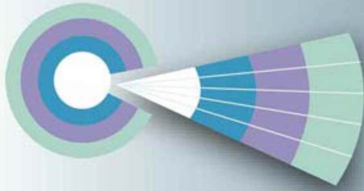




# Trusted Advisor or Compliance Enforcer?

***Can anybody remember when the times were not hard and money not scarce?***
Ralph Waldo Emerson

Of all the various roles Finance can play in a bank, the two most necessary to balance are complying with legal, tax, and regulatory requirements and dispensing sound advice on the efficient allocation of resources. In the first, Finance must focus on regulatory standards, checks and controls. In the second, it leverages its extensive expertise in understanding what resources are required to generate which types of assets, liabilities and fee income. It is uniquely positioned to play this second role because, while most commercial functions push as far as they can in a single direction, Finance must evaluate the bank's contrasting realities.

How Finance strikes this balance (and many others) to a large measure determines the success or failure of the business. *Is your budget a tool to control costs, or to sponsor investment?* Depending on economic circumstances, and where various products and services fall in the market life cycle, one choice is better than the other.

Finance is the mind of the business, using a structured approach to evaluate the soundness of the many business propositions and opportunities you face every day. Information feeds this process, and Finance has more information than most departments. As it fills its role of balancing—aligning processes and controls while advising the business on future directions—Finance faces a number of barriers when it comes to information and how to use it.

**Barrier 1:** ***Lack of information needed to regulate what has happened and shape what will happen***

Finance requires new levels of information about past and present processes and events to meet its regulatory compliance responsibilities (e.g., Basel II). Did the right employee or department sign off a particular credit application (operational risk)? Did the appropriate customer approval process and risk assessment take place before accepting a new mortgage application (credit risk)? For some banks, the information demands of compliance and control have forged better relationships between Finance and IT. They have led to changes in information gathering and collaboration methods (such as linking disconnected spreadsheets, for example), lowering the control risks these represent.

But while Finance works to manage these issues, it must also ensure the information investment helps drive its other key responsibility: helping guide decisions that make a difference to the future bottom line.

The executive team and commercial functions both look to Finance to help the business unit plan its future with confidence, not simply manage compliance and controls. Finance must pay attention to the drivers that make profit, using value-added analysis to extrapolate the impact of these drivers on tomorrow's results—and anticipate them when necessary.

Valuing, monitoring, and making decisions about intangible assets exemplifies the interconnection and sophistication of the information Finance requires. Regarding human capital, for example, Human Resources and Finance must work together to identify the value-creating roles of individuals, reflect their worth, and manage their growth, rewards, and expenses.

Without information sweet spots that show both the status of control and compliance and the impact of drivers on future business opportunities, Finance can't strike the necessary balance.

**Barrier 2:** ***The relevance, visibility, and credibility of what you measure and analyze is designed for accounting rather than business management***

Finance collects, monitors, and reports information with distinct legal, tax, and organizational requirements to fulfill its fiduciary role. But Finance also needs an integrated view of these and other information silos to fill its role of advisor. This role requires not simply reporting the numbers, but adding value to those numbers.

For example, executives must understand the costs and transfer prices related to various activities, products, and services. Finance must, therefore, categorize relevant line items across a wide range of detailed and hierarchically complex general ledger accounts. Without this integrated view, the executives will lack the comprehensive understanding around income growth and profitability to manage the various business units and product offerings effectively.

Another example: Risk-adjusted returns and effective customer segmentation is not possible without an integrated approach to information. With the increasing need to develop a "tailored" value proposition designed from a customer perspective, this gap increasingly affects the long-term success and competitiveness of a bank.

**Barrier 3:** ***Finance must balance short term and long term, detailed focus and the big picture***

Finance balances different and contradictory requirements. It must deliver on shareholder expectations every 90 days; it must also determine a winning vision and a strategy to achieve that vision over quarters and years. Banks can cut costs and investments to meet short-term profit objectives, but at what point does this affect long-term financial performance? A well-informed executive team is better able to understand the drivers, opportunities, and threats when balancing short- and long-term financial performance.

