Storkey & Co

MANAGEMENT CONSULTANTS

International Government Cash Management Practices

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INTRODUCTION

In most countries, 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 with:

- net public sector injections of cash into the banking system being financed by sales of long dated government securities;
- primary banking sector liquidity being managed by periodic treasury bill tenders and daily open market operations undertaken by the Central Bank.

Expenditure control is normally rigorously exercised but minimising the cost of financing the government's cash requirement is not a specific role or objective of either the Central Bank or the Ministry of Finance/Treasury.

Under this system, Government entities (ministries, departments and agencies) have little control over the cash management process. The need to make small and/or immediate payments using electronic funds transfer, cheques or cash normally leads to most entities maintaining multiple accounts at commercial banks as entities seek to exercise greater control over the timing of payments. This can often lead to a significant cost to the government through lost interest on idle balances and high transaction costs imposed by the commercial banks.

Reviews of government cashflow management and disbursements have shown that these arrangements give tight control over payments and therefore over government expenditure from its centralised payment process. However, the disadvantages are often great, including:

- there is no clearly defined responsibility for good cash management and therefore the choice of short term funding alternatives is inefficient;
- there are no incentives for efficient cash management and therefore there is no concern about the existence of idle balances or the timing of payments and receipts;
- the limitations of the government payment/revenue collection system mean that innovation in payment methods is limited and that information is not appropriate for cash management purposes;
- the treasury function is isolated from information on position keeping and control of bank accounts.

To overcome these problems and exercise greater control over the management of cash resources, reform is needed so that:

- Government entities need to increase control over the day-to-day management of cash as they have the best knowledge of likely payment timings and are in the best position to influence likely cashflows. Hence it makes sense for day-to-day liquidity management to be the responsibility of entities. This can also be consistent with entities assuming greater responsibility

for the control of their accounting and finance if there is a move to adopt bulk funding.

- Government does not lose the use of money through idle balances in Entity accounts and that the keenest financing rates can be obtained. To achieve this, it is accepted that a degree of centralisation is desirable so that bank balances maintained by entities could be netted and aggregated, and consolidated cashflow forecasts can be prepared to allow full use to be made of funding opportunities.

In most countries, government cash management practices can be characterised as primarily:

- monitoring and controlling expenditure and revenue against Budget appropriations;
- manual processing with a significant volume of cheque- and cash-based transactions;
- focused on meeting accounting requirements rather than ensuring effective cash management.

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EFFECTIVE CASH MANAGEMENT

Cash management can be defined as:

"Having the **right** money in the **right** place at the **right** time to meet Government's obligations in the most cost-effective way"

This is achieved by ensuring:

- more accurate and timely forecasting of cash flows and balances;
- greater efficiency & responsiveness in cash management processing and service provision;
- management of consolidated risk positions;
- integration of cash and debt management.

Reforms are a first step in the move to more effective cash management across the whole of government that include:

- identification of cash management objectives for the government and how it is translated to the operational policies and procedures for the MoF, Treasury, Debt Management Unit, Central Bank and government entities;
- introduction of incentives for efficient cash management to minimise the level of idle balances and create greater certainty around the timing of payments and receipts;
- innovation in payment/revenue collection methods so that the government can move to a greater use of electronic funds transfers rather than using cheques;
- enhancement of existing infrastructure, banking and information systems;
- closer integration of cash management with public debt management.

It should be noted that Cash Management is different from Budget Appropriation and Financial Control. There is an increasing trend internationally for governments to separate the functions of "Authorisation and Financial Control" (i.e., the accounting and financial controller functions) from "Confirmation and Settlements" (i.e., the back office functions). It is common practice in developing countries for the Comptroller-General to be required to authorise disbursements under appropriation, to then sign the cheque or authorise the transfer or payment, and to sign-off on the financial statements. This would be totally unacceptable in a financial institution and is no longer consider sound practice for a government treasury or debt management operation.

Therefore, it is strongly recommended that there is clear segregation of functions responsible for the authorisation and accounting of government's finances and the settlement and physical payment of governments cash management transactions.

