



 **ERNST & YOUNG**

Quality In Everything We Do

The 2006 Corporate Treasury Survey – Australia and New Zealand

Elevating your risk issues across the board



Risk. Let's talk.

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Executive summary

Analysing and reporting the results of the Corporate Treasury Survey is always an interesting and absorbing task and this year has been no exception. While many of the trends are anticipated and supported by anecdotal evidence, there are always some results which surprise, sometimes disappointingly so. Some examples of this are the drop in respondents measuring treasury performance, the decrease in documented treasury procedures, a fall in respondents with disaster recovery plans in place and the finding that half of all respondents don't report breaches of policy to their board. On the upside, we are pleased to see an increased participation of board members in risk management committees and generally improved reporting to the board.

Operational risk management has increased in status to second most important treasury function from fifth place in the past two surveys while interest rate risk management and foreign exchange risk management have slipped to third and fourth place respectively. Cash and liquidity, as always, remains the top priority for respondents and so it's not surprising that reporting of cash and liquid investments to the board remains high in this survey. Given the importance placed on cash management, it is not remarkable that cash flow forecasts are undertaken by almost all respondents. However, a somewhat lower proportion of respondents actually monitor actual cash flows against forecast. We are pleased to see respondents continuing to report that boards enjoy a good to excellent understanding of financial risks and exposures. In addition, board participation

in risk management committees continues to rise. However, it is disappointing to see little improvement in the quality of information provided by business units to treasury and that business units continue to have only a poor to fair understanding of risks and exposures.

There is no doubt that the responsibilities of a treasurer have never been more diverse as in recent years. An increase in responsibilities across all functions was observed with the exception of commodity price risk, with a decreased number of respondents reporting exposure to this in the current survey. Perhaps in anticipation of this broadening of responsibilities continuing into the near future, organisations have reported an expectation of increasing treasury staff numbers. Interestingly, a new question in this year's survey found that treasurers had not found it particularly easy to recruit appropriately qualified treasury staff.

A new section on treasury technology in this survey found that over half of all respondents use spreadsheets to record their treasury transactions. The percentage was even higher for other functions, with cash flow forecasting topping the list at over 80%. Given the extensive use of spreadsheets for recording and reporting on various treasury activities, we found it concerning that a third of all respondents do not have a disaster recovery plan in place. Respondents that use specialised treasury systems are more likely to have disaster recovery plans.

**“The mountains will always be there.
The trick is to make sure you are too.”**

Hervey Voge



Since the last survey, Australian companies (and some New Zealand companies) have adopted International Financial Reporting Standards (IFRS). Many respondents commented that meeting the requirements of the standards was the biggest issue for their treasury in the 2005/2006 year. However, the survey found that over 60% of respondents did not feel that the transition had impacted on their financial risk management activities suggesting that, despite the requirements, many were well prepared. Over 60% of respondents that hedge interest rate and foreign exchange risks expect to achieve hedge accounting. This is mildly surprising given anecdotal evidence suggesting this proportion might be higher.

Once again, in this survey, we asked treasurers to comment on what factors would drive change over the next few years and how they could improve their treasury operation. The answers were many and varied indicating the diversity of factors impacting on treasuries. Some of the more common factors included financial product innovation, competitive pressures, technology and corporate governance.

The Finance and Treasury Association and Ernst & Young wish to thank all those treasurers who completed the survey. We will be sending out benchmark reports to all those who requested them in the coming weeks.

Key findings

Financial risk management

Operational risk management has increased in prominence in this year's survey, becoming the second most important function, after cash and liquidity management. In previous surveys, it was considered the fifth most important function behind interest rate risk management, foreign exchange risk management and funding. Despite the increase, the survey has not shown a corresponding increased emphasis on performance measurement of treasury operations.

Organisations are increasingly undertaking exposure analysis such as 'at risk' and sensitivity analysis with a corresponding increase in reporting of this analysis to boards.

10% of respondents enter into speculative foreign exchange transactions either sometimes or on a regular basis. This compares to 6% in 2004. The main reason given for entering into these positions is to meet company objectives.

There has been a marked decline in the use of most instruments used to manage interest rate risk. Swaps remained the most popular instrument, used by 88% of respondents that hedge.

Dealing via the telephone remains the most popular method for transacting foreign exchange deals despite expectations of an increase in the use of bank dealing portals in past surveys. Notwithstanding, there is still the expectation amongst more than half the respondents that they will move to bank dealing portals in two years time.

Liquidity and funding

Almost all respondents reported undertaking some form of cash flow forecasting but only 84% monitor their actuals against forecast. Of those who do monitor, 60% claimed an average variance of 10% or less with 12% reporting a variance in excess of 20%.

Although the proportion of respondents with a policy on minimum liquidity reserves remains relatively unchanged at 58%, the minimum set level of liquidity reserves has increased since the last survey. The number of respondents with a minimum of less than 10% of debt has decreased to 35% compared with 43% in 2004.

There has been an increase in the average weighted maturity of debt compared with the previous survey. In particular, the survey shows a move out of the two to three year maturity range into the greater than five years range.

An increase in the use of multi option facilities and hybrids was the most obvious change reported in domestic borrowing sources. Overdrafts and bank loans are the most used domestic sources of funding. Parent loans are the most popular form of funding for those who use offshore sources (40%, 2004: 24%).

67% of respondents think their organisations could reduce working capital; 44% think a reduction of 10% is required and 23% want a cut of more than 20%.



Governance, reporting and control

The proportion of respondents which have risk management committees has fallen to 69% (2004:77%). However, of those, 70% (2004:65%) are board risk management committees.

The participation of the board in risk management committees has increased steadily over the last few surveys with more than 40% of respondents now having board members involved.

More organisations are reporting liquidity related information (cash balances, cash flow forecasts) than in previous surveys, underlining the importance of cash to directors. However, it is surprising that, similar to 2004, 50% of organisations don't report breaches of policy to the board.

The survey shows a substantial decrease in the proportion of organisations which measure treasury performance. This reverses the upward trend of the past three surveys and is only partly explained by an increase in the number of smaller organisations (less than \$500m revenue size) responding to the survey.

The level of dissatisfaction with information provided by business units to treasury remains high. Around 40% of respondents indicated that the information provided was either not timely or inaccurate. Also, business units' understanding of treasury related risks and exposures was rated as either fair or poor by more than 60% of respondents.

Treasury policies are being reviewed on a more regular basis. Almost 60% are reviewed at least annually compared with 40% in 2000. However, more than a third of respondents don't document their treasury procedures, a surprising increase on both the past two surveys.

The importance of segregating between key functions such as transacting and settling appears to have slipped according to the findings of this survey. Almost 40% of respondents don't segregate between these two functions compared to 23% in 2004.

Treasury structure and staffing

Treasuries are, in general, undertaking a broader range of activities than in the previous survey. The functions which show the biggest increases are equity raising, dividend policy and insurance risk.

Treasurers appear to be on the lookout for more staff as the survey shows a decreasing trend in one person treasuries with an expected increase in two to three person treasuries in future.

Only 7% of respondents who had recruited treasury staff in the past two years said it was easy to do so. 22% encountered a significant shortage of suitable candidates.

The recruitment of treasurers from outside the organisation continues to increase. 70% are now externally recruited versus 50% in 2000. The number of treasurers aspiring to the position of CFO or equivalent has also increased from previous surveys.

Survey data shows that treasurers working in the financial services, property and telecommunications and media industries are the most highly remunerated, while those in education and government are paid the lowest.

Treasury systems

51% of respondents use spreadsheets for their core treasury requirements. Surprisingly, 10% of these are organisations with revenues above \$1 billion which are more likely to perform a greater number of transactions per month.

Specialised treasury systems continue to fall short of providing the appropriate functionality or ease of use when it comes to cash flow forecasting. Spreadsheets are still the most commonly used applications for this important treasury function. Almost three quarters of respondents who use a treasury system do not make full use of its functionality.

40% of respondents who use spreadsheets for their core treasury functions do not have a disaster recovery plan (DRP) in place compared with 15% of specialised treasury system users. Overall, a third of respondents do not have a DRP in place compared with one quarter in 2004.



Accounting AASB 139/NZ IAS 39

Whilst the transition to IFRS has been burdensome to many respondents, over 60% noted no impact on their financial risk management activities. This would indicate that many were well prepared for the transition.

The issue most noted by treasurers in the past twelve months has been dealing with the requirements of IFRS. Respondents indicated significant time, staffing, and/or cost pressures associated with the onerous documentation requirements of hedge accounting.

Almost half of all respondents did not recognise or measure embedded derivatives.

Major issues, drivers of change and future directions

The main drivers of change reported by respondents were financial product innovation, business evolution, competitive pressures, technology and governance.

The impact of these drivers on a treasurer's role are anticipated to be the need for an increased skill set for treasurers, the need for treasurers to play a more strategic role in the organisation, and an increase in reporting/documentation.

Given the ability to change their treasury operations, treasurers indicated a need for more resources, improvements to technology, better relationships within the organisation in order to improve information flows and a wider range of risk management responsibilities.

“The pleasure of risk is the control needed to ride it with assurance so that what appears dangerous to the outsider is, to the participant, simply a matter of intelligence, skill, intuition, coordination... in a word, experience.”

William Arthur Ward

Financial risk management

Risk management approach

Management of operational risk has continued to increase in importance rising from 24% of respondents in 2002 to 47% in 2006 and is now the second most important treasury function. Consistent with previous surveys, the management of cash and liquidity is still regarded as the most important function and has risen to 90% (2004: 81%). The importance of both interest rate risk and foreign exchange exposure management has declined from the last survey. Refer to Chart 1.

The survey asked whether organisations were exposed to each particular treasury risk and if so, whether they hedged or not. Hedging of both foreign exchange and interest rate risks remains strong at 76% and 62% respectively (2004: 82% and 61%). One third of respondents had commodity price risk and the level of hedging reduced to 40% compared to 57% in 2004.

As in 2004, the two main reasons stated by respondents for hedging are to achieve certainty of cashflows, margins, revenues and costs and to protect the value of assets and liabilities.

The risk reward profile continues to be the most important factor in determining which instrument to use for hedging, closely followed by price i.e. 65% and 61% respectively

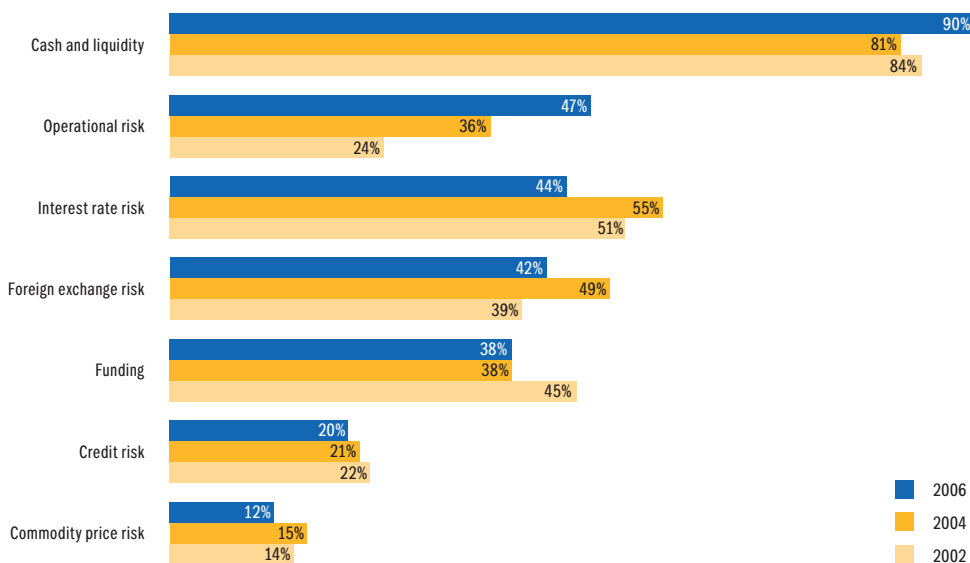
Other factors considered important are:

- market liquidity of the instrument
- accounting treatment
- ability to value the transaction.