Executives and financial analysts define performance in terms of shareholder value creation. This makes metrics such as net income, earnings per share (EPS) growth, or economic value added (EVA) important. However, these distilled financial measures tell only part of the story. You need to augment them with more detailed measures that capture risk ratios, asset quality, operating efficiency, market share gains, and revenue growth targets to understand the real performance of the business, and strike a good balance between long- and short-term growth.

**Barrier 4:** ***Finance must find the path between top-down vision and bottom-up circumstances***

To what extent should goals be set top-down versus bottom-up? *If the executive team mandates double-digit net income growth, does this translate into sensible targets at the lower levels of the organization? Does it require a double-digit target at the lowest profit center?* Top-down financial goals must be adjusted to bottom-up realities. Finance must accommodate top-management vision while crafting targets that specific business units can achieve.

This barrier particularly illustrates the importance of engaging frontline managers in financial reporting, planning, and budgeting. The need for fast and relevant information requires an interactive model. Frontline managers must assume some budgetary responsibility and feed back changes from various profit or cost centers as market conditions change. This decentralized model engages the business as a whole rather than relying on a centralized function to generate information.

Besides freeing up Finance for value-added decision support, bottom-up participation generates an expense and revenue plan that overcomes hurdles of relevance, visibility, and credibility. Individuals who engage in the process take responsibility for delivering on expectations. This helps expose drivers of success and failure that are otherwise lost in a larger cost calculation or financial "bucket"—for both the frontline manager and Finance.

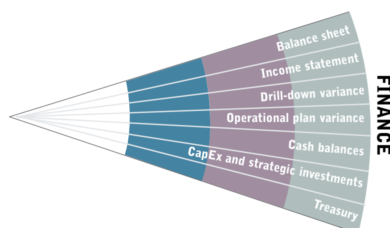
### Balancing Short Term and Long Term, Past and Future, Compliance and Advisor

The information Finance uses to report what has happened and shape what will happen is critical to the rest of the organization. Dynamic tools that allow Finance to balance compliance and performance, accounting and business structures, short term and long term, top-down vision and bottom-up reality, are more important than ever. Information sweet spots can support Finance's responsibilities and decision areas.

### A Balanced Financial Experience

Finance decision areas include:

- **Balance sheet** ➔ How do we balance and structure the financial funding options, resources, and risks of the business?
- **Income statement** ➔ How did the business team score? Where was performance strong or weak?
- **Drill-down variance** ➔ What causes changes in financial performance?
- **Operational plan variance** ➔ How do we best support, coordinate, and manage the delivery of meaningful plans?
- **Cash balances** ➔ How do we manage the cash proof and monitor cash use effectively?
- **Capital expenditure (CapEx) and strategic investments** ➔ What are the investment priorities and why?
- **Treasury** ➔ How can we efficiently manage cash, liquidity requirements and cost of capital?

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*Using a performance management system instead of Excel spreadsheets largely automates the process of consolidating the group companies' figures. It makes things much easier. Automated plausibility checks take the burden off our financial analysts and simplify reporting by producing all of the statistics and notes that we need.*

Alexander Huber, Project Manager and Team Leader, Zurick Cantonal Bank

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## Balance Sheet

The ratios generated from the balance sheet are frequently top of mind with Finance executives, who seek not only to balance the financial structure of the bank's assets and liabilities, but increasingly also to mine the balance sheet as a source of nontraditional income opportunities. These range from loan securitization to off-balance sheet activities such as derivatives and financial guarantees. All of these are associated with various risk profiles, and since capital and risk are connected, the balance sheet and the associated capital adequacy standards are a key concern for any bank.