Experience internationally has shown that there is a need for a "treasury financial services function" that supports government's financial operations and is responsive

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to the needs of government agencies. This "operational or service function" is different from the "compliance and control function" that the MoF/Treasury also perform. The Debt Management Unit is often best placed to undertake this function, which can include a focus on developing operational relationships with the finance officers from each government entity and with the government's bank(s) to deliver high quality and efficient financial services.

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INTERNATIONAL CASH MANAGEMENT PRACTICES

In reviewing international practices, the countries that are most advanced in cash management innovation are Australia, Canada, Finland, New Zealand, Sweden, United Kingdom and the United States. The major advances in cash management have involved:

- banking devolution and the use of commercial banks;
- greater autonomy for Ministries;
- moving to electronic transaction processing and systems;
- greater integrity, openness and responsiveness;
- introduction of incentives for more effective cash management.

Over the past 5-10 years, governments particularly in the OECD countries have recognised the potential cost savings from improved cash management and integration of cash and debt management. This has led governments to clearly separate government's cash management from the Central Bank's monetary policy operations to avoid any perception of conflicts of interest in market operations and to ensure greater transparency and clarity for market participants.

Our understanding of the developments in other countries suggest that cash management is an evolving process due to:

- institutional rigidities;
- willingness for reform;
- consistency with other government initiatives;
- state of the banking, settlement and clearing systems;
- range of banking products;
- state of technology.

Therefore, there is no single model that is applicable to a country. This means that each country must develop its own solution mindful of international sound practices.

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How to Improve Cash Management

There are a significant number of opportunities to reduce costs through more effective cash management practices. For instance:

1. Banks charge for the processing of transactions by imposing fees or paying reduced interest. Bank charges can be lowered by reducing the number of transactions by, for example, paying suppliers once per month rather than on a per invoice basis.

2. Processing invoices is costly. These costs can be reduced by, for example, using procurement cards for small value items or by setting up recurring payments where possible.

3. Money cannot be invested effectively if you are not aware of its existence or if you have to maintain a reserve to cover unanticipated debits to the bank account such as bank fees and cheques clearing. This can be mitigated by:

   - promoting greater certainty through making payment/receipts using electronic means rather than cheques;
   - improving the accuracy and timeliness of forecasting cashflows and balances;
   - retaining the ability to change the timing of payments.

4. Money has a value and cash holding and idle bank account balances do not earn interest. In order to maximize the earnings, it is vital to minimise:

   - undeposited funds;
   - funds held in non-interest bearing accounts;
   - cheques being processed through the clearing system;
   - physical cash holdings.

5. An organisation requires liquidity to support volatility in the cash flow of its operations. Liquidity includes cash on hand, marketable securities, and standby facilities. Liquidity has a cost. The level of liquidity required can be reduced by:

   - increasing certainty around the timing and value of receipts and payments;
   - making greater use of short-term instruments through government's liquidity management activities such as open market operations;
   - having access to standby facilities.

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INTEGRATION OF DEBT AND CASH MANAGEMENT

A major focus of the Debt Management Unit (DMU) should include the integration of cash and debt management. This helps ensure that decisions surrounding the issuance of debt are taken in the context of the government's overall cashflows. Accurate forecasting will enable short and long-term expenditure and revenue patterns to be established on a more accurate basis, thereby providing the DMU with information necessary to determine the optimal long-term debt program. While government's borrowing is often structured around meeting the budget deficit, funding of capital projects and existing debt repayments, there may be opportunities to make savings by funding short-term requirements using short-dated debt instruments rather than locking into long-term debt.

Many countries opt to create certainty in the domestic bond market by funding the financial deficit and debt repayments through regular bond tenders with the program schedule announced at the beginning of the financial year in the Budget. The timing of individual tenders will to a large extent be set by net expenditure and revenue flows. Actual tender details (maturity and amount) are then announced several weeks prior to the tender but the DMU can look to signal its intentions with the Budget announcement and media releases during the year. This process ensures transparency and certainty for market participants. To the extent there is short-term variability in expenditure/revenue flows, this is normally managed through the issuance and buy-back of treasury bills on a daily basis.

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Examples of International Practices

Australia

Introduction

Prior to July 1999, each Financial Management and Accountability Act 1997 (FMA Act) agency was required to draw down funds as required, to make payments from the Commonwealth's centralised Official Public Account (OPA) held within a group account arrangement with the Reserve Bank of Australia (RBA) called the "overdraft group". Processing was conducted largely through the Department of Finance and Administration's (DOFA's) Central Accounting and Payment Service (CAPS), with the Treasury undertaking an aggregate cash and debt management function on the Commonwealth's behalf on the basis of forecasts from agencies of daily cashflows.

