also be virtual reality goggles, with which the CFO could move around the reporting room, pulling up reports with a look, or it could also be a device that records your thoughts, passing them on immediately to your Treasury Management System.

But let's start in the here and now and leave the future for a bit. The definition of digitalization in treasury mentions change and optimization. And here, in our humble opinion, lies the crux of the matter what digitalization means for today's treasury: the adjustment and optimization of existing process and methods with an increased use of data with the goal being an improvement of process results (quality, degree of automation, acceleration). Automation, improved performance and data centricity are therefore key terms as far as the digital change in treasury is concerned. However, something else that should not be forgotten is the 4th dimension, i.e. Compliance. Because there are also completely new possibilities in this regard: the efficiency of internal and external questions of compliance, not to speak of the required resilience against the ever increasingly dramatic threat scenarios coming from cyber criminals. When speaking of digitalization, one of the aspects that always needs to be kept at the back of the mind is the cost/benefit ratio: just because we are digitalizing the department does not mean that commercial rules of thumb no longer apply.

When speaking of renewals in and around treasury, the questions of how relevant its implementation is and what kind of added value is being brought to the table should never be forgotten. This means that the question needs to be answered whether the use of a specific technology or procedure will truly be an advantage in comparison to the one used now. The truth is that intensively researching innovative topics (let's say, blockchain or the use of cryptocurrencies in treasury) will gobble up valuable resources. Therefore, the question whether the results will then make a difference should be answered early on.

In the current Treasurer Panel there is a lot of talk about the use of mobile solutions or cloud technologies, which are paraded as examples of an increase in digitalization. However, the jury is still out on that. Of course, mobile access to a TMS or treasury reports brings with it a certain flexibility and maybe even an increase in efficiency. But what kind of progress is it for treasury if the reporting is just as static (and in the end, unsuitable) on your smartphone as it is today? How is treasury and its tasks and objectives optimized if the TMS is not located on the premises but in a cloud? Maybe moving the server might help IT save some costs but will not really have much of an impact on treasury. These two examples should make it clear that it is hardly the technology that adds value and which should therefore be part of the digitalization strategy but rather the services that build up on this and usage cases in the context of treasury's own roadmap.

So how can treasury become digital? And how can you tell whether you have been barking up the wrong digital tree? How should you define your current digital maturity, the starting point for all further considerations on what measures to take? In the end (and this may sound quite banal but is the truth and nothing but the truth), the next steps in your personal treasury digitalization roadmap always depend on how digital you are already now. Remember that the path from making payments with payment slips to using blockchain is long (and maybe rocky) one.

In order to determine the initial situation, one of course doesn't require an attitude just like in the movie mentioned above ("let's play dumb for a moment"). In order to do some self-reflection, we have composed a couple of questions which ideally, you should answer with yes, before you give digitalization any further thought:

1. Is your treasury reporting (from work reports to management reports up to your Compliance reporting) automated and does it comprise complete data sets?
2. Is your bank account structure optimized and are the entire payment operations (internal and external) processed through a centralized platform using standardized formats and communication channels? Turning this around, do your bank accounts across the world send you electronic bank statements and are daily liquidity balances and movements transparent?
3. Are you basing yourself on a complete risk position when managing financial risk positions (especially for currency exposures)?

I will not ask about a fully functional TMS and a related truly straight-through processing or being able to generate the financial status at the press of a button, as this should be the standard at this point. Or is it?

Irony aside, all of this means that there is a lot of homework to be done before the next level of digitalization can be achieved, because it is only once the possibilities and potentials of solutions already available today are leveraged to the maximum that it makes sense to take the next step. Even if a treasurer's top-most duty should be to observe innovations and technology trends, including the offering of external service providers, such as fintechs, the focus should still be on the optimization of own processes and system landscapes. Do not dream of robotics in treasury if your TMS can do most tasks using a job scheduler as a routine and automated already now. Are you thinking of artificial intelligence to prevent fraud in payment operations but also are also using 50 different electronic banking systems globally? You probably just realized the problem yourself. Therefore, the conclusion should be: what is already possible now and how can you get your horses on the road with the available treasury solutions? It is only once these questions have been answered that further thoughts pertaining to blockchain, cryptocurrencies and self-learning systems in Treasury make any sense, adding value. Seen like this, the definition of digitalization for treasury could be quite different: i.e. implement the technologies you missed in the last few years because in fact, they can do a lot already!