However, the only factor to show an increase on 2004 (2006: 39%, 2004: 34%) is accounting treatment, most likely due to the requirements of AASB 139/NZ IAS 39.

Overall, speculative positions are never entered into by over 90% of respondents. Only 2% of respondents regularly enter into speculative positions with the main reasons being to meet company objectives and/or to generate cash/profit. For foreign exchange, 10% of respondents reported entering into speculative trades some of the time or regularly.

Chart 1 Most important financial risk management functions



Interest rate risk management

Hedging practices remain similar to the past survey with 69% of respondents hedging within a range, 21% hedging a fixed proportion of exposures and only 10% choosing to hedge all exposures.

A quarter of respondents had no predetermined time horizon used for managing interest rate risk. Chart 2 shows time horizons used by industry. The instruments used for interest rate

risk management are shown in Chart 3. This Chart shows marked declining trends in the use of various instruments since 2002. In fact, the only instrument which has maintained its role, albeit small, is the swaption. The decline in instrument usage reflects the lower importance placed by respondents on interest rate risk management compared to operational risk management. This is probably due to the relatively stable interest rate environment of the past two years.

Chart 2 Time horizon for interest rate risk management

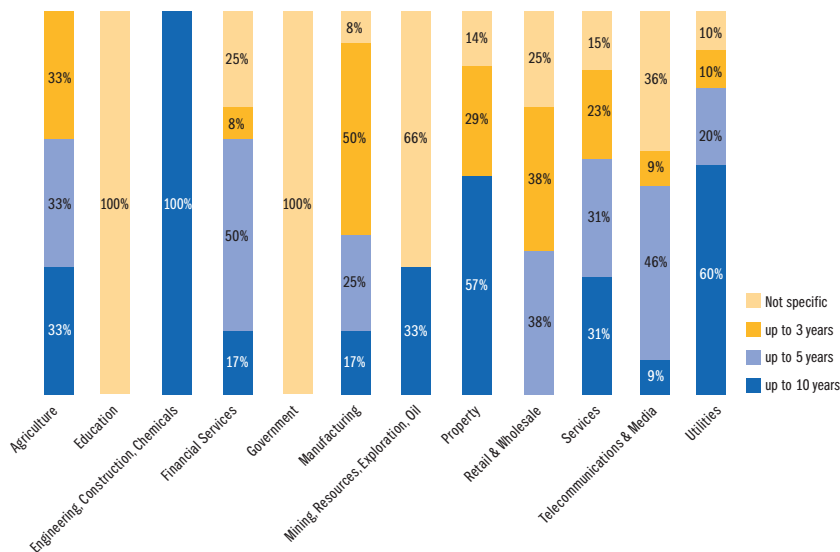
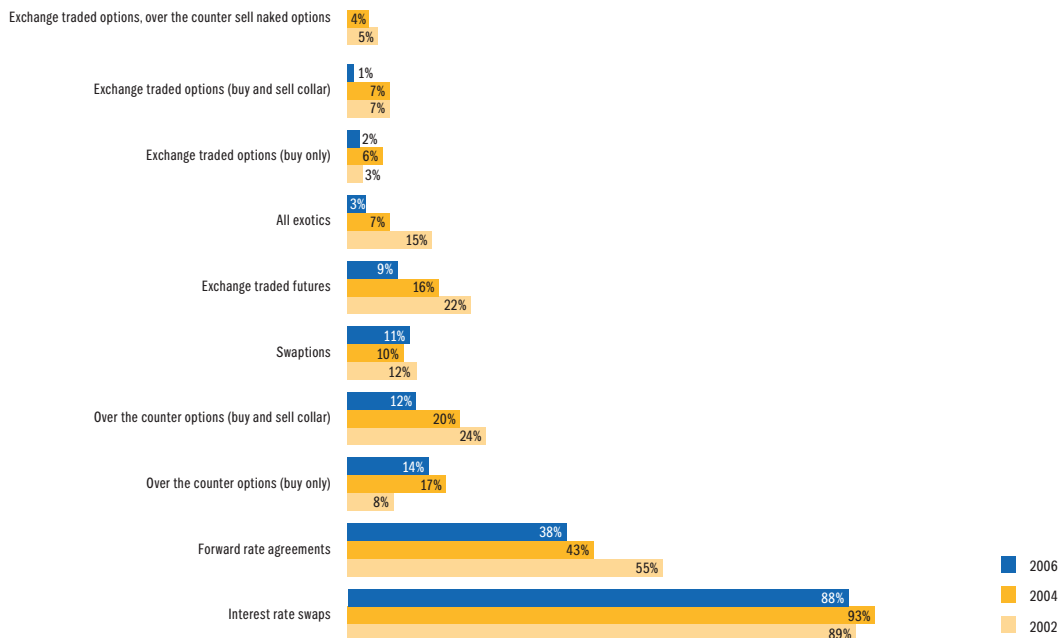


Chart 3 Interest rate instruments used



Foreign exchange risk management

Of those respondents who hedge their foreign exchange exposures:

- 8% hedge a fixed proportion (2004: 10%)
- 48% hedge a range (2004: 41%)
- 44% hedge everything (2004: 49%).

In addition, 57% of respondents have off-setting exposures and of these, 70% net them. Netting has declined for the past two surveys (2004: 77%, 2002: 87%).

Respondents were asked whether they apply the same policy parameters when hedging transactional exposures arising from capital expenditure and operating expenses. Among those for whom it was applicable, 71% indicated that they do (2004: 62%).

Chart 4 shows the time horizon used for hedging foreign exchange has decreased, compared to observations from previous surveys.

Chart 5 shows the instruments used for managing foreign exchange risks. The decline in the use of exotics has continued as shown in previous surveys.

Chart 4 Time horizon for hedging foreign exchange

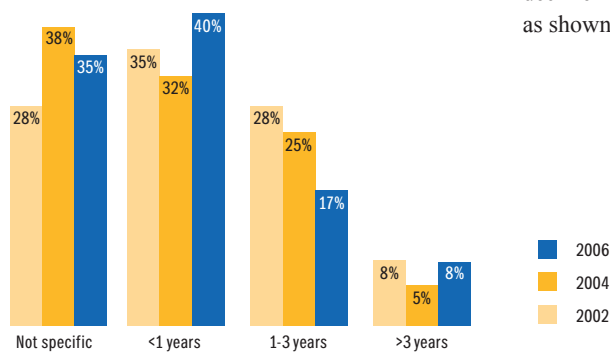
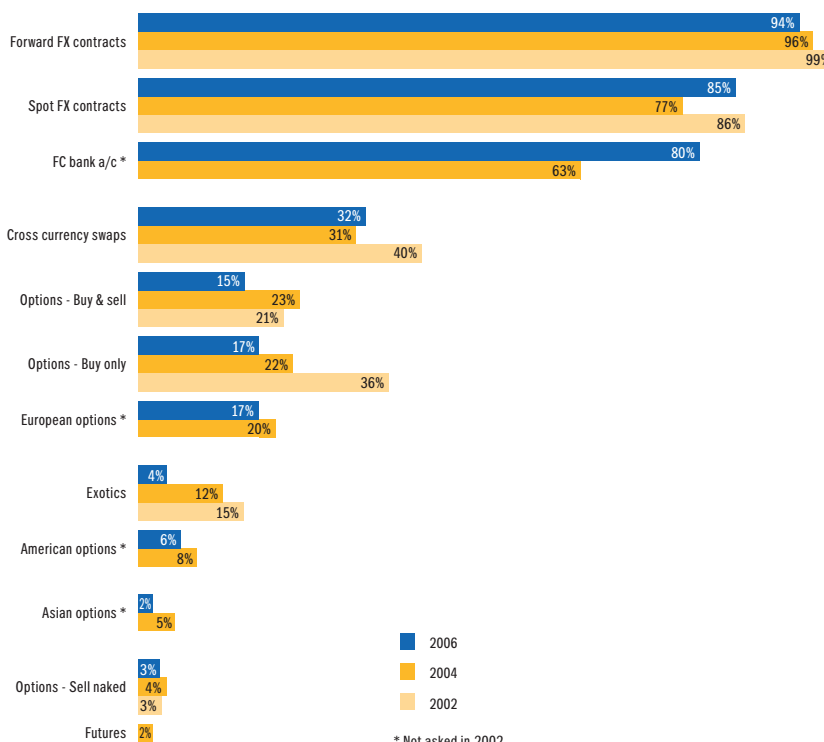


Chart 5 Foreign exchange instruments used



Dealing portals

In the 2004 survey, we noted that the migration away from the phone to bank dealing portals had not eventuated as anticipated in the 2002 survey. The current survey maintains the dominance of phone trading, unchanged at 76%. Compared with the past two surveys, there has been a reduction in the use of bank portals. However there continues to exist the expectation of a move away from the phone to the use of bank portals – a slightly greater level of expectation than in 2004 with more than half the respondents now expecting to use them in future, compared with 48% in 2004.

Management of foreign exchange translation risk

Respondents were asked whether they have foreign exchange translation exposures arising from offshore assets, such as investment in offshore subsidiaries, or from offshore liabilities, such as foreign currency loans. They were then asked to state how this exposure was managed. Results show that offshore assets are more likely to be naturally hedged, while offshore liabilities are more likely to be hedged with financial instruments.

The use of natural hedging is the most common form of managing translation risk. Deciding on the optimal amount of foreign currency debt remains the key issue. For those sourcing funds from offshore to manage translation risk on offshore assets, the following factors were stated as being drivers for the amount of foreign debt to source:

- thin capitalisation rules (81%, 2004: 35%)
- comparative value of interest rates (44%, 2004: 53%)
- the preferred gearing rate for the asset (30%, 2004: 41%).

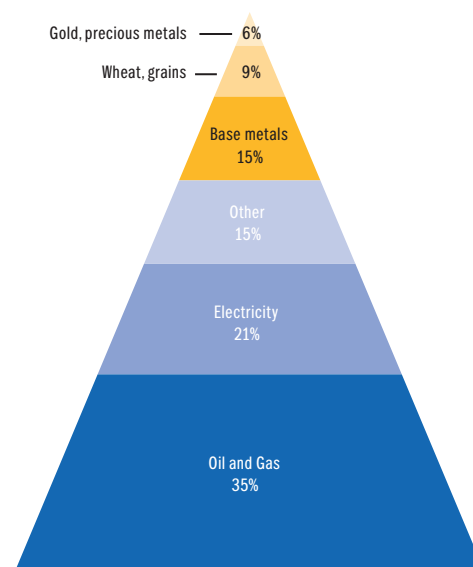
Commodity price risk management

Respondents were asked which commodity prices they were exposed to and whether they hedge all or part of their exposures. Chart 6 shows the percentage of respondents exposed to the various commodities. Overall, there was a reduction in the number of respondents who indicated exposure to commodities. The vast majority of these only hedge a portion of their exposure.