With Basel II and the need to profile the risks associated with any capital allocation, the executive focus on the balance sheet has increased dramatically. The ability to leverage commitments both on and off balance sheet in a volatile market environment with the associated risks will directly impact the bank's ability to maximize its return on equity (ROE) or more appropriately its risk-adjusted return on capital (RAROC). RAROC reflects how well the business can convert capital into profit for a given risk exposure. Selling the financial performance and attractiveness of the business to new investors is an important Finance function. RAROC can be a benchmark that reflects positively or negatively on senior management and Finance. It highlights the importance of managing future capital, risk, and balance sheet decisions and having a clear understanding and sense of priority about which investment projects generate better returns. This understanding leads to the next decision area: looking at where income is generated.

| GOALS | METRICS | DIMENSIONS |
|---|---|---|
| Return on Assets (%)<br>Return on Equity (%)<br>Earning Assets/Total Assets<br>A/R Reserve ($) | Risk Adjusted Return on Capital (RAROC) (%)<br>Interest Income/Average Assets<br>Non-Interest Income/Average Assets<br>Assets ($)<br>Liabilities ($)<br>Asset growth (%)<br>Liability growth (%)<br>Volatile Liabilities<br>Loans<br>Deposits<br>Net Loans & Leases<br>Securities over One Year<br>Fixed Assets<br>Equity ($)<br>Market Value ($)<br>Reserve for Loan Losses<br>Provision for Loan Losses<br>A/R $/% Outstanding<br>A/P $ | Balance Sheet Accounts<br>Sub-class<br>Account<br>Fiscal Month<br>Year<br>Quarter<br>Month<br>Organization<br>Division<br>Department<br>Org. Code<br>Loan Type<br>Deposit Type |

| FUNCTION | DECISION ROLES | PRIMARY WORK | CONTRIBUTORY | STATUS |
|---|---|---|---|---|
| Finance | Executives | • | | |
| | Managers | • | | |
| | Analysts | • | | |
| | Professionals | • | | |
| Audit | Executives | | | • |
| | Managers | • | | |
| | Professionals | • | | |
| Risk Management | Executives | | • | |
| | Analysts | | • | |
| General Management | Executives | | | • |
| Marketing | Executives | | | • |
| Operations / Production | Executives | | | • |
| Product Management | Executives | | | • |
| Sales | Executives | | | • |

## Income Statement

This decision area represents the bottom line. It is the cumulative score achieved by everyone in the business for a set period. Everyone needs to understand his or her individual contribution and performance measured against expectations. You must understand where variances above budget occur so you can correct the course. If costs are increasing too quickly, you risk damaging future profits unless you control them, adjust selling prices, or develop new markets. Unexpected revenue spikes can mean additional resources are required to continue future growth. Adjustments such as these take time, and the sooner you take action, the sooner you improve margins and realize the full potential of a growth opportunity. The ability of Finance to quickly identify, analyze, and communicate important variances has competitive implications for your company. How quickly the business capitalizes on a new situation is determined by how quickly it discovers budget variances.

| GOALS | METRICS | DIMENSIONS |
|---|---|---|
| Actual vs. Plan Variance ($/%) | Income Tax Expense ($/%) | Fiscal Month |
| Income ($) | Non Interest Income ($/%) | Year |
| Net income/Profit ($/%) | Interest Expense ($/%) | Quarter |
| | Non Interest Expense ($/%) | Month |
| | Income Tax Expense ($/%) | Organization |
| | Net Operating Income ($/%) | Division |
| | Net Interest Margin (%) | Department |
| | Salaries/Benefits Expenses ($/%) | Org. Code |
| | Operating Expenses ($/%) | G/L Accounts |
| | Overhead Expense($/%) | Class |
| | Loan & Lease Losses/Gains ($/%) | Group |
| | Securities Losses/Gains )$/%) | Account |
| | Tax ($/%) | Plan/Actual Scenario |
| | | Scenario |