From 1 July 1999, new banking arrangements were introduced for agencies covered by the FMA Act, namely Departments of State, Parliamentary Departments and prescribed FMA Agencies. These agencies are now required to open and manage their own bank accounts, managing their payment and receipt arrangements (cash management), and are responsible for managing their relationship with their chosen transactional banker. The total cost of all fees and charges associated with the operation of agency accounts is met from agency departmental funds.

Cash management arrangements to accompany agency banking are different for departmental funds (those controlled by agency managers) and administered funds (those administered by agency managers on behalf of the Government).

To encourage a focus on cashflow planning and management, agencies receive interest on their departmental account balances and also meet overdraft charges. They also have access to term deposits of departmental funds, which are administered on behalf of DOFA by the Reserve Bank of Australia (RBA).

Private sector competition has been introduced to the Commonwealth's domestic transactional banking services that were previously provided solely by the RBA. Agencies are able to choose the transactional banking provider that can best meet their business needs in terms of cost and quality of service. The RBA's transactional banking business operates in competition with private sector banks and competitive neutrality principles apply. Transactional banking refers to the services associated with the operation of bank accounts for the purpose of processing of receipts and payments, and for the corresponding record keeping and transmission of instructions and transaction/balance information.

There are some core service requirements or protocols, which a bank providing transaction services has to satisfy. This ensures the effective operation of the Commonwealth's central cash and debt management and RBA central banking functions related to the management of liquidity in the banking system. Agencies also need to address their transactional banking service requirements in accordance with competitive tendering and contracting policies and guidelines.

Treasury's manages the central cash management function and the Australian Office of Financial Management (AOFM) manages the debt management function.

Departmental and Administered items are reported separately in departments and agencies financial reports because the nature of accountability is different, due to varying degrees of control over transactions:

- Departmental items are those assets, liabilities, revenues and expenses controlled by departments or agencies in providing their goods and services;
- Administered items are those assets, liabilities, revenues and expenses which are controlled by the Government and managed or oversighted by departments or agencies on behalf of the Government.

Appropriation – Drawdown

Under the accrual budgeting system, running costs have been replaced by resourcing based on the full price of outputs produced, reflecting the purchase by Government of the agencies' outputs. This shift from cash to accrual budgeting and accounting and from an input to an output focus allows competitiveness of output pricing, an essential element of the new Budgetary decision framework. Accrual budgeting and agency banking arrangements provide mechanisms to encourage agencies to behave in a more business like manner in relation to all resourcing decisions, including cash and cashflow management.

Departments also have access to money received under a net appropriation arrangement, including interest received quarterly under the new cash management incentive arrangements. All drawdowns to agency bank accounts are executed electronically via the Cash and Appropriation Management Module (CAMMS) in Accrual Information Management System (AIMS) – drawdowns are not executed by cheque payment.

Departmental Receipts

Under the previous appropriation arrangements, departmental receipts were deposited into Official Receipts Accounts then transferred to the OPA. The changes to the FMA Act allow departmental receipts to be paid into agency departmental bank accounts and held there until spent.

Administered Receipts

All administered receipts are transferred from agency-administered accounts to the OPA daily, either immediately following the close of RTGS processing (for aggregate RTGS amounts) or as part of overnight sweeping arrangements. Agencies are responsible for the accounting of administered receipts and reporting daily via AIMS, the amounts transferred (including identification of receipts collected for other agencies).

Foreign Exchange Payments and Receipts

To ensure consistency with the RBA's exchange rate management objectives, all agencies are required to undertake foreign exchange transactions with the RBA

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which, in turn, passes these transactions through to counterparties in the commercial market at times of its own choosing. However, subject to agreement with the RBA's International Department, agencies may be able to arrange for the delivery of some or all low-value transactions through their provider(s) of their domestic transactional banking services or an alternative provider.

Central Bank Accounts

Previously, all major Commonwealth transactions were facilitated through the OPA, which is the Commonwealth's central account, one of a large number of Commonwealth bank accounts