Communicating treasury issues to your board or shareholders

A special white paper from FEI Canada's Treasury and Capital Markets Subcommittee

Your board or company owner has asked you for a presentation on treasury issues.

What are the topics they care about?

What topics should they care about and how can you bring it to their attention?

What is the appropriate level of detail?

What is the right frequency and format for future/ongoing communication?

This article, prepared by Tyrone Cotie, Treasurer, Clearwater Seafoods, from FEI Canada's Atlantic Chapter, and Paul Stinis, Senior Vice President and Treasurer, BCE Inc., from the Quebec Chapter, provides some suggestions for these and other questions.

Please note in the following article the words board and shareholder(s) on occasion are used interchangeably.

Whether you are part of a public company with a board to report to or a private company with a shareholder or shareholders to answer to, treasury issues are critical and communicating them in an efficient and effective method is key to getting alignment and support on the organization's key treasury initiatives.

In fact, treasury should be always at the executive and board table when it comes to strategic, business, or operational decision making given the significant contribution treasury can provide in creating and/or protecting value. The priorities of treasury departments typically include: i) liquidity management; ii) minimizing the cost of capital; iii) business support; and iv) financial risk management.

Liquidity management

Liquidity management includes many treasury functions such as cash management, cash forecasting, bank liquidity lines and financing. Your board or shareholders may want to understand the controls that are in place and if they are achieving the expected results; understand covenants in loan agreements, the restrictions they impose on the business, circumstances that may lead to a default and actions being taken to mitigate a potential default. The board may also want to know how the business plan will be financed, assumptions made in developing the financing plan and some stress testing and/or contingency plan if assumptions do not materialize.

Minimize cost of capital

A key role of treasury is to minimize the organization's cost of capital. It is important to communicate how treasury accomplishes this goal. There are a number of ways this is typically done including continuous monitoring of the loan and capital markets for opportunities, ensuring a diversity of funding sources by market and type of instrument and through minimizing treasury administration costs.

Business support

The role of treasury in supporting the business and strategic initiatives should also be understood by your board.

This includes support or leading roles in matters such as structuring major contracts, mergers and acquisitions, capital markets strategy (dividend policy, capital structure, credit metrics, liquidity, investor relations) and actions and initiatives on cost reduction within treasury (including interest and other financing costs) or in the operations (e.g., improving working capital management), enhancement of controls and increasing flexibility.

In addition, treasury has a key role to play in adding insight and financial expertise to forecasting and budgeting cycles processes.

In addition to having a better understanding of treasury's initiatives, the board should receive confirmation that treasury policies and objectives are consistent with the strategic and business plan.

Financial risk management

The board should also be aware of financial risks faced by the business and the actions taken by treasury to identify and manage those risks.

Depending on the business, financial risks include interest rate and currency exposure, counterparty risk, pension plan surplus/deficit, and risk management and insurance programs.

While this is an obvious concern for public companies, it is even more true for private companies where shareholders and management teams may look to the treasury role for strong leadership.

One very practical, and visual (hence easy to understand) tool that can be used with private company advisory boards or executives are presentations of 12 month forecasts showing differing earnings scenarios and illustrating the impact on the company's balance sheet of those differing forecasts – i.e. impact on bank line margin availability, impact on financial ratio covenants, and how dramatically these can be impacted by performance, good and bad.

Frequency and detail of communications

The amount of time spent on various topics will naturally depend on priorities or issues of the organization.

If time does not permit discussing all relevant topics in reasonable detail, they can still be addressed by providing clear summary information that both explain the current situation and set the framework for future formal or informal discussions.

If possible, you should try to get your board's or shareholders' ear on a more regular basis as it gives you the opportunity to discuss a broader range of issues and in greater depth.

You will need to be respectful of the fact that not everyone is a treasury expert nor do they have an unlimited amount of time to devote to treasury issues.

In addition, although the materials and discussion should be free of jargon, the discussion should be framed in economic and treasury themes and perspectives. Accounting and other impacts should be presented, but should not be the main focus.