| FUNCTION | DECISION ROLES | PRIMARY WORK | CONTRIBUTORY | STATUS |
|---|---|---|---|---|
| **Finance** | | | | |
| | Executives | • | | |
| | Managers | • | | |
| | Analysts | • | | |
| | Professionals | • | | |
| **Tax** | | | | |
| | Professionals | • | | |
| **Audit** | | | | |
| | Executives | | | • |
| | Managers | • | | |
| | Professionals | • | | |
| **General Management** | | | | |
| | Executives | | • | |
| **Customer Service** | | | | |
| | Executives | | • | |
| **Human Resources** | | | | |
| | Executives | | • | |
| **IT / Systems** | | | | |
| | Executives | | • | |
| **Marketing** | | | | |
| | Executives | | • | |
| **Operations / Production** | | | | |
| | Executives | | • | |
| **Purchasing** | | | | |
| | Executives | | • | |
| **Product Management** | | | | |
| | Executives | | • | |
| **Sales** | | | | |
| | Executives | | • | |
| **Compliance** | | | | |
| | Executives | | | • |
| | Analysts | | • | |

### Drill-Down Variance

Once you identify a difference between actual and plan, you need to drill down into the details to understand what caused it. *If net income increases by 5 percent between two time periods, was the cause greater transaction volume, higher price, or a change in the mix? Did your competitors have the same increase? Alternatively, have internal changes impacted costs or possibly the transfer pricing used to allocate departmental costs? What are the drivers of these allocations, and are they directly attributable to the business activity? Also, has the risk profile changed with the increase in net income?*

Finance needs to understand the why behind changes. Knowing what drove changes in revenue and net income provides a more complete picture to help guide the company.

| GOALS | METRICS | DIMENSIONS |
| --- | --- | --- |
| Net Income/Profit Change ($/%)<br>Income Change ($/%)<br>Product/Service Variance ($/%) | Avg. Net Loss/Gain for Loans & Leases<br>Avg. Net Loss/Gain for Securities<br>Interest Rate Spread (%)<br>GL Expense Detail ($/%)<br>Net Change ($/%)<br>Asset Loss Rate (%)<br>Loan Ratio (%)<br>Yield (%)<br>Net Interest Spread | Fiscal Month<br>Year<br>Quarter<br>Month<br>Organization<br>Division<br>Department<br>Org. Code<br>G/L Accounts<br>Class<br>Group<br>Account<br>Product Line<br>Product Line |

| FUNCTION | DECISION ROLES | PRIMARY WORK | CONTRIBUTORY | STATUS |
| --- | --- | --- | --- | --- |
| Finance | | | | |
| | Executives | • | | |
| | Managers | • | | |
| | Analysts | • | | |
| | Professionals | • | | |
| Audit | | | | |
| | Executives | | | • |
| | Managers | • | | |
| | Professionals | • | | |
| Customer Service | | | | |
| | Executives | | | • |
| | Analysts | | • | |
| Compliance | | | | |
| | Executives | | | • |
| | Analysts | | • | |
| IT / Systems | | | | |
| | Executives | | | • |
| Marketing | | | | |
| | Executives | | | • |
| | Analysts | | • | |
| Operations / Production | | | | |
| | Executives | | | • |
| | Analysts | | • | |
| Purchasing | | | | |
| | Executives | | | • |
| | Analysts | | • | |
| General Management | | | | |
| | Executives | | | • |
| Product Management | | | | |
| | Executives | | | • |

**Operational Plan Variance**

Once Finance understands what caused performance variances, it can lead discussions about future operating plans. The ability to advise and push back on management plans is important. Knowing the why behind variances from plan helps companies re-evaluate and improve the next plan. Without this information, plans lose their purpose and become academic exercises to please senior management. Ideally, Finance offers input and feedback that other business areas can use for guidance. At the same time, these other areas provide frontline information to Finance that helps improve the plan. Such cross-functional and coordinated effort lets you test the roadworthiness of existing business plans.