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Shared Services

Why not also for Treasury?

Corporate Treasury

Digitalization is becoming more and more pervasive – be it in our private or professional lives. The transformation of corporate processes, which is already being implemented in many cases, also encompasses Treasury, changing the requirements placed on Treasury's operating model and its employees.

However, while for instance in research and development or production, the implementation of digitalization processes and thus the digital networking of all those involved in the process has become essential for a company's competitiveness, the main driver in the central administration will be the improvement of the financial processes' effectiveness and efficiency.

In addition to the proven aspects of process optimization (e.g. eliminating redundancies, standardizing processes), the finance department also has a further measure to increase effectiveness and efficiency: the (internal) outsourcing or bundling of processes in shared service units. While the establishment of shared service centers in financial accounting, human resources management and travel expense accounting has become quite standard as far as optimization in the finance department is concerned, shared service attempts in treasury management are still quite rare. This may be due to not recognizing the potential or fearing the loss of control when outsourcing processes. But is this attitude justified? Shouldn't the structuring principles that apply to the financial organization in general also apply to Treasury?

Shared Services in Treasury – What does this actually entail?

The general perception is that the quality of results and performance measurability for these processes and activities can be increased by centralizing processes when implementing a shared service unit and the associated bundling of expertise and alignment of the organizational purpose. At the same time, there is a shift in focus in the divested areas from generally manual, repetitive activities to more complex, value-creating activities. That sounds like a win-win situation! Why not also use it for the Treasury function?

Before doing anything, the following question should be answered: Which Treasury function processes are even suitable for outsourcing to a shared service unit? The answer here is the same as for other business functions: The more standardized, repetitive and automatable a task is, the more suitable it is for outsourcing. In general, the task areas can be arranged hierarchically according to their outsourcing potential:

What does this mean for Treasury? Treasury processes can be easily assigned to the categories shown in the diagram. Typical transactional activities that are generally suitable for outsourcing can be found in the following processes, for instance:

- Cash management, in particular bank account management, bank statement processing, management of liquid funds and payment transactions:
  The management of bank accounts (e.g. opening and closing of accounts, document management, administration of powers of attorney) is usually already highly repetitive and standardized, due in part to banks' formalized application processes. Examples of other largely transactional activities include the reconciliation of balances in connection with the management of liquid funds (incl. checking bank statements for their completeness), the monitoring of payment processes and the initiation of escalation measures in the event of irregularities, or the checking of denied parties in the course of checking payment files. Even the process of managing liquid funds can be outsourced, as it can be almost completely automated and controlled on the basis of rules.
- Transaction management, especially the settlement of financial transactions:
  In particular, many repetitive and standardized activities can be found with regard to the reconciliation of business confirmations (e.g. with a regulatory background for EMIR), processing of confirmations of fixing dates, checking and approving financial transactions or reconciling securities account statements.

Compliance? This is what you need to take into account

Particularly in the case of sensitive treasury processes, such as payment transactions, no unresolved issue may remain when it comes to compliance. Precise process models and service agreements must be formulated for each outsourced process. Additional agreements should be concluded with regard to specific treasury processes, interfaces and authorization roles. Finally, appropriate monitoring of the agreed-upon performance and process quality must be ensured.

Conclusion

The examples of suitable processes listed above clearly show one thing: these are core Treasury Management processes – which is why the outsourced processes must be smoothly integrated into a Treasury process model. This is made possible by integrating treasury management systems so that they enable the workflow-supported handling of business processes, distributing these spatially and over time.