An example of proactive treasury in action

As you are presenting these issues you should point out the company's policies in each area.

If you do not have formal policies in each of the key areas you need alignment you should strongly consider working to develop company policies as they can serve as a very useful tool in obtaining agreement on key treasury alternatives and policies.

For example, if you do not have a policy on how much liquidity your company should have you will invariably migrate towards one of two options; too much liquidity and an inefficient capital structure or more likely, too little liquidity and a capital structure that does not tie into the company's needs.

Developing a liquidity policy should start with answering several questions:

- *What is the average and high/low leverage of peer companies?*
- *Do you have a seasonal pattern in your business that places more demands on cash resources?*
- *Are there particular risks that you should allow flexibility for in your capital structure?*

In April 2012 FEI Canada conducted a quick poll in which 81 FEI Canada members took part and responded to the question "One of the common measures of liquidity is the number of weeks cash, or room on revolving credit facilities, that an organization has to fund its operating expenses. On average, how much cash or room on revolving lines of credit does your company maintain?"

The majority of the responses (52%) maintain more than two months of liquidity, with 15% maintaining more than one month, 23% keeping two to four weeks and just 10% holding one to two weeks worth of liquidity.

Up to now we've discussed initial and special communications with the board. We would strongly recommend that you continue and expand your communication by formally meeting with the board at least once a year to discuss treasury matters. Interim reviews can be indirect (unless the matter is material enough to require more direct communication). For example, treasury issues related to an M&A transaction or business or strategic plan can be incorporated in the materials and discussions at the board.

In addition to matters identified above, this annual treasury meeting could also include:

1. An update on the capital markets: This can cover both debt and equity markets from a macro, peer and company specific basis. Quite often the company's external advisors (investment dealers) can assist in preparing this information. This can also be broadened to cover the economic environment, the bank and insurance markets, regulatory or other developments that can affect the company.

2. Treasury accomplishments of the past year and objectives for the upcoming year: The update could include key strategies, opportunities for improvements and the management of risk as well as ongoing improvements in electronic payments, where located, repatriation of cash, etc. and other treasury operation functions, renewal of credit facilities in light of market conditions, interest rate hedging strategy, etc.

3. Governance

    a. Key control processes regarding treasury related activities

    b. Policies and results re liquidity, leverage and key ratios, covenants, hedging, capital investments. This should include a sensitivity analysis for each key metric, presented in context with peer analysis.

    c. Counterparty risk: Quantify the risk with key lenders, swap counterparties, suppliers, and insurance companies.

    d. Formal signoff regarding compliance with named treasury policies (if not already part of the business plan).

4. Key relationships

    a. Institutional investor review: Update on key lender (banks and institutional debt investors) and equity investor relationships and profiles of each

    b. Rating agency review: Current ratings, perspective on industry, companies strengths and weaknesses, items that can results in an upgrade/downgrade

    c. Debt and equity analyst reviews: Update on company security pricing, analyst reports, valuation methodology, multiples, forecasts, etc.

5. Dividend policy and proposed dividend levels, cost of capital and capital structure considerations (including financial policies and excess cash distribution policies).

6. Resources: Address the adequacy of treasury's human resources (in-house competencies, deficiencies), systems and tools, how deficiencies are being addressed.

7. Other: Depending on the company and the treasurer's responsibility, the treasurer may be required to provide updates on pension plan management, investment management, enterprise risk management and insurance.

Don't forget the importance of ongoing discussions of treasury related issues with the company's executive. They should have an understanding of constraints that may affect them so they can be addressed in the early stages of strategic or business plans.

It's important for your executive to understand treasury's role in working with the various business units to execute strategy be it from funding capital projects to reducing foreign exchange risk.

You should consider having a short and focused update that you can provide to your Executive on a regular basis to ensure you continue to play a valuable role in driving growth in your business.

By having a dialogue with your board and executive and aligning treasury objectives and priorities with those of your board or key shareholder(s), you will increase the likelihood of success and the role and value of treasury in the company.