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Government Cash and Treasury Management Reform

Governments in developing countries need to reform the public sector to overcome banking and cash management inefficiencies and adopt international best practices. Inefficient cash management presents to governments a significant opportunity cost, often overlooked as it is not appropriated or expensed. Government cash and treasury management in most developing countries uses manual processes with check- and cash-based payments, multiple bank accounts, large cash floats, and idle balances earning little or no interest; and focuses on budget expenditure control rather than efficient banking and cash management. In large developing countries, the float commonly exceeds $1 billion. If the average cost of borrowing is 4–6% and the average interest earned is zero or close to zero, this float could cost up to $50 million yearly.

Cash management is having the right amount of money in the right place and time to meet the government's obligations in the most cost-effective way. This is achieved through

- more accurate and timely forecasting of cash flows and balances;
- more efficient and responsive cash management processing and service provision;
- management of consolidated risk positions; and
- integration of cash and debt management.

Reforms in cash and treasury management in several countries, particularly in the Organisation for Economic Co-operation and Development (OECD), has produced significant cost savings for their governments. These reforms are emerging in developing countries, and should be seen as an important and high-priority component of reform in government financial management. The Royal Thai Government, through the Controller General's Department in the Ministry of Finance, has received assistance for cash management reform under the Thailand Australia Capacity Building Facility, funded by the Australian Agency for International Development. Other countries like the Fiji Islands and Mongolia began similar reforms under technical assistance programs funded by the Asian Development Bank (ADB) in the late 1990s.

Government Cash and Treasury Management

In most developing countries, government cash and treasury management involves

- expenditure and revenue monitoring and control against budget appropriations, focusing on control of overspending;
- manual processing largely of check- and cash-based transactions;
- many government bank or imprest accounts, particularly in commercial banks;
- a large cash float with idle balances earning little or no interest in government accounts at the central bank and in commercial banks;
- a focus on government accounting requirements rather than effective cash management; and
- inaccurate forecasts of cash flows and end-of-day bank account balances

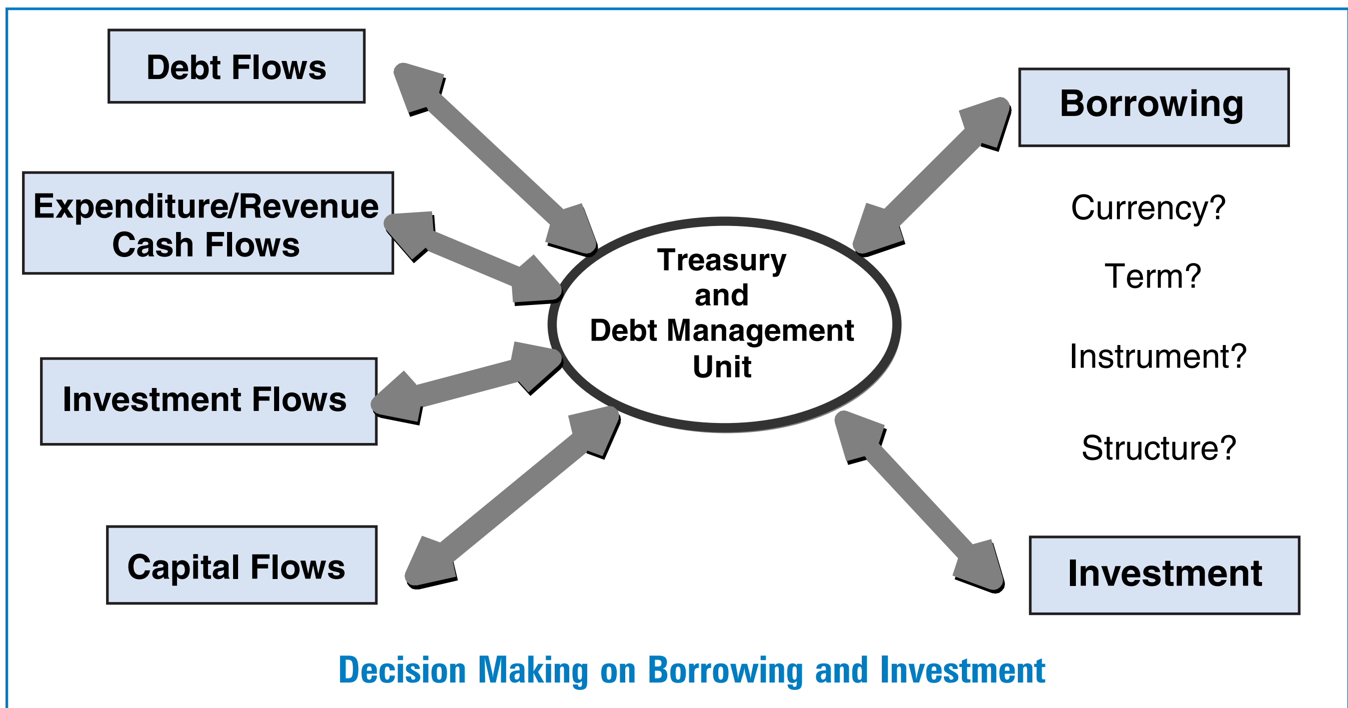
Government banking and cash management is primarily undertaken through government accounts held at the central bank. The balance in these accounts is managed mainly for monetary policy purposes. Expenditure control is normally rigorous, but neither the central bank nor the ministry of finance or treasury is specifically concerned with minimizing the cost of financing the government's cash requirement.