27% of respondents exposed to commodity price risk hedge up to one year and 40% hedge over a one to three year time horizon which represents a trend to hedging over a shorter timeframe. The proportion that hedge beyond three years has remained at 10%, as in 2004. The AASB 139/NZ IAS 39 requirements to ascertain ‘highly probable’ forecast transactions may be a contributing factor to shorter term hedging.

We note a decrease in the use of OTC options, reversing the trend shown in the 2004 survey. Minor changes have occurred in the use of other instruments.

Chart 6 Exposure to commodities



Credit risk

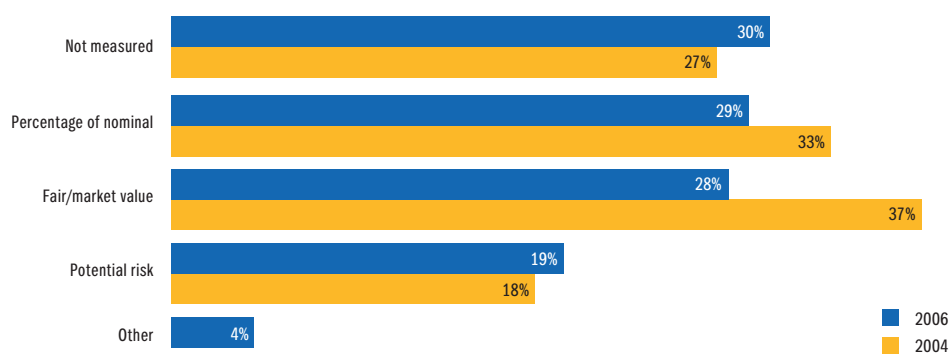
Nearly 60% of respondents monitor credit risk (2004: 66%) and as in 2004, 87% have a credit risk policy. Of those who monitor credit risk, the proportion monitoring on a real time basis, daily basis or less frequently are 14%, 28% and 59% respectively. This remains relatively unchanged from the previous survey.

The proportion of organisations using the various approaches to monitor credit risk is similar to prior years:

- 89% establish limits based on the credit rating of the counterparty
- 42% limit exposures to a particular amount for particular counterparties
- 7% establish country limits
- 3% set the percentage or number of transactions with any counterparty.

The approaches taken towards calculating credit exposures on derivative positions held by respondents are shown in Chart 7.

Chart 7 Calculation of credit exposure on derivative positions



Risk analytics

There has been a significant increase in the number of respondents who undertake ‘at risk’ and/or sensitivity analysis on their exposures. In relation to foreign exchange, ‘at risk’ and sensitivity exposure analysis has doubled in the last two years. The proportion of respondents undertaking analysis by exposure type is shown in Chart 8.

Among those undertaking exposure analysis, the proportion reporting the analysis to the board is also generally higher compared with two years ago. Chart 9 is clearly demonstrating a trend towards using ‘at risk’ for reporting exposure analysis to the board.

Chart 8 Undertaking of exposure analysis

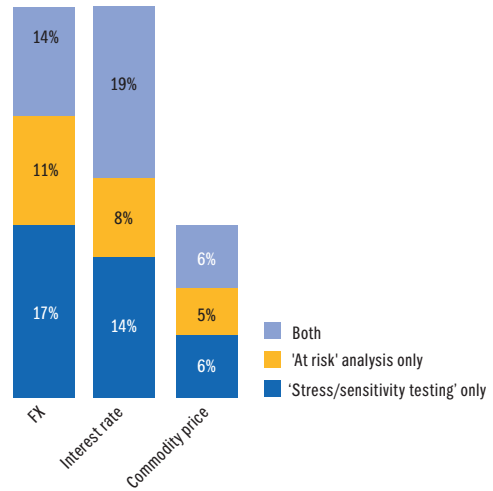
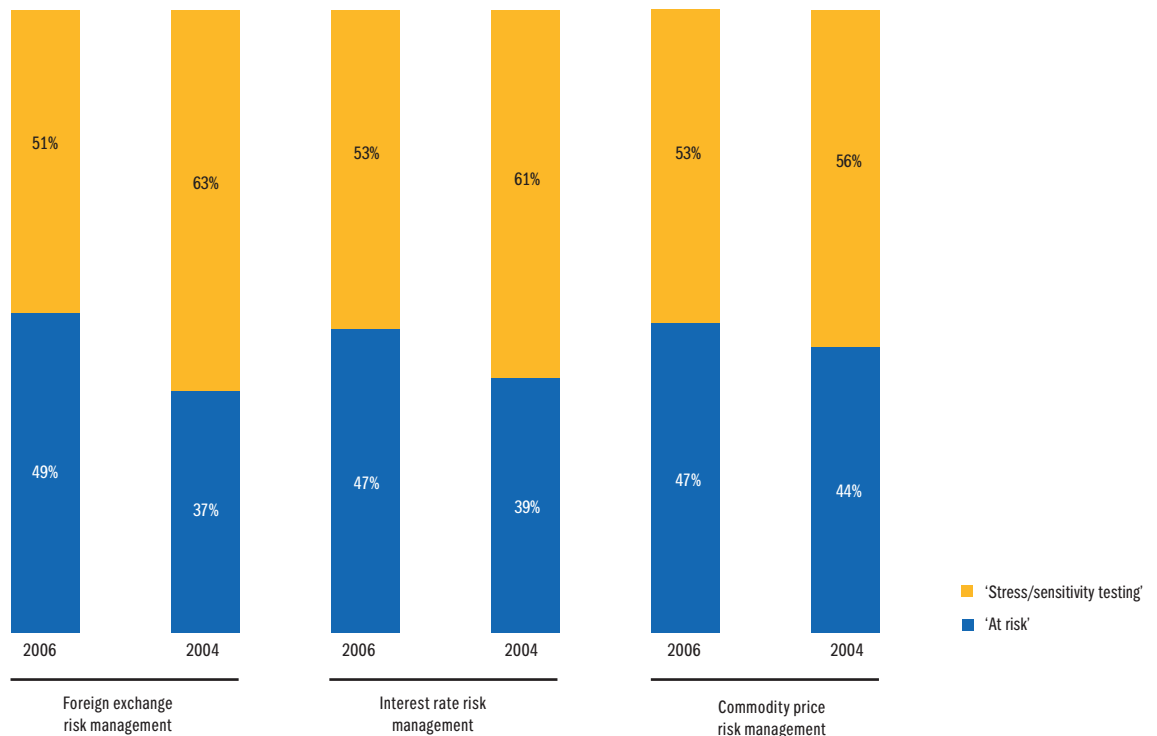


Chart 9 Risk analytics reported to the board



Liquidity and funding

Financial risk management

61% of respondents indicated that they have a liquidity policy, down from 70% in 2004.

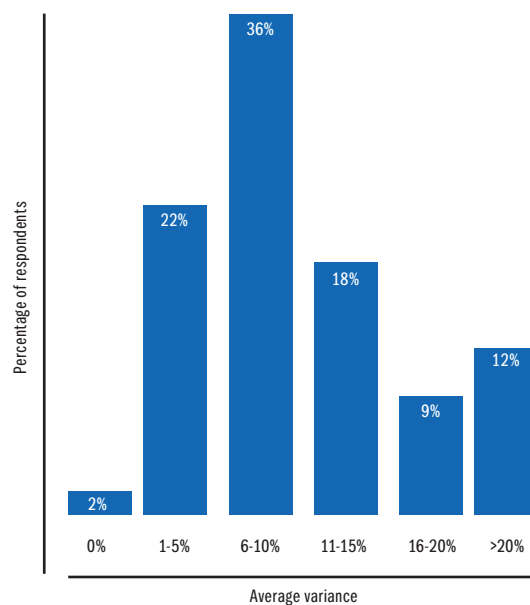
Respondents were asked to indicate the time horizon over which they performed cash flow forecasting and whether they monitored actual versus forecast. Approximately 35% of respondents undertake daily and weekly forecasting while 65% undertake monthly or quarterly forecasting.

The average variance of actual to forecast is shown in Chart 10. 84% of respondents monitor actual to forecast with 60% reporting a variance from 0% to 10%. 12% of respondents reported an average variance of greater than 20% to forecast. With relatively low

interest rates at present, variances above 10% may be acceptable. However, as interest rates move higher, greater accuracy with cash flow forecasting will become more critical.

The main method of sourcing cash flow data continues to be from a combination of verbal notification from the business unit and reports from financial support systems (52%). Fully integrated systems are used by less than 10% of respondents while business units inputting data directly into treasury models was indicated by only 2% of organisations.

Chart 10 Actual to forecast - average variance



Only 58% of respondents (2004: 56%) have a policy on minimum liquidity reserves. The actual minimum liquidity reserve level set has increased, with only 35% of respondents (2004: 43%) with a liquidity reserve level of less than 10% of net debt. Refer to Chart 11.

The factors listed by respondents as being important in determining the level of liquidity reserves required, is shown in Chart 12. Increasingly, organisations are citing growth reasons (either acquisition or expansion) as a rationale for their liquidity reserves.

The prospect of possible acquisitions (49%) has continued to increase and is now the second most important factor behind unexpected capital expenditure (59%).

The most common form of liquidity reserve remains cash or liquid investments at 68% (2004: 70%) while committed facilities and standby lines are also important at 57% (2004: 61%).

Chart 11 Minimum liquidity reserves set by policy

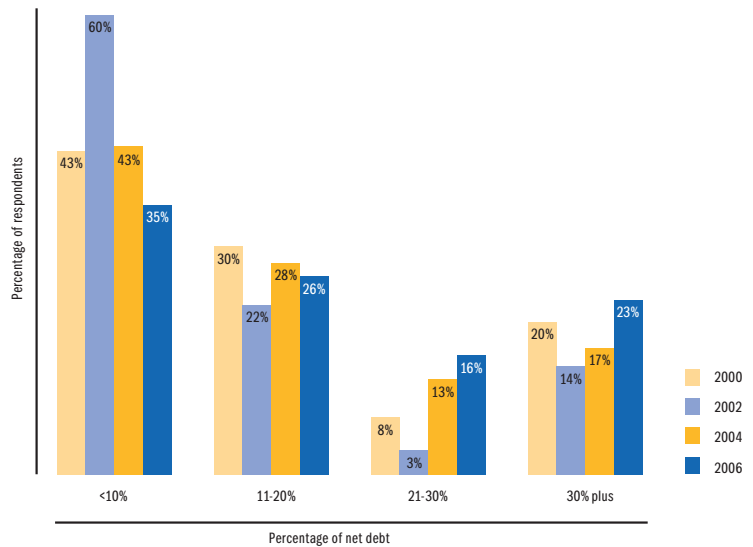
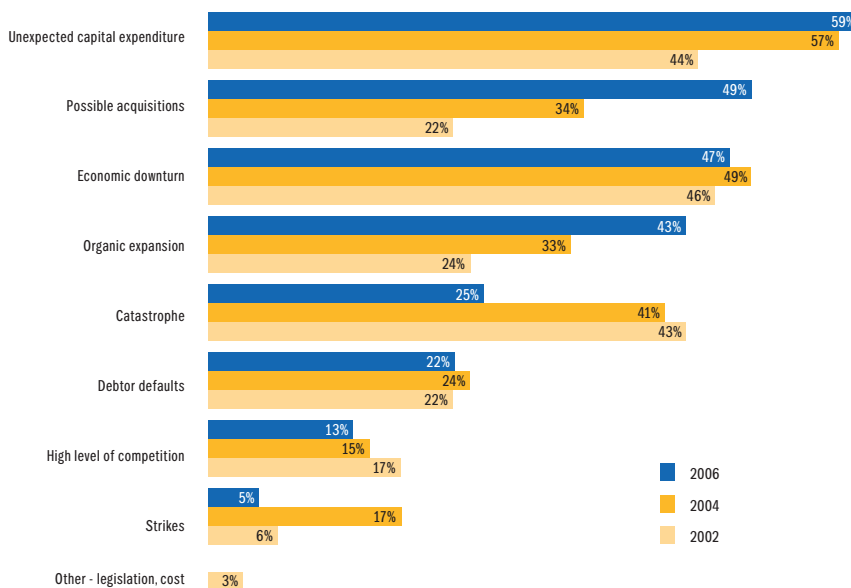


Chart 12 Factors determining levels of liquidity reserves



Borrowings

Only 40% of respondents (2004: 46%) have a policy to diversify borrowing sources. However, as in 2004, 50% have a policy to stagger maturity dates of committed facilities.

