

Payroll Tribune

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Treasury Management 101

Game back on! Interest rates are rising, and deposits are important again. In the last year interest rates have risen over 100 bps (bond speak for basis (one one hundredth) points). Many service bureaus have seen their interest income rise 40% or more. It is a very important source of revenue in a very competitive market place.

With the rise in interest rates comes the raise in phone calls to payroll bureau managers from brokers with lots of ideas on how to make more money. If you believe in an efficient market, as I do, you believe that there are no free lunches. Reward follows risk. **Fiduciary funds, money that belongs to other people, need to be managed prudently.**

Here are some trade-offs for you to consider when interest rates raise—yield curve, maturity, duration, liquidity, and credit quality. In general the yield curve raises from lower yielding short term credits and higher yielding longer term credits. That, in bond speak, is a “*normal curve*”. *Flat curves*, like today’s curve, mean that creditors pay basically the same rate for both short and long term credits. “*Inverted curves*” are not quite as common as “normal curves”, but mean that shorter credits are paying higher rates than longer credits. **As rates rise in a normal environment good treasurers slowly extend the effective maturity/ duration of their portfolio.** Payroll bureau treasurers deal with a great deal of very short term funds, and only a small amount of medium term credits (up to 3 years).

Liquidity is as important in treasury management as understanding the yield curve. Liquidity means that the credit can be turned into cash. Government securities, especially short term, can be sold in the open market and turned into cash in minutes. They are liquid. A one year CD at a top rated bank may not be liquid. There may be restriction on selling it. There may be penalties for turning it in prior to its stated maturity. A CD, even if “insured” by the FDIC, from a small or weak bank may be very illiquid because only a few brokers will buy it back, and then at a large discount.

We sometimes forget that the most important risk to be managed by the treasurer is **credit quality**. How soon we forget that in the early 90s most of the country’s S&Ls failed. Most of the banks in Texas failed or were taken over. The only major bank remaining with its headquarters in California has its headquarters there only because its CEO doesn’t like the cold Minnesota winters. Orange County California defaulted on its municipal debt. The taxpayer bailed out lots of creditors last time. Who knows next time? Credit matters. Who you buy credit securities from, matters.

What you might do today when the curve is basically flat: review the maturity characteristics of your fiduciary deposits, match fund (that is bond speak for buy credits which will mature just before you need to pay out the funds) the majority of the portfolio, and for longer term funds stay shorter than you might normally. Buy the best credit quality and liquidity available from reputable brokers. If the curve inverts, run down your maturities and shorten your portfolio. If the curve normalizes, stick with good quality and extend a bit as directed by your deposit cash flow needs.

Guy Henshaw will be speaking at the IPPA Annual Conference 9-11 August in Charleston, SC. He will review IPPA member survey responses and benchmarking data. If you would like to schedule a time to talk about your company’s performance in specific with either Guy or Les Vierra, please send an email to guy@henshawvierra.com.

On Governance (again)

In the past I have written about achieving good governance through ethical behavior by— setting the ‘tone at the top’ for your business, building and training a strong staff, listening to your customers, and managing your business through a well thought out business plan.

We are now in year three of SOX. Time has been spent, billions have been spent, and lessons have been learned by businesses, accounting firms and regulators alike. Common deficiencies were found: accounting and reporting processes were found to be informal and prone to error, there was a lack of general computer controls at the application level, there was a lack of control and risk review in companies, employees lacked training, many companies lacked complete definitions of key controls and areas of risk in their processes, and there was little documentation of processes and controls.

Most service bureaus do not work with accountants to compile, review, or audit their books. Here are two reasons why you should be different: payroll is a financial service and will become regulated like one, and service bureau business buyers are beginning to pay for normalized earnings at multiples that are equal to or greater than multiples for straight asset purchases.

Good governance and common sense requires that a service bureau owner and manager put internal audit capabilities in place to define and manage the risks inherent in payroll processing.

You can do it. Be aware of the risks in payroll. Learn from the experience of others, if possible. Put written procedures in place. Train your staff. Trust, but verify!

There are lots of places to start when thinking about putting internal controls in place. I think a good one is to follow Jerry McGuire’s

advice and ‘show me the money’. Flow cash and cash related transactions throughout your payroll process. Define and document the process and procedures encountered. Review and understand the control processes within your IT applications. If you rent IT, have the software provider explain it to you and help train your staff. Segregate the duties of your staff who create or review customer orders of cash flows, from staff who review bank wire instructions and authorize ACH and other transfer orders, from staff who do regular (daily is best) reconciliations of all bank accounts. Get an accountant who really knows the business in for real look and evaluation.

The demand for high level internal controls is coming to a payroll service bureau near you. Use it to enhance the efficiency of your operation, the quality of your service, and the value of your company.

Henshaw/Vierra Management Counsel, LLC

Henshaw/Vierra was founded in 1995 to serve the needs of the owners of family held companies, with annual sales of from \$1 million to \$75 million, who wished to build and/or enhance the value of their company. Our partners are experienced business leaders and system planners who can provide our clients with sound advice and workable solutions with the client’s best interests in mind.

We work with owners and their key staff to: develop a business plan; evaluate and, if required, change operating systems; system conversions; define the control environment within a service bureau; plan for succession of family ownership, governance, management; plan for the sale of the company.

Henshaw/Vierra has deep experience in the payroll business as owners of payroll service bureaus and payroll service bureau software companies, as consultants to over 20 bureaus around the country; and as advisors in the purchase and sale of service bureaus.

We can help you manage a better, more profitable bureau.

Contact us at 510 749-3225 or by email: guy@henshawvierra.com or les@henshawvierra.com

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