| GOALS | METRICS | DIMENSIONS |
|---|---|---|
| Operating Expense variance ($/%)<br>Operating Efficiency (% of assets)<br>Cost/Income Ratio (%) | Actual vs. Plan (%/$)<br>Plan/Forecast ($)<br>Department Costs ($/%)<br>Salary Costs ($/%)<br>Employees (#)<br>Marketing Costs ($/%)<br>Revenue per Employee<br>Direct Expenses<br>Other Expenses ($/%)<br>Overhead Costs ($/%)<br>Non-Interest Income/ Non-Interest Expense (%) | Fiscal Month<br>Year<br>Quarter<br>Month<br>Organization<br>Division<br>Department<br>Org. Code<br>G/L Accounts<br>Class<br>Group<br>Account<br>Product Line<br>Product Line |

| FUNCTION | DECISION ROLES | PRIMARY WORK | CONTRIBUTORY | STATUS |
|---|---|---|---|---|
| Finance | | | | |
| | Executives | • | | |
| | Managers | • | | |
| | Analysts | • | | |
| | Professionals | • | | |
| Audit | | | | |
| | Executives | | | • |
| | Managers | • | | |
| | Professionals | • | | |
| Customer Service | | | | |
| | Executives | | | • |
| | Analysts | | • | |
| Marketing | | | | |
| | Executives | | | • |
| | Analysts | | • | |
| Operations / Production | | | | |
| | Executives | | | • |
| | Analysts | | • | |
| Purchasing | | | | |
| | Executives | | | • |
| | Analysts | | • | |
| Product Management | | | | |
| | Executives | | | • |
| | Analysts | | • | |
| Sales | | | | |
| | Executives | | | • |
| | Analysts | | • | |
| Human Resources | | | | |
| | Executives | | | • |
| | Analysts | | • | |
| IT / Systems | | | | |
| | Executives | | | • |
| General Management | | | | |
| | Executives | | | • |

### Cash Balances

The management of cash balances is also associated with reserve management and the objective to minimize cash holdings. When cash balances increase significantly above legal requirements, money managers need to evaluate if this is a short- or long-term occurrence and consider the appropriate action, such as a short-term money market instrument or a longer-term government security. Equally, a cash shortage will require selling short-term liquid securities or possibly purchasing deposits. This daily activity extends to a cash proof role to identify the reconciliation floats for nostro and vostro accounts. *Do the cash positions reconcile? If not, why not?* Without the systems and information to manage these positions effectively, there are likely to be missed opportunities. Also, the constantly changing external market conditions and internal variances in loan demand and deposit activity put daily pressure on managing these cash balances efficiently. *If the bank expects an interest rate to increase, should fed funds be purchased earlier in the reserve maintenance period?* Finance will seek to monitor and evaluate its cash balances in the broader context of its liquidity management strategy.

| GOALS | METRICS | DIMENSIONS |
|---|---|---|
| Liquidity Ratio<br>Volatile Liability Dependency<br>Cash & Securities/Assets<br>GL $ Reconciliation (%) | Nostro Account Balance ($)<br>Vostro Account Balance ($)<br>Suspense Account Balance ($)<br>Unreconciled Accounts (#)<br>Securities & Treasury ($/%)<br>Cash assets ($/%)<br>Interest Cash<br>Non-interest Cash<br>Temporary Investment Ratio<br>Net Change ($/%)<br>A/R $/% Outstanding<br>A/P ($) | G/L Accounts<br>Class<br>Sub-class<br>Account<br>Day<br>Year<br>Quarter<br>Month<br>Day<br>Organization<br>Division<br>Department<br>Org. Code<br>DDA Accounts<br>DDA<br>Account<br>Third Parties<br>Third Party |

| FUNCTION | DECISION ROLES | PRIMARY WORK | CONTRIBUTORY | STATUS |
|---|---|---|---|---|
| Finance | | | | |
| | Executives | • | | |
| | Managers | • | | |
| | Analysts | • | | |
| | Professionals | • | | |
| Audit | | | | |
| | Executives | | | • |
| | Managers | • | | |
| | Professionals | • | | |
| IT / Systems | | | | |
| | Executives | | | • |
| | Analysts | | • | |
| Marketing | | | | |
| | Executives | | | • |
| Operations / Production | | | | |
| | Executives | | | • |
| | Analysts | | • | |
| Product Management | | | | |
| | Executives | | | • |
| Sales | | | | |
| | Executives | | | • |
| | Analysts | | • | |
| Risk Management | | | | |
| | Executives | | | • |
| | Analysts | | • | |
| Compliance | | | | |
| | Executives | | | • |

## CapEx and Strategic Investments

Since capital expenditure (CapEx) has an impact on ROA performance, businesses must evaluate and monitor investment decisions carefully. Investments can range from minor to strategically significant; from a new computer to a market investment into a new country. Finance must ensure that CapEx and investment requests don't simply become wish lists. Finance must establish the basis for prioritizing and justifying capital expenditure. This means coordinating with different function areas. For example, Finance must understand the impact of both yes and no before agreeing to new investments. *Will the business be exposed and lose market share if the investment is delayed? Will this action improve service standards? Will efficiencies be made over the longer term?*

Mergers and acquisitions represent the strategic dimension of investments. *What are the potential cost savings from combining the two businesses? If the banks serve the same market or product segments, what is the likelihood of customer erosion?*

Understanding upside and downside impacts from potential investments is part of the evaluation process. Finance arbitrates such decisions, and requires detailed financial scenarios that forecast investment ROI and payback.

| GOALS | METRICS | DIMENSIONS |
|---|---|---|
| Investment ($)<br>NPV ($)<br>ROI (%) | Acquisition Profit Growth (%)<br>Acquisition Income Growth (%)<br>Capex $<br>Breakeven Months (#)<br>IRR (%)<br>Payback Months (#) | Balance Sheet Lines<br>Class<br>Sub-class<br>Account<br>Fiscal Month<br>Year<br>Quarter<br>Month<br>Organization<br>Division<br>Department<br>Org. Code<br>Plan/Actual Scenario<br>Scenario<br>Potential Projects<br>R&D Project Type<br>Project<br>Project<br>Project/Program Type<br>Project |

| FUNCTION | DECISION ROLES | PRIMARY WORK | CONTRIBUTORY | STATUS |
|---|---|---|---|---|
| Finance | | | | |
| | Executives | • | | |
| | Managers | • | | |
| | Analysts | • | | |
| | Professionals | • | | |
| Audit | | | | |
| | Executives | | | • |
| | Managers | • | | |
| | Professionals | • | | |
| General Management | | | | |
| | Executives | | | • |
| IT / Systems | | | | |
| | Executives | | | • |
| | Analysts | | • | |
| Marketing | | | | |
| | Executives | | | • |
| | Analysts | | • | |
| Operations / Production | | | | |
| | Executives | | | • |
| | Analysts | | • | |
| Product Management | | | | |
| | Executives | | | • |
| | Analysts | | • | |
| Risk Management | | | | |
| | Executives | | | • |
| | Analysts | | • | |
| Sales | | | | |
| | Executives | | | • |
| | Analysts | | • | |

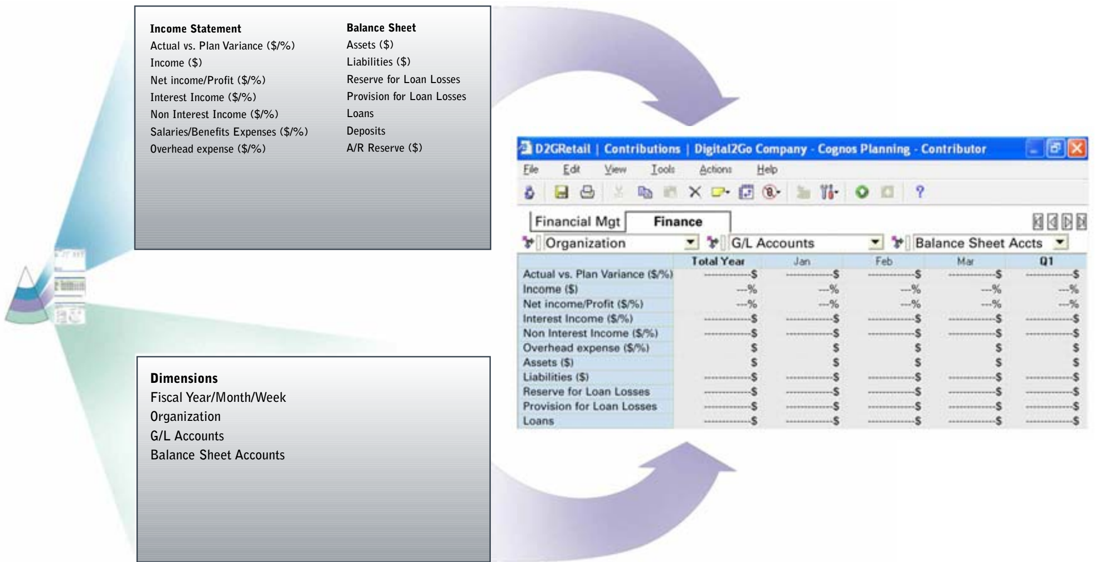
**Treasury**

The Treasury decision area moves beyond the tactical cash balances into the broader area of the asset-liability mix and bank strategy. Capital adequacy, regulatory deposit requirements, off-balance sheet product derivatives, and even foreign exchange exposures are evaluated with the objective of optimizing the cost of funds. Increasingly tailored solutions are available for Finance executives to lower the cost of capital. Improved collateral management can be achieved through the use of tri-party repurchase agreements to more effectively leverage the bank's collateral and thereby reduce cost of overnight funding. Lower costs of capital benefits are achieved through better utilization of securitized instruments owned by the bank, because the bank is making a loan to itself rather than borrowing money. There is the additional benefit of eliminating unmatched liabilities incurred by The Money Desk when they go for overnight funding without a matching offset; the tri-party contract will have been priced to reflect the current market value.

Effectively managing these asset-liability and liquidity options is a balancing act, and fine-tuning can make a difference. But without the appropriate system and information support, there will be lost opportunities in terms of managing the bank's cost of funds. Having access to current market information and aligning it with future business requirements is the key to effectiveness.

| GOALS | METRICS | DIMENSIONS |
|---|---|---|
| Interest Sensitivity Ratio (%) (Assets/Liabilities)<br>Dollar Gap Ratio (%) (Interest Sensitivity) | Cumulative Gap<br>Gap/Total Assets<br>Unsecured Assets (#/$)<br>Rate Sensitive Assets<br>Rate Sensitive Liabilities<br>Non-Rate Sensitive Assets<br>Non-Rate Sensitive Liabilities<br>Relative Gap Ratio<br>Duration Gap<br>Duration Drift<br>Net Worth<br>Shares Issued (#)<br>Shares Outstanding (#)<br>Dividend Payments ($/%)<br>Options Paid-Up ($)<br>Intra-day Loan (#/$)<br>Overnight Loan (#/$)<br>Legal Reserve RRequirements ($/%) | Maturity Buckets/Time Periods<br>Security Types<br>  Security Type<br>  Security ID<br>Depositories<br>  Depository<br>Cash Accounts<br>  DDA Account<br>Balance Sheet Accounts<br>  Class<br>  Sub-class<br>  Account<br>Fiscal Month<br>  Year<br>  Quarter<br>  Month<br>Organization<br>  Division<br>  Department<br>  Org. Code |

| FUNCTION | DECISION ROLES | PRIMARY WORK | CONTRIBUTORY | STATUS |
|---|---|---|---|---|
| Finance | | | | |
| | Executives | • | | |
| | Managers | • | | |
| | Analysts | • | | |
| | Professionals | • | | |
| Audit | | | | |
| | Executives | | | • |
| | Managers | • | | |
| | Professionals | • | | |
| General Management | | | | |
| | Executives | | | • |
| Risk Management | | | | |
| | Executives | | | • |
| | Analysts | | • | |




*The Income Statement and Balance Sheet decision areas illustrate how the Finance function can monitor its performance, allocate resources, and set plans for future financial targets.*