The average weighted maturity of debt has lengthened compared to the previous survey, with a noticeable shift from two to three years maturity, to five or more years maturity. Similar to the last survey, 45% of respondents have an average weighted maturity of debt less than two years.

79% of respondents indicated that liquidity needs are taken into consideration in determining the length of maturity. Other notable factors considered are asset life, interest rate, fees and credit ratings. Refer to Chart 13.

Overdrafts (61%) and bank loans (43%) are the more popular domestic short term borrowing sources. The use of multi option facilities has increased to 26% in the current survey (2004: 18%). Refer to Chart 14.

For long term funding sources, fixed funding was preferred (30%) over floating funding (22%). Notably, the use of hybrids has doubled in the past 2 years from 7% to 13%. 30% of respondents indicated they have raised more than 20% of their debt via the capital markets. Half of these raised more than 80% via this method.

Chart 13 Factors determining length of debt

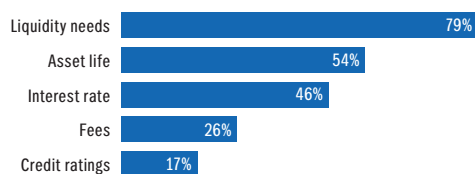
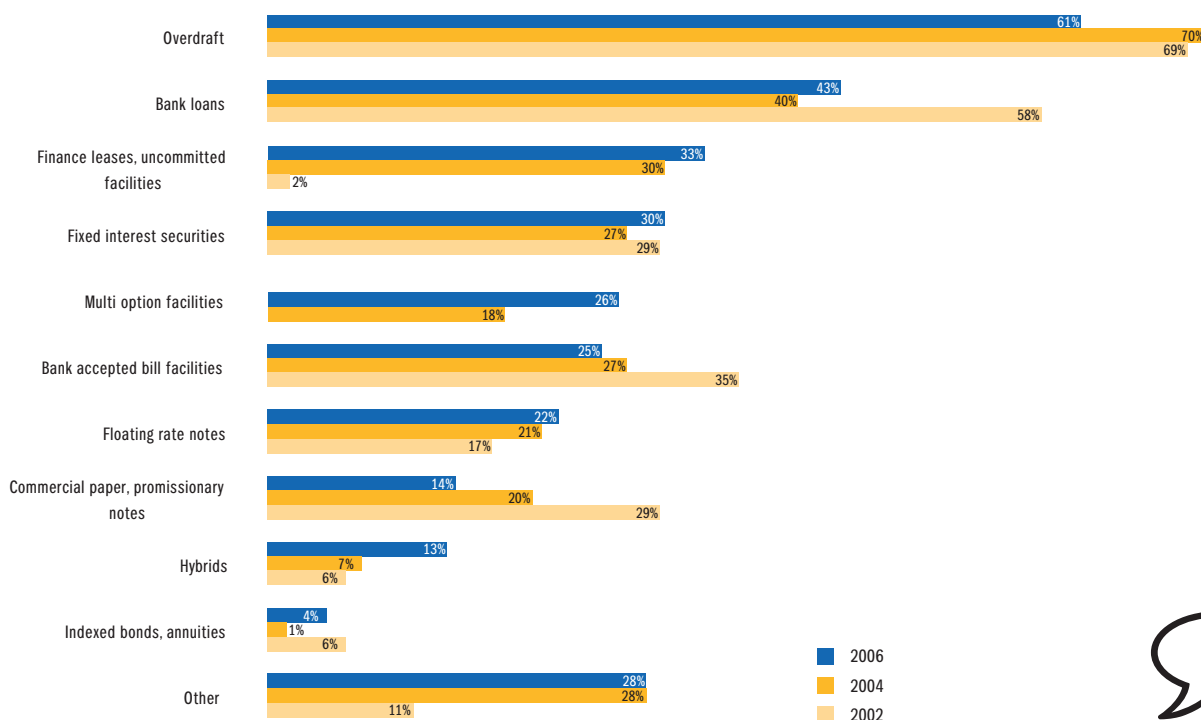


Chart 14 Domestic borrowing sources



While the majority of respondents source their debt domestically (see Chart 15), there has been a significant increase in funding sourced offshore. Sources most used are parent loans (40%) followed by US markets debt (29%).

Chart 16 highlights an analysis of average credit margins achieved across all facilities and shows 54% of the rated respondents achieve a margin of 0.50% per annum or less, while only 36% of non-rated respondents achieved a margin of 0.50% per annum or less. 41% of

respondents have a targeted gearing ratio. The favoured ratio is 41 to 60% (42%, 2004: 50%) followed by 21 to 40% (29%, 2004: 23%).

Working capital

30% of respondents indicated it was not possible to improve the efficiency of their working capital and 44% indicated working capital could be reduced by 10%. 23% of respondents indicated working capital could be reduced by more than 20%, however of these, 35% indicated that they are not responsible for working capital.

Chart 15 Proportion of debt sourced domestically

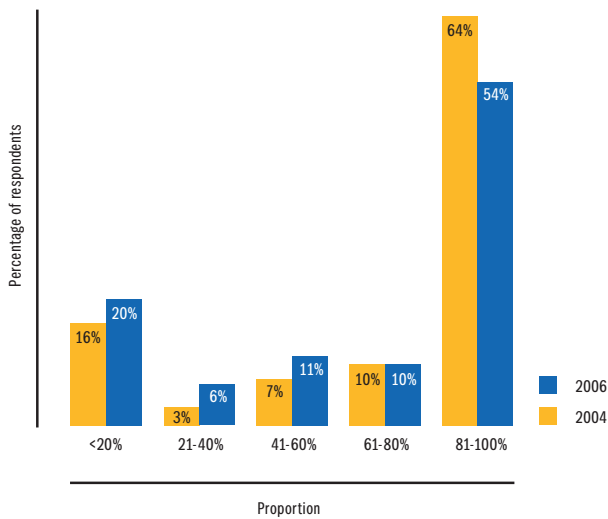
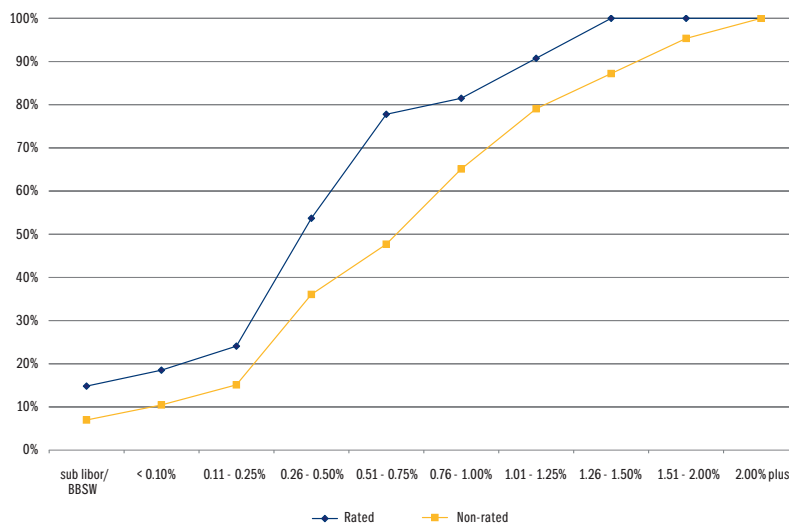


Chart 16 Average credit margin for rated and non-rated respondents



Governance, reporting and control

The role of the board

Boards appear to have become more actively involved in financial risk management activities over the last few surveys. Chart 17 confirms the trend since 2000 for boards participating in risk management committees to the extent that the 2006 survey indicated that 42% of organisations' risk management committees had board participation. The reduction in the percentage of boards that set, review and approve policy may be explained by the activity being delegated to a board risk committee.

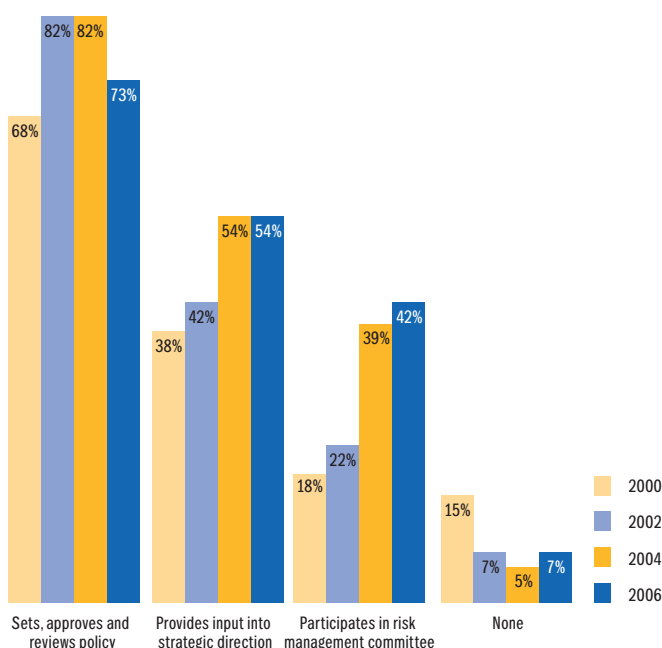
Respondents reported that boards' understanding of financial exposures (foreign exchange, interest rate, liquidity, credit and commodity price risks) is generally strong which is consistent with past surveys. 19% of boards were rated as excellent and 51% good.

Where respondents felt that improvement was required, the most common recommendation (38%) was for treasury to make presentations to the board.

“Consider what you want to do in relation to what you are capable of doing. Climbing is above all, a matter of integrity.”