Under this system, government entities have little control over cash management and payment. To make small or immediate payments—through electronic funds transfer, checks, or cash—most entities, seeking to exercise greater control over the timing of payments, maintain several accounts at commercial banks. The government thus incurs a significant cost through lost interest on idle balances and high transaction costs imposed by the commercial banks.

Government cash flow management and disbursement have tight control over payments and, therefore, over government expenditure through centralized authorization and payment. However, the disadvantages are often great:

- poorly defined responsibility for good cash management and inefficient choice among short-term funding alternatives;
- absence of incentives for efficient cash management, with no concern about idle balances or ill-timed payments and receipts;
- constrained innovation in payment methods;
- inappropriate information for cash management; and
- isolation of the treasury from information on cash balances and control of bank accounts.

Quality cash management requires accurate forecasting of the cash flows between the government and the banking system and end-of-day cash balances in government accounts. Many countries, however, have difficulty forecasting cash flows accurately, particularly daily as required by the central bank for monetary policy purposes. Some countries have adopted incentives for government cash management to improve the forecasting and management of expenditure and revenue cash flows.



Decision Making on Borrowing and Investment

In countries where cash management reforms have occurred, government entities control the daily management of cash and bank accounts, and have been given incentives to manage surplus funds through deposit placements. To eliminate overnight exposure to the commercial banks, bank accounts are swept to the government account at the central bank. These countries have also found it important to coordinate all government cash flows.

Cash management in developing countries, on the other hand, is often fragmented, with many different government entities setting policies and forecasting and managing cash flows. They hardly, if ever, communicate with one another to determine accurately each day's consolidated cash position.

The decision that government debt managers need to make on borrowing and investment can be complex, particularly without a treasury or debt management unit. The diagram illustrates this complexity.

The responsibilities and agencies involved are as follows:

Debt Flows

- Domestic debt policies, debt issuance, and debt servicing—the central bank or a separate finance department in the ministry of finance
- External debt policies and debt negotiation and issuance—the department within the ministry of finance that is primarily responsible for international financial institutions and government bilateral lending arrangements
- Debt servicing—the treasury, with the central bank acting as the agent for the physical settlement of payments and receipts

Expenditure and Revenue Cash Flows

- Budget appropriations—the budget department of the ministry of finance
- Disbursements to government entities—the treasury or the controller general
- Annual and daily cash flow forecasts and collection of revenue—the government revenue entity responsible, with the revenue deposited into the government account at the central bank

Investment Flows

- Management of the government's foreign exchange reserves—the central bank
- Domestic investments such as financial assets, on-lending, and government equity in state-owned enterprises—the treasury or the controller general, although policy decisions will be made by the department in the ministry of finance responsible for state-owned enterprises (increasingly the department responsible for asset and liability management for the government)