In many cases, there is no profitable business case to be made for establishing a shared service center for Treasury processes on their own for lack of bulk. However, if a shared service infrastructure has already been established (and implementation costs do not have to be measured against treasury revenues alone), then a Treasury Shared Service unit quickly becomes an advantageous alternative. This is also in view of the fact that treasurers are increasingly having to deal with the subject of

standardization and automation anyway. It should not be forgotten that the standardization and automation of processes are critical to being prepared for digitalization.

The Shared Treasury Service concept is only a first step. In order to use economies of scale optimally, external service providers bundle treasury processes across companies – naturally, measures for data protection and data security are a matter of course. "Managed Treasury Services" is a concept we will certainly see and hear much more of in the future.

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IFRS 9

Effects on disclosures in the Notes on financial instruments

Corporate Treasury

IFRS 9, which is to be applied from 1 January 2018, has kept many companies busy in the last few weeks and months. In the projects, the changed classification of financial assets was analyzed and adjusted on the basis of the business model and the SPPI criterion, value adjustment models for financial receivables were developed taking expected loan defaults into account, and hedging relationships were analyzed and adjusted with regard to the changed requirements.

These changes in the accounting treatment of financial assets and liabilities also call forth extensive changes in the disclosures in the Notes to the financial statements. In addition to the innovations and amendments to IFRS 7, there are further disclosures in the year in which IFRS 9 is applied for the first time in accordance with IAS 8; these are meant to make comparisons with previous financial statements in accordance with IAS 39 possible for readers of the financial accounts. The requirements of IAS 8 are substantiated by IFRS 7/9.

The amended and extended Notes on financial instruments have not only been relevant as at the end of the financial year 2018. Disclosures in this respect were already necessary in the quarterly and interim financial statements in accordance with IAS 34 , even if there has been no adjustment to IAS 34. In the condensed financial statements, IAS 34 requires at least the presentation of the material IFRS 9-induced changes and their effects on the balance sheet and income statement. In accordance with IAS 34.15 et seq. these comprise significant events and transactions such as value adjustments for financial assets or changes to these. This will be relevant for most companies due to the expected credit loss model of IFRS 9. The transferability of the data to the previous year must also be ensured so that the changes in financial assets and liabilities can be tracked by the balance sheet reader. For this purpose, changes in accounting policies and the resulting (quantitative) effects on the company's net assets, financial position and results of operations must be disclosed. In accordance with IAS 34.16A, changes in estimated values reported in previous periods must also be presented in the interim financials. Irrespective of the conversion from IAS 39 to IFRS 9, the disclosures required by IAS 34.16A (j) of IFRS 13 91-93 (h), 94-96, 98 and 99 as well as IFRS 7 25, 26 and 28-30 must of course be made. In concrete terms, this means that a significant number of new disclosures must be made in the first interim financial statements in accordance with IFRS 9.

As in the 2016 annual financial statements, the expected effects of the conversion from IAS 39 to IFRS 9 in accordance with IAS 8 must also be presented in the 2017 annual financial statements. In the 2017 financial statements, this presentation will have to be more detailed than before and reflect the current status of the projects. ESMA expects companies to explain the expected impact on the

company and to provide quantitative estimates of this impact. Accordingly, ESMA and, as a consequence, the FREP has chosen to focus its follow-up audit of the financial statements for 2017 on the disclosures in the Notes on the expected conversion effects of IFRS 9. Companies should therefore take sufficient account of the preparation and presentation of these additional disclosures when planning the preparation of financial statements.

Summing it up, it can be said that the project does not end once the balance sheet implementation of IFRS 9 has been completed, but continues with the preparation of the Notes to the financial statements. To this end, qualitative adjustments must be made and new or amended data be collected in order to meet the quantitative requirements. As the Notes to the financial statements are relevant not only for the first complete annual financial statements in accordance with IFRS 9, companies should make the necessary preparations quickly if they have not already done so.