Gaston Rebuffat

Chart 17 Board involvement



Board reporting

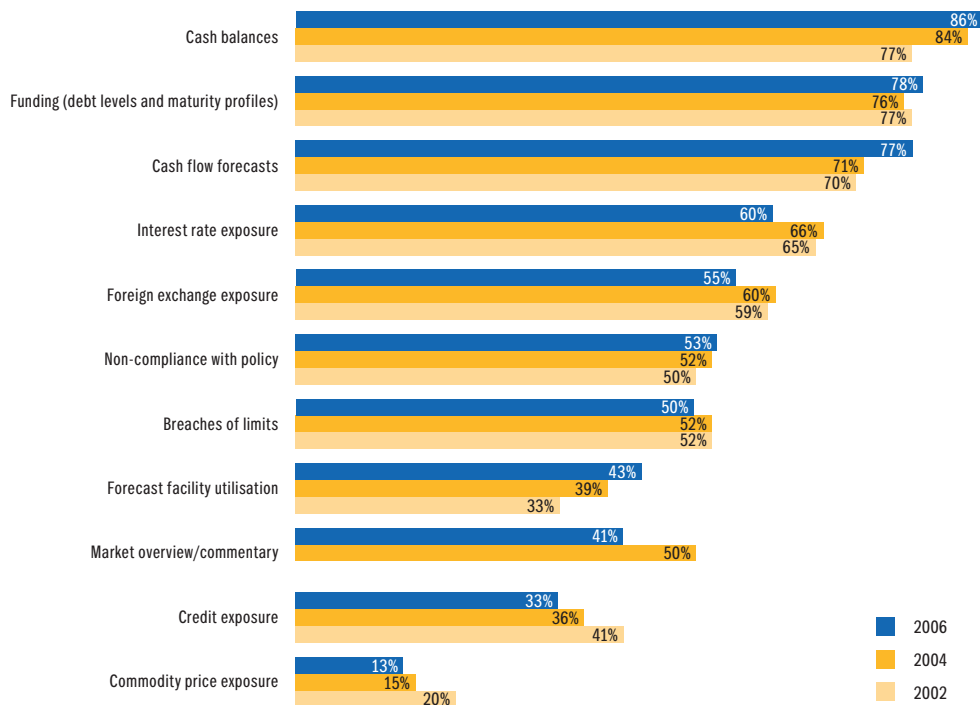
Cash is king and liquidity is important to directors. Increased reporting of cash balances, cash flow forecasts, funding and forecast facility utilisation since the last survey would indicate that boards have increased their focus on this important area (refer to Chart 18). Recent high profile convictions of directors who have allowed companies to trade whilst insolvent may have assisted this change.

Board reporting of non-compliance with policy and limit breaches remains a concern. Approximately 50% of organisations don't report breaches. Anecdotal evidence indicates that management may be of the belief that 'technical breaches' (whereby a material change in a market price created the breach as opposed to a specific management action) do not require reporting to the board. However, anecdotal

evidence from directors is that they wish to see all non-compliance and limit breaches reported. The board explicitly delegates its authority to management through the treasury policy; when management exceeds that authority it is difficult to accept that it shouldn't advise the board. For the protection of both the board and management, all non-compliance and limit breaches should be reported.

Board satisfaction with the information received from treasury remains high with 77% of respondents (same as 2004) reporting that they had received no complaints regarding information provided to the board. Of the complaints received, the most common was that the information was not detailed enough.

Chart 18 Board reporting

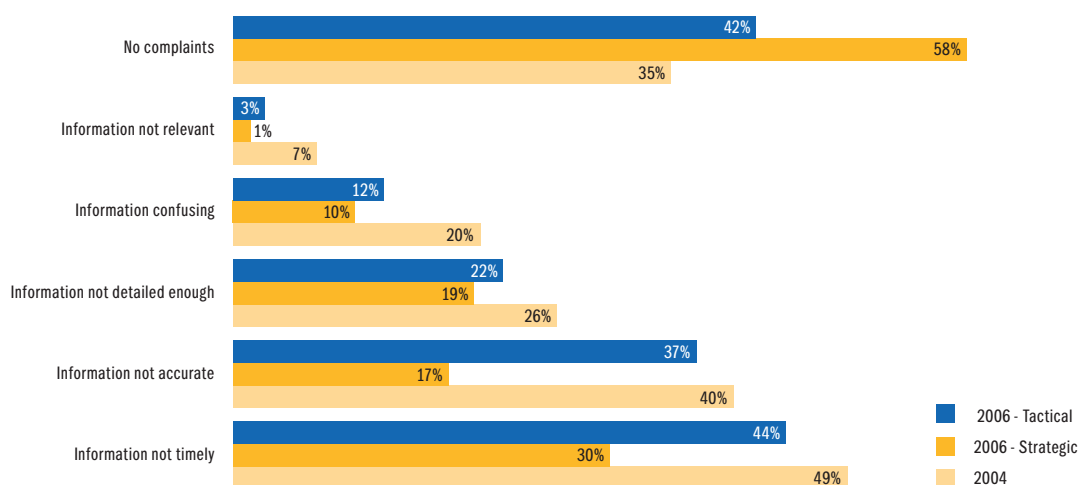


Information flows

■ **Information provided to executive management.** As with the board, executive management's satisfaction with information provided by treasury remains high with 74% (75% in 2004) of respondents reporting that there were no complaints. It is interesting that respondents reported that executive management's understanding of financial exposures (foreign exchange, interest rate, liquidity, credit and commodity price risks) had decreased slightly since the last survey (72% rated as either excellent or good compared to 78% in the 2004 survey). Hence the rating of executive management's understanding is now similar to the board's rating (72% as either excellent or good for executive management and 70% as either excellent or good for the board).

■ **Information received from business units.** Business units provide treasury with strategic information regarding high level business operations and tactical information regarding cash flow forecasts (daily, weekly, monthly) and future currency and commodity exposures. In past surveys, respondents have consistently reported a high level of dissatisfaction with the information provided by business units. Given that treasury uses this information for financing and hedging decision-making, we felt it was important to understand the source of the dissatisfaction. Hence, in this survey we split the responses into strategic information and tactical information and compared them with the general dissatisfaction reported in 2004 (refer to Chart 19). It is interesting to note that the dissatisfaction arises predominately with the tactical information and is mostly concerned with timeliness and accuracy.

Chart 19 Business unit information



Control of the treasury function

Following the trend from the 2002 and 2004 surveys, the majority of respondents (81%) indicated that they have a treasury policy. This is most commonly in the form of a single document (56%) or a series of individual policies (28%). It is encouraging to note that 57% of respondents with a treasury policy have reviewed it within the last year. This shows a steady increase from previous surveys.

Consistent with previous surveys, we find that the most common inclusions in the treasury policy are delegations of authority and authorised instruments. See Chart 20. It is not surprising to note that reference to IFRS requirements in treasury policies have more than doubled (2006: 33%, 2004: 15%) with the impact of AASB 139 coming into effect since the 2004 survey.

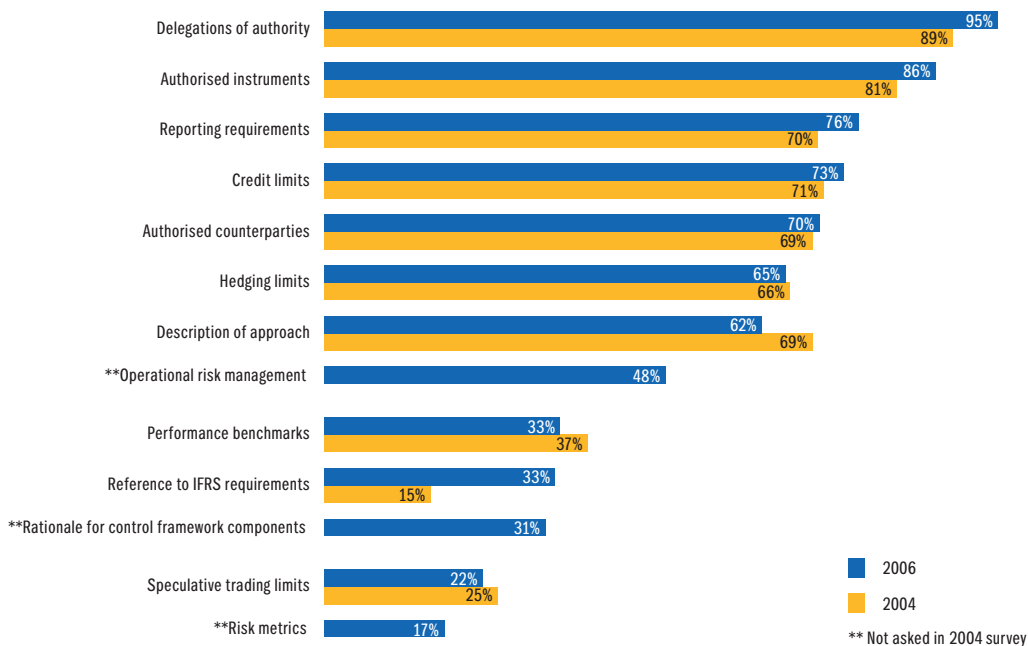
Governance reforms

The most common governance reason for changes being made to treasury policies, procedures or practices has come as a result of ASX Corporate Governance Guidelines (20%) closely followed by IFRS (15%).

Procedures manual

Only 34% of respondents have a treasury procedures manual covering all procedures, whilst the majority (37%) reported having no treasury procedures documented. We also note that the number of organisations with no treasury procedures documented has increased considerably over the last four years (2006: 37%, 2002: 19%). See Chart 21. Typically, larger organisations are much more likely to have appropriate documentation for all or some of their procedures.

Chart 20 What is included in the treasury policy



Segregation of duties

It is surprising to observe that almost 40% of respondents indicated they are not segregating transacting and settling duties – compared with 23% in the 2004 survey. See Chart 22. Almost 40% of organisations that don't segregate between these two core functions have two or more staff involved in treasury. This is not a satisfactory treasury practice as even organisations with only one person dedicated to treasury should have in place procedures to segregate between dealing and settling (for example, where the latter may be performed by another department/function within the organisation).

Documentation and settlements

There has been a decline in the reported use of International Swaps and Derivatives Association agreements by respondents in the current survey (60%, 2004: 67%, 2002: 64%). However, of those that use them, over 80% use them for all counterparties (rather than just some). Almost 90% of respondents use standard settlement instructions 95% of the time or more.

FX confirmations process

As in the previous survey, written facsimile confirmations (61%) remain the most popular way to confirm foreign exchange transactions, followed by email confirmations (22%). Only 11% of respondents use an automated matching process.

Chart 21 Respondents with treasury procedures documented

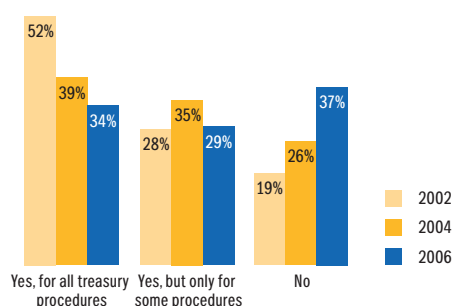
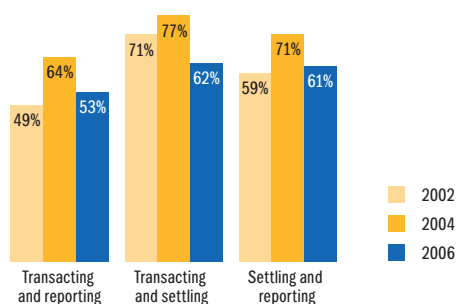


Chart 22 Segregation of duties



Performance measurement

The number of respondents who undertake treasury performance measurement has dropped substantially in this survey (2006: 39%, 2004: 55%, 2002: 48%).

This is unexpected but may be partly explained by a higher proportion of smaller organisations responding to the survey (68% of all respondents who don't measure performance had revenues of less than \$500m). These respondents typically have fewer resources dedicated to treasury, although only 15% of respondents stipulated this as a reason for not measuring performance. The main reasons given for not measuring performance, as in past surveys, is that it is not required by the board (58%) and that there is no value added (34%). See Chart 23.

It is interesting to note that approximately half the treasuries that operate as profit or service centres, do not measure treasury performance. See Chart 24.

Those industries most likely to measure performance are financial services, utilities and mining. Those least likely to measure are the manufacturing, retail and wholesale and services sectors. For those who do measure performance, the main reason remains that it assists in the evaluation of treasury's effectiveness (89%). As for the previous survey, measuring performance because it is required by the board is only indicated by a third of respondents.

82% of respondents are satisfied with their performance measures. This figure shows a steady increase since 2002. (2006: 82%, 2004: 77%, 2002: 72%). For those respondents who were unsatisfied with

their measures, the main reasons were that the measures were still being developed (71%) and/or were too simplistic (50%).

The benchmarks used by respondents remain similar to past surveys with 'market rates' and 'budgeted rates' the most used.

The percentage of respondents who measure treasury operations performance remains relatively unchanged (2006: 22%, 2004: 20%). This is somewhat surprising given the increased importance placed on operational risk management and we would certainly expect to see an increase in performance measurement of treasury operations in future surveys. As seen in the last two surveys, the preferred measures against which to measure operations performance are the previous year's result and against budget.

Chart 23 Main reason for not measuring performance

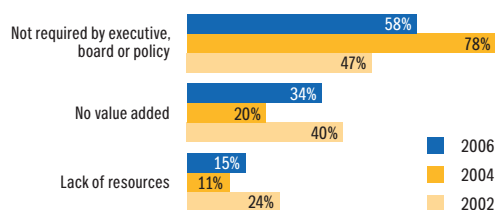
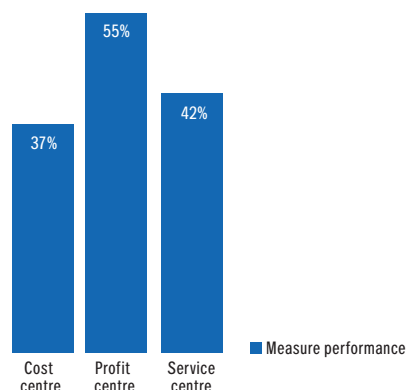


Chart 24 Percentage of respondents measuring treasury performance by treasury type



Treasury structure and staffing

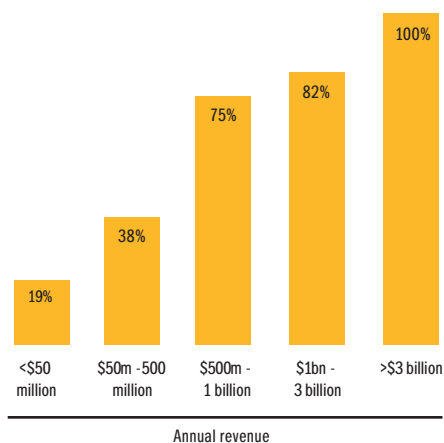
53% of organisations have a separate treasury unit (defined as having a unit, department or division with at least one person involved primarily in treasury-related activities), compared with 61% in 2004 and 70% in 2002. Chart 25 shows the clear correlation between organisational size and the existence of a separate treasury unit.

Respondents were asked to classify their treasury (whether a separate unit or not) as either a cost centre (defined as passing on costs and savings), a service centre (taking a fee to cover its costs), or a profit centre (holding on to savings). The percentage of respondents classified as a service centre remains consistent with previous years, approximately 15%. However, there has been an increase in the number of respondents classified as a profit centre (2006: 13%, 2004: 7%), with an equivalent decline in cost centre respondents (2006: 72%, 2004: 78%). This is not entirely explained by a

slightly higher proportion of financial services organisations in the current survey compared with 2004. Interestingly, smaller organisations (by annual revenue) are more likely to classify their treasury as a profit centre. Only 6% of respondents with annual revenue in excess of \$500 million classified their treasuries as profit centres, compared to respondents with annual revenue less than \$50 million (19%) and between \$50 million and \$500 million (13%).

16% of organisations have a separate corporate finance unit, a slight increase from previous surveys (2004: 15%, 2002: 12%). The proportion of respondents which have risk management committees has fallen to 69% (2004: 77%). However, of those, 70% (2004: 65%) are board risk management committees.

Chart 25 Separate treasury unit

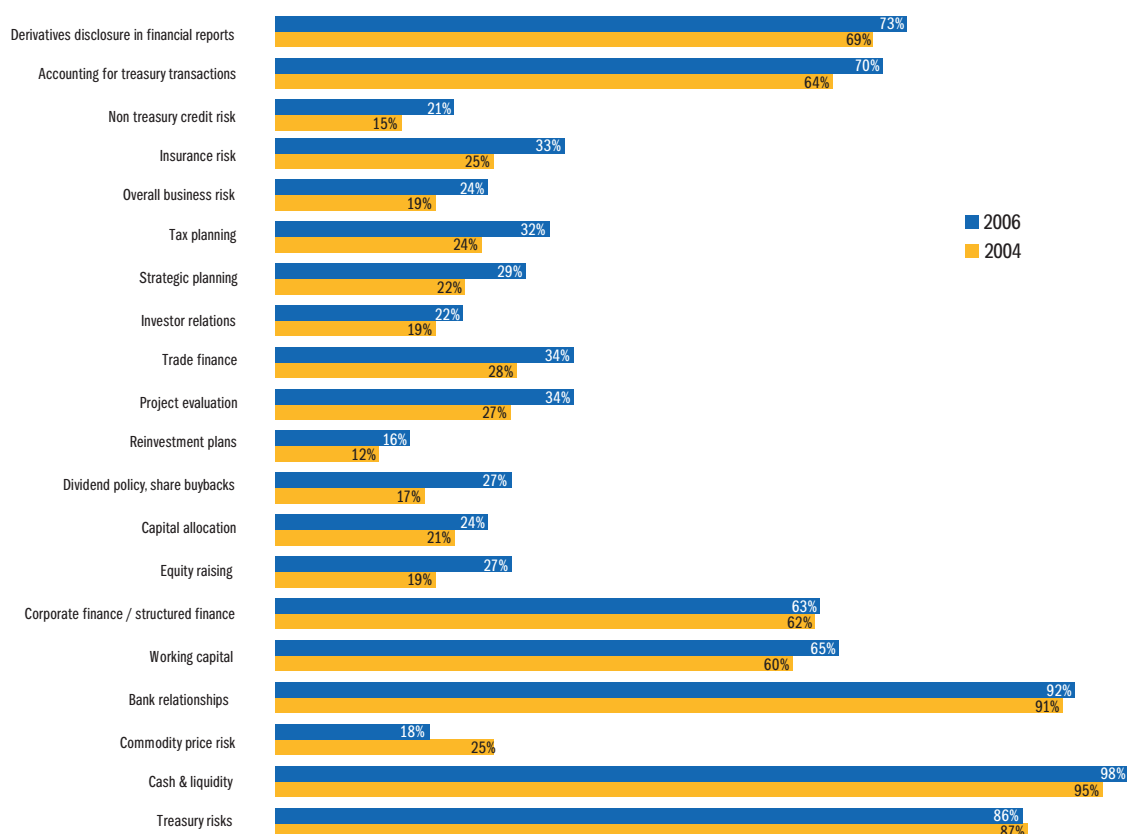


Functions undertaken by treasury

Respondents were asked to nominate the functions for which their treasury is responsible. As expected, the main functions currently undertaken by treasury are those of managing cash and liquidity, banking relationships and treasury risks.

Compared to 2004, there has been an increase in the proportion of treasuries which undertake various functions. The biggest increases relate to the functions of equity raising, dividend policy and insurance risk. See Chart 26. Notably, the percentage of respondents currently responsible for the activities listed below has increased across almost all categories (except for commodity price risk) when compared with 2004. The average across all categories increased from 35 to 40%. It is clear that treasuries are, in general, undertaking a broader range of activities today than two years ago.

Chart 26 Treasury functions



Treasury staffing

Respondents were asked to indicate what their treasury staffing level was two years ago, presently and expected in two years time. The most telling statistic is the decreasing trend of one person treasuries with an increased expectation of two to three person treasuries in the near future. Refer to Chart 27.

A new question in the current survey asked respondents what degree of difficulty they encountered in recruiting treasury staff. Only 7% of respondents who had recruited in the last two years found it easy to do so. 'Easy' was defined as numerous candidates with the appropriate skill level. 71% found it moderately difficult (few candidates) and 22% difficult (significant shortage of candidates).

Chart 27 Number of staff in treasury units

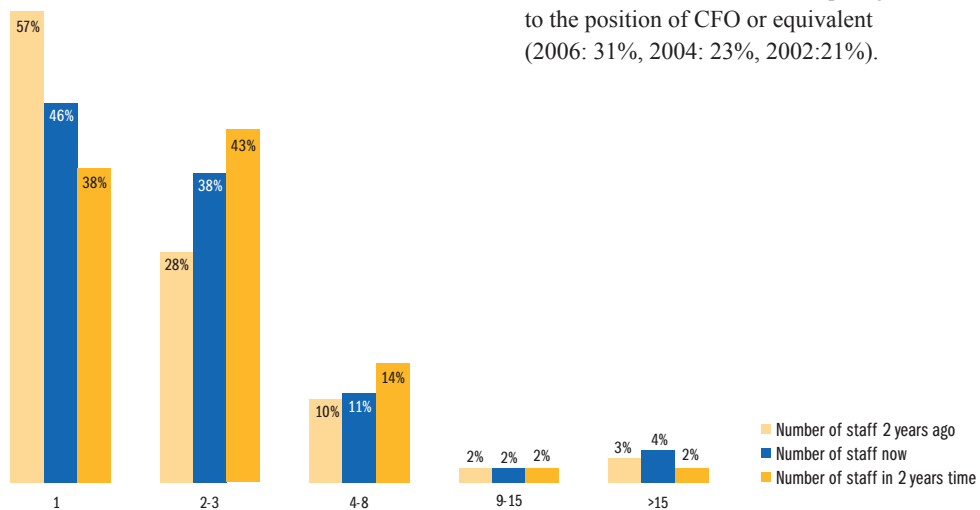


Chart 28 Treasurers externally recruited



Treasurer profile

The profile of the treasurer remains largely unchanged from previous surveys. Treasurers are predominantly male and aged between 36 and 45 years. However, there has been a small increase in the proportion of female treasurers in the current survey (2006: 14%, 2004: 13%, 2002: 11%).

Treasurers are more likely to have come from the private sector (2006: 61%, 2004: 51%) than a financial institution (22%) or government sector (14%). Increasingly, treasurers are recruited externally. Only 30% have been promoted to their current position compared with almost 50% in 2000. See Chart 28.

Although almost half of all respondents expect to be in their current role in five years time (2004: 63%, 2002: 66%), there has been an increase in those aspiring to the position of CFO or equivalent (2006: 31%, 2004: 23%, 2002: 21%).