Capital Flows

- Policies and management of structural and balance sheet reforms, including privatization—a separate department in the ministry of finance (increasingly the department responsible for asset and liability management for the government)

Effective cash management is different from budget appropriation and financial control. More and more, governments worldwide are separating the authorization and financial control functions from confirmation and settlement. In developing countries, however, the controller general still commonly authorizes disbursements under appropriation, signs the checks, or authorizes the transfers or payments, and approves the financial statements. This arrangement would be totally unacceptable in a financial institution and should no longer be considered sound practice for a government treasury or debt management operation.

Government agencies often do not appreciate the value of money and do not recognize that cash holdings and idle bank account balances earning no interest are an opportunity cost

to the government. To minimize this cost, it is vital to minimize undeposited funds, funds held in noninterest-bearing accounts, processing of checks through the clearing system, and physical cash holdings.

Money cannot be invested effectively if its existence is unknown or if a reserve or float is maintained to cover unanticipated payments, including checks presented for clearing. This problem can be mitigated by using electronic payment and receipt methods rather than checks, forecasting cash flows and balances more accurate and more timely, and retaining the ability to change the timing of payments.

For the government to maintain a significant float, it has to borrow, and then service this debt. Several governments are now targeting a zero or close-to-zero float.

International Practices

Innovative cash management reforms have been made by Australia, New Zealand, United Kingdom, and United States. The major advances in cash management have involved

- banking devolution and the use of commercial banks;
- greater banking and cash management autonomy for government entities;
- a move to electronic transaction processing and systems;
- adoption of systems and procedures for accurately forecasting cash flows and end-of-day bank account balances;
- delineation of clear responsibilities and accountability for all government entities;
- promotion of greater integrity, transparency, and responsiveness in managing and providing banking and cash management services; and
- incentives for more effective cash management.

Australia

The key features of the new banking arrangements introduced in Australia on 1 July 1999 for agencies covered by the Financial Management and Accountability (FMA) Act—Departments of State, Parliamentary Departments, and prescribed FMA agencies are as follows:

- Agencies must now open and manage their own bank accounts, payments and receipts, and relationship with their chosen transaction banker.
- To encourage good cash flow planning and management, agencies are to receive interest on their departmental account balances, are required to meet overdraft charges, and have access to term deposits of department funds.
- Through competitive tendering and contracting, agencies can choose the transaction banking provider, whose cost and quality of service best meets their business needs.
- Treasury manages the central cash management function and forecasts the Commonwealth's expected daily aggregate cash balance from administered and departmental revenue and expenditure information provided by agencies. The Australian Office of Financial Management sees to it that the Commonwealth has enough cash for its needs.
- All government accounts held with commercial banks are swept to the Reserve Bank of Australia at the end of each day so that agency accounts do not affect the daily cash balance.

New Zealand

Banking and cash management reforms, introduced in 1988 in New Zealand, have the following key features:

- Government departments have more control over the day-to-day management of cash, consistent with their increased responsibility for accounting and finance functions under wider public sector reforms.
- The New Zealand Debt Management Office (NZDMO) has overall responsibility for government cash management, including monitoring the funding requirements of government departments, disbursing funds to the departments and taking their deposits, and funding the aggregate requirement in the domestic debt market. The Financial Management Branch of the Treasury acts as financial controller while the NZDMO serves as the central treasury to maximize cash management efficiency.
- At the end of each half-year, each department pays a capital charge levied on the net taxpayers' funds at a rate reflecting the weighted average cost of capital for the department. The cost of capital is to be recovered to reveal the full cost of outputs and to encourage departments to minimize their use of capital.
- WestpacTrust, a commercial bank, was chosen to provide transaction banking services to the entire government, and the aggregate balance in these government accounts is swept to the Reserve Bank of New Zealand overnight.