Treasurer remuneration

The remuneration of treasurers increased in the last two years, with 35% of treasurers earning in excess of \$200,000 (2004: 31%). Chart 29 shows the current cumulative distribution of the remuneration for treasury staff.

The size of an organization (by annual revenue) is a significant factor in determining a treasurer's remuneration. 47% of respondents for organisations with annual revenue in excess of \$3 billion earn in excess of \$250,000 compared with only 14% with annual revenue less than \$3 billion.

Chart 30 displays cumulative treasurer remuneration by industry classification and shows the highest paying industries as financial services, property and telecommunications and media, while education and government are the lowest.

Outsourcing

28% of respondents have outsourced some function of treasury. The most outsourced functions are settlements (10%) and systems administration (9%). Only 10% of organisations are considering additional outsourcing, with no one function being considered by more than 3% of respondents. Four years ago, the main driver for outsourcing was cost efficiency (2002: 64%). Organisations are now just as likely to outsource due to the non core nature of a function (48%) as for cost efficiency reasons (46%).

Chart 29 Treasury remuneration

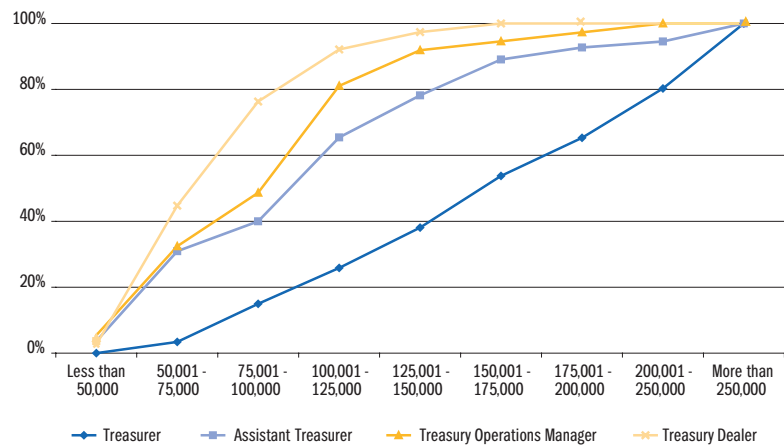
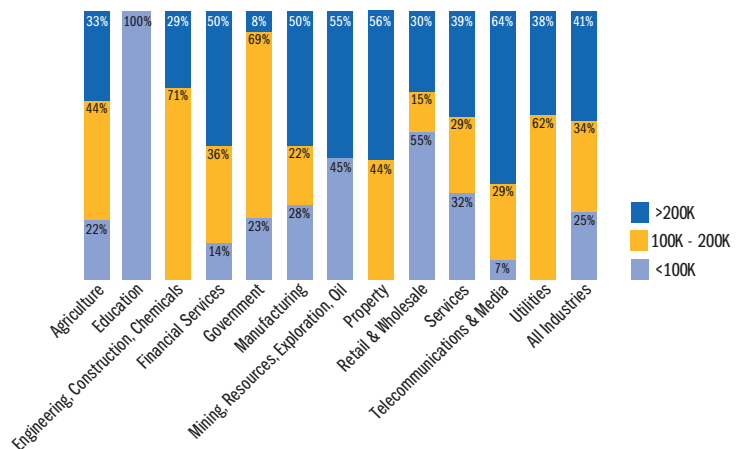


Chart 30 Treasurer remuneration by industry



Treasury systems

The current survey asked respondents to indicate what system/s they use for various treasury functions.

As shown in Chart 31, 50% of those who responded to this question use spreadsheets for their core treasury function. A surprising 10% of these are classed among the larger organisations (\$1 billion and above) which are more likely to deal in excess of 30% liquidity or hedging transactions per month. Spreadsheets are also the application of choice for many organisations required to undertake effectiveness testing and associated documentation under AASB 139/NZ IAS 39.

Only half the respondents who use the most popular system for core treasury (Quantum) use it for effectiveness testing and documentation. Amongst users of integra-T, this figure is around a quarter. Specialised treasury system users show a high dependence on their system to provide mark to market figures but not so for cash flow forecasts. 81% of respondents use spreadsheets for their cash flow forecasting function. Perhaps as a result, of those who use a treasury system, only 42% indicated that they use it to combine

treasury and non treasury cash flow data in order to provide organisation wide data.

A significant 71% of respondents do not make full use of their system's functionality. The main reason given is that not all functions are required (68%) and/or that some functions are not suited to the organisation (30%). Inadequate staff training on the system accounted for 15% of responses, whilst 13% noted that some functions were not user friendly.

The survey shows that 40% of respondents who use spreadsheets for their core treasury function, do not have a disaster recovery plan (DRP). This compares to 15% of treasury system users.

Although the survey shows a drop in the overall proportion of respondents who have a DRP in place (2006: 67%, 2004: 75%, 2002: 56%), there has been a substantial increase in the percentage of respondents who have tested it in the last 12 months. There is a disappointingly increasing proportion of respondents who have never tested their DRP. (See Chart 32).

Chart 31 Systems used for treasury functions

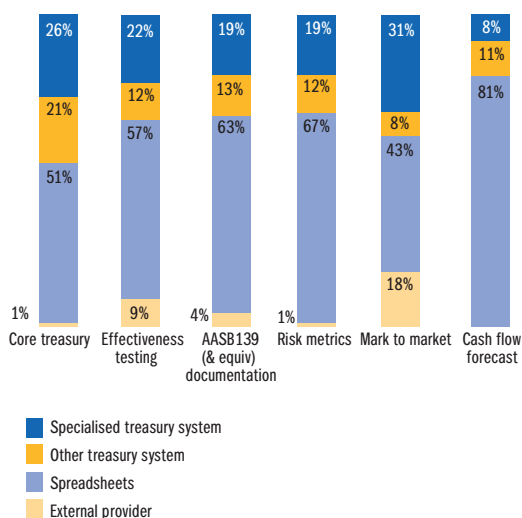
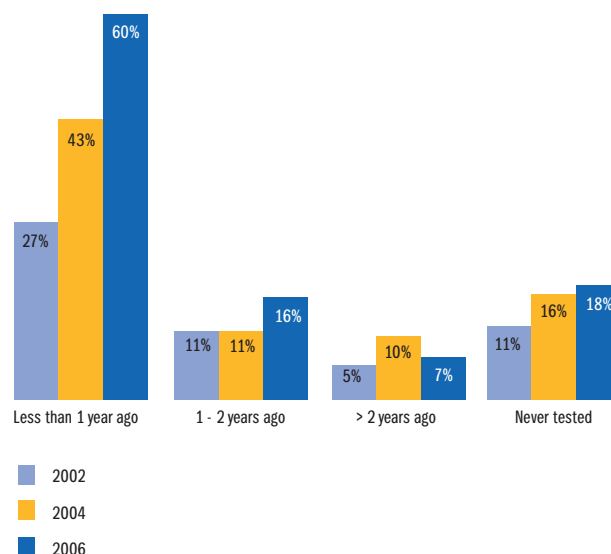


Chart 32 Timing of last DRP test



Accounting AASB 139/ NZ IAS 39

Since the last survey, Australian companies have adopted IFRS and although not required to comply until 1 July, 2007, some New Zealand companies have been early adopters of the equivalent standard, NZ IAS 39. The standards have required, inter alia, that derivatives be recognised and measured at ‘fair value’ on the balance sheet, with changes in fair value being recorded in earnings. Under AASB 139/NZ IAS 39 special provisions provide for the volatility in earnings that would otherwise result from the application of the broader provisions to be eliminated through the adoption of hedge accounting.

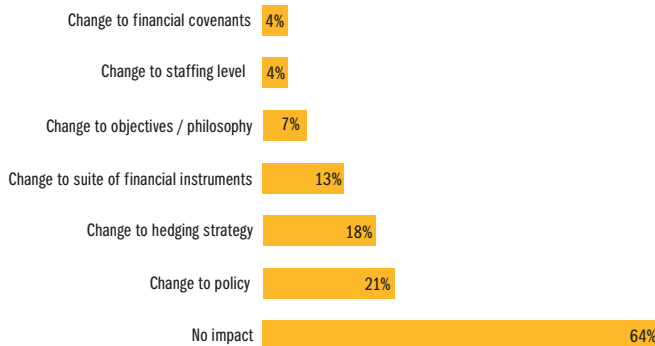
The current survey shows that, whilst the transition to IFRS has been particularly burdensome for most respondents, over 60% noted that the adoption of AASB 139/NZ IAS 39 had no impact on their financial risk management activities. See Chart 33. This would indicate that many were reasonably well prepared for the transition, an observation consistent with the response to the question in 2004 in which over 80% of respondents indicated varying stages of readiness for compliance with AASB 139/NZ IAS 39.

Surprisingly, few respondents that hedge noted that the adoption of AASB 139/NZ IAS 39 has affected or resulted in changes to financial covenants (4%).

Despite 50% of respondents that hedge reviewing their policy annually, only 21% amended their policy to reflect changes resulting from the introduction of AASB 139/NZ IAS 39.

Under AASB 139/NZ IAS 39, derivatives are required to be recognised and measured at fair value (mark-to-market) on the balance sheet. Many respondents rely on spreadsheets to calculate the mark-to-market of their derivatives (42%), whilst Quantum and Visual Risk are used by 11% and 10% of respondents respectively. Treasury systems in general are only used by less than a quarter of respondents. 18% relied upon counterparties to provide valuations.

Chart 33 Impact of the adoption of IFRS



Embedded derivatives

Respondents were asked if they recognised and measured embedded derivatives (required under AASB 139/NZ IAS 39). Disturbingly, of those that are impacted, almost half either do not (45%) or don't know (8%). Of those respondents that do recognise and measure embedded derivatives, the responsibility is almost evenly distributed between the treasury department and that of other departments. This compares quite markedly with the general responsibility for compliance with AASB 139/NZ IAS 39 where 27% of respondents nominated the treasury department as responsible and 52% nominated the accounting/finance department as responsible. Such a difference is most likely attributable to the existence of embedded derivatives in contracts that are the responsibility of commercial or operations departments.

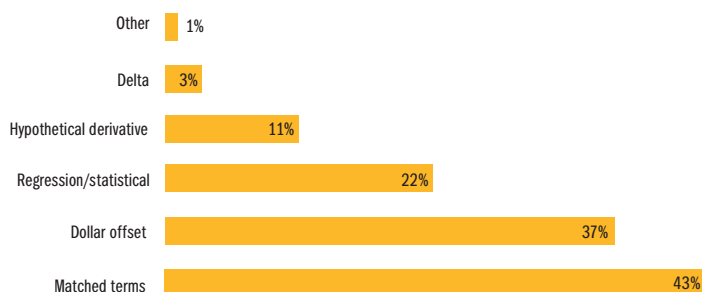
Hedge accounting

Over 60% of those respondents that hedge interest rate and foreign exchange risk expect to qualify for hedge accounting under AASB 139/NZ IAS 39. These results are similar to those in the 2004 survey in which over 70% of respondents expected to achieve hedge accounting.

Over half of those respondents qualifying for hedge accounting are using word processing software for hedge documentation (63%) and spreadsheets for assessing hedge effectiveness (57%). Of those respondents using software specific solutions (treasury systems), 26% use Visual Risk and 16% use Quantum. The high incidence of 'in-house' developed solutions is most likely due to the lack of clarity around the approaches to hedge effectiveness testing (as AASB 139/NZ IAS 39 does not prescribe a methodology).

Of those respondents who knew the methodology they employed to assess hedge effectiveness, 43% used matched terms. See Chart 34. Whilst this approach is the most straightforward, this is indicative of the move to more 'vanilla' hedging. This is supported by the minimal use of the hypothetical derivative methodology, which is often used to assess hedge effectiveness for those hedging relationships that are not 100% effective. 14% of respondents used a combination of methodologies.

Chart 34 Methodology used for hedge effectiveness testing



Major issues, drivers of change and future directions

Treasurers were asked what they understood the drivers of change to be for their treasury, what impact these would have and what they would change if free to do so. In addition, the current survey asked treasurers what was the biggest issue they had had to deal with in the past year.

Main issue for 2005/2006

The main issue by far was the requirements of AIFRS and AASB 139/NZ IAS 39. Treasurers indicated significant time, staffing, and/or cost pressures associated with the onerous documentation requirements associated with hedge accounting. The implementation of new treasury management systems required for the adoption of a hedge accounting framework added an additional burden on corporate treasury staff, with respondents indicating operational and conceptual difficulties. In some isolated cases, the complexities of the requirements and systems were a contributor to the decision to outsource the treasury function.

The responses have highlighted a significant concern among corporate treasurers with the increasing influence of accounting standards in a business area that has not traditionally been accounting-driven. In addition, the ongoing difficulties and pressures associated with treasury management systems may be indicative of the absence of opportunities and forums to share experiences (both successes and failures).

Aside from hedge accounting, a large segment of respondents cited concerns associated with core treasury activities as the major issues faced. These included issues such as: FX volatility; the direction of interest rates; cash flow and liquidity management; and implementation, unwinding and/or cessation of major hedging programs.

Treasury policy was also a common theme among respondents. Issues ranged from the complexities of conforming with policies mandated by an overseas parent, to the implementation of new policies in response to board requirements. The increasing focus on treasury policy is likely to be associated with the escalating demands by audit and risk management committees of corporate boards for transparency and accountability in the treasury function.

Drivers of change

Financial product innovation

Financial product innovation was identified as a key driver of change, both in a positive and negative sense. A rapidly expanding range of financial products is becoming available to meet the diverse range of investment requirements and financial risk scenarios faced by organisations. However, the greater choice available to treasurers is accompanied by a greater level of complexity and sophistication in the instruments available. The skill sets of the treasurer and treasury professionals must also keep pace in order to have sufficient working knowledge of new financial instruments and to understand whether any additional inherent risks are introduced.

Business evolution and financial strategy

Evolution of business activities was seen as the main driver of change among respondents.

Examples of such evolution were:

- movement from private to listed company structures
- organic expansion into new product lines, customer segments and geographical regions
- expansion/integration/divestment through merger & acquisition activity
- growth/downsizing in domestic and/or international operations.

The evolution was accompanied by changes in financial strategy with respondents indicating the need to re-evaluate:

- capital structure
- funding options
- internal rates of return
- risk-based and regulatory-based capital allocation
- relative attractiveness of different debt markets.

The results of the survey also indicate that the treasury area is increasingly playing a strategic advisory role, rather than purely acting in a risk management capacity.

Competitive pressures

Competitive pressures were another common theme that was highlighted as a driver of change. The emergence of developing economies such as China and India have appeared either as direct competition or as an opportunity to meet competitive pressures associated with domestic competition, the latter being achieved through offshore outsourcing and/or value chain rationalisation.

Intra-company competitive pressures have also been highlighted, with many respondents outlining the need to cut costs and undertake rationalisation programs.

Technology

Respondents indicated that technology was an important driver of change, where innovations in the specific areas of treasury management, cash management and forecasting were highlighted. Organisations were also embracing opportunities from advances in systems that would enable them to automate as much activity as possible. In addition, advances in technology and systems could help to harmonise treasury and accounting functions, and help to align and integrate treasury risk management with enterprise risk management.

The adoption of web-based and other electronic-based trading and management facilities by banks was seen as an important step to achieving seamless integration of treasury processes. Advances in payment systems at the retail/consumer level (e.g. smart card technology) were also expected to have an impact on treasuries.



Governance, accountability and regulation

A driver of change that emerged from the survey was the increasing attention to treasuries by boards and executive management. The increase in attention comes in the wake of high profile corporate collapses in Australia and overseas. While this is positive in the sense that it raises the profile of the treasury area, it also means there will be increased demands on the limited resources of the treasury operation. Increased attention inadvertently raises standards, as treasuries are subject to higher scrutiny and are required to report performance against internal/external benchmarks. Boards are becoming more financially astute and have a greater awareness of the risks to the business associated with the treasury function. Where the skills do not exist, boards are becoming more likely to seek external advice.

As outlined previously, accounting standards (e.g. AASB 139/NZ IAS 39), external reporting requirements (e.g. ASIC, ASX) and internal control requirements (e.g. Sarbanes-Oxley) all continue to be drivers for change amongst treasuries. The expected result is less of an economic approach and more of a compliance approach to treasury operations, with some respondents claiming that it would provide no additional value to the business.

Proposed changes to treasury

Treasurers proposed the following changes to their organisations:

- expansion of staff numbers and resources to build a stronger treasury operation
- implement technology to achieve full automation from deal through to settlement
- achieve efficiencies through increasing treasury deal approval limits and counterparty limits
- increase and broaden skill level of the treasurer and other personnel in the treasury operation
- increase scope to alter working capital management and general financial performance across the corporation
- greater integration of the treasury area and systems with other areas and systems within the business, thereby providing better access to operating information which will assist in forecasting and planning
- wider risk management responsibilities.

“Climb if you will, but remember courage and strength are nothing without prudence and that a momentary negligence may destroy the happiness of a lifetime.”

Edward Whymper

About this survey

Background

This survey was conducted by the Finance and Treasury Association Limited and Ernst & Young's Financial Risk Management Group (FRMG). It is the ninth survey of its type begun in 1988 to identify and report on trends in corporate treasury activities.

The survey was conducted during July 2006. Questionnaires were sent to organisations in Australia and New Zealand. This report summarises the findings from all respondents and aims to compare and contrast risk management practices across different industries and organisations by size as well as report on historical trends.

Respondent profile

The sample consists of 181 respondents, classified into twelve industries as shown in Chart 35. Chart 36 provides a breakdown of the respondents by revenue size. The current survey contained a larger sample of organisations with revenue below \$500 million (64%) compared with approximately 50% in 2004.

Benchmark report

As part of the survey process, a tailored benchmark report is offered to respondents who indicated their interest. The report will benchmark their treasury operations to their peers.

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Chart 35 Respondents by sector

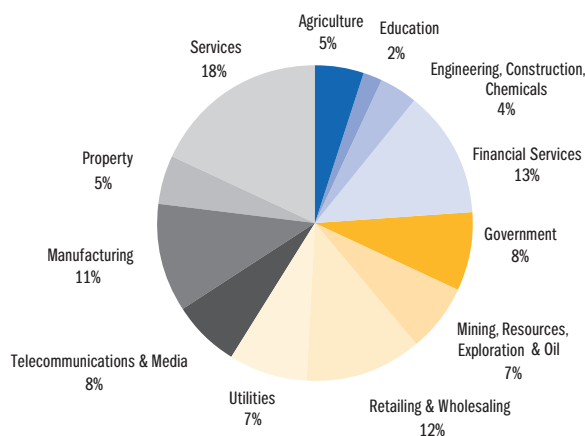
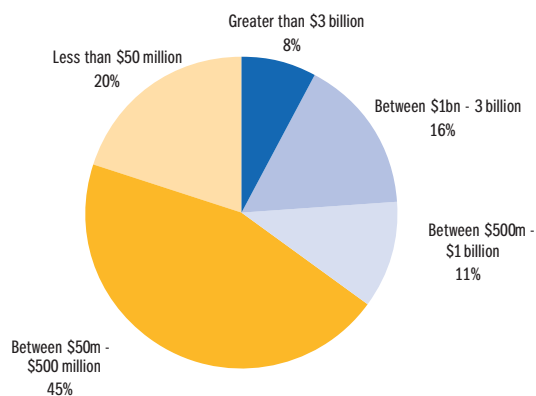


Chart 36 Respondents by revenue size



The Finance and Treasury Association

“Promoting excellence in financial risk management”

The Finance and Treasury Association (FTA) is a not-for-profit association with approximately 1,300 members who are individual financial risk management professionals predominantly working in Australia and the Asian region.

FTA members may manage risk at a strategic or group-wide level, or they may manage specific finance and risk functions, such as corporate treasury. Many members work at both levels. Just as holistic financial risk management requires processes and systems that recognise correlations and interdependency among financial markets and other risk factors, so too FTA’s membership reflects the spectrum of risk management activity.

Members manage risk through their roles as treasurers within companies, banks and public authorities, as chief financial officers, energy and commodity traders, corporate financiers, corporate risk managers, investment managers, and many other related roles. FTA’s skill-set orientation and mission to provide a professional network means that providers of service to these groups such as corporate banking, consulting, professional and technology services, as well as finance and risk management academics and students, are all encouraged to join and participate equally in the association. Members organise activities locally, usually via a chapter structure, with support from FTA staff.

The FTA office centrally co-ordinates a professional development program of regular briefings, workshops and specialist conferences. FTA’s premier event is its annual Congress and exhibition. FTA offers

education and career pathways with post-graduate certificates and diplomas. Members access information about technical matters, chapter functions and other events from the Association’s password-protected website www.finance-treasury.com. They receive publications such as technical updates, the Association’s journal *The Finance and Treasury Professional*, and research reports about finance, treasury and risk management practices. FTA technical sub-committees also develop submissions on key professional issues to governments and regulatory authorities.

FTA is your professional network for professional recognition, financial risk information, professional development and education.

If you would like to join, or would like information on any of our activities, please contact us at:

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Ernst & Young's Financial Risk Management Group

Ernst & Young's Financial Risk Management Group (FRMG) is a specialist business unit within Ernst & Young's Risk Advisory Services practice, created to provide treasury and financial risk management assurance and advisory services.

The FRMG undertakes treasury assignments across many industries and organisation types in Australia and abroad. The Australian FRMG is part of Ernst & Young's Global Treasury Consulting Services team, which is also represented in North America, Asia, Europe, Central and South America.

Most FRMG consultants have held senior management positions in the private sector, and in addition to their treasury expertise, bring a combination of pragmatism, experience and empathy to their treasury advisory assignments.

FRMG consultants are able to offer advice and operational assistance on a broad range of corporate treasury risk management activities, including:

- development, implementation and review of financial risk management frameworks, policies and procedures
- quantitative analysis, valuation, development and testing of measurement and control models for market, balance sheet, operational and credit risk
- advice and assurance in respect of the requirements of IAS 32, IAS 39, IFRS 7, including hedge accounting and 'fair value' calculations

- treasury and transaction processing health checks, peer reviews, benchmarking and workplace solutions
- treasury and risk management system selection, implementation and post implementation reviews
- advice on financial instruments and funding; transactional banking arrangements, cash management and bank account structures
- specialised treasury and financial risk management training
- secondments of specialised treasury personnel.

For further information please contact the Ernst & Young's Financial Risk Management Group.

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