United Kingdom

The United Kingdom Debt Management Office (UKDMO), which took over responsibility for cash management from the Bank of England (BOE) in 2000, is primarily focused on overall liquidity management. The transfer of functions followed the Government's decision to give the BOE full independence and responsibility for setting short-term interest rates. To clarify accountability for policy functions and allocation of responsibilities, the Government decided to divide responsibility between the institution setting short-term interest rates and the Government's debt manager.

The UKDMO intends to smooth the daily cash flows across the private sector. For cash management purposes, the UKDMO operates a stand-alone treasury function responsible for managing outstanding Exchequer sterling short-term assets and liabilities while simultaneously working to minimize day-to-day net cash flows. The intent is to neutralize changes in the aggregate cash position of the Exchequer across the Government's accounts at the BOE.

United States

The US Senate passed the Cash Management Improvement Act (CMIA) in 1990 to ensure efficient, effective, and equitable transfer of funds between state and Federal governments. The following are the major provisions of the CMIA:

- Federal agencies must make timely fund disbursements and grant awards to states.
- State and Federal agencies must minimize the interval between the time that Federal funds are transferred to states and that the states' checks or warrants are presented or electronic funds transfer (EFT) payments are settled for program purposes.

- With minor exceptions, states are entitled to receiving interest from the Federal Government for state funds advanced for program purposes pending Federal disbursement.
- The Treasury may charge Federal agencies for excessive or repeated incurrence of Federal interest liabilities.

The Treasury encourages, and in some cases requires, agencies to use electronic methods for improving Federal cash management. Most agency payments are made through EFT under Federal law. This general commitment to an all-electronic Treasury is reflected in the guidance provided by the US Government.

The primary goal is to pay bills and to collect debts on time. The cash management policy of the US Government is zero float. To eliminate the float, the United States is using electronic funds transfer; electronic benefits transfer; credit cards for collections; and payment cards for travel, fleet management, and small purchases.

Applicability of Reforms to Developing Countries

Experience suggests that cash management reforms are not easy, particularly in developing countries.

- **Institutional rigidities.** Significant structural adjustments are often difficult to make in most developing countries, where it is not easy to recruit and retain staff with the right skills on low public sector salaries, reassign staff to other parts of government or make staff redundant, or transfer functions and responsibilities.
- **Lack of willingness for reform.** In many developing countries, government officials who authorize and make payments can determine the payments and its timing. Such officials, influential in government cash management and banking, could resist change.
- **State of technology.** In many developing countries, technology has not developed to the level required for efficient banking, settlement, and clearing systems. Internet facilities and broadband communications may not be available due to budget constraints.
- **Banking facilities and services.** The range of banking products available will depend on the state of the banking sector and the services demanded by the public. In developing countries, many government employees and the public still expect to be paid in cash rather than through electronic means.

Developing countries will benefit enormously from using available technology and moving away from manual to electronic processing, and promoting more effective communications between government agencies involved in cash management. They can adopt many of the cash management practices in the developed countries as banking technology and forecasting systems become more widely available.

Conclusion and Recommendations

With better cash management, a government can target a zero or close-to-zero float, thereby reducing significantly its debt service cost. Therefore, governments in developing countries should give high priority to banking and cash management reforms.

In undertaking such reforms, developing countries should ensure

- government commitment to the reforms;
- zero or close-to-zero float as the government's overall objective for banking and cash management reform;
- clearly defined responsibilities for good cash management in each government agency;
- incentives for efficient cash management by providing deposit facilities for surplus funds or sweeping government accounts overnight or both, along with recognition for accurate forecasts of cash flows and end-of-day cash balances;
- use of banking technology innovations to move from manual to electronic processes to the fullest extent possible; and
- a centralized treasury function responsible for overall government cash management and closely integrated with the government debt managers.

This article was contributed by Ian Storkey, one of the senior managers responsible for New Zealand treasury debt management reforms. Mr. Storkey has advised developing countries on public debt and cash management.

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For inquiries, comments, and suggestions, contact Claudia Buentjen (cbuentjen@adb.org) and/or Merly Mallion (mmallion@adb.org) at ADB's Governance and Regional Cooperation Division. Previous issues of *The Governance Brief* can be accessed through ADB's governance web site http://www.adb.org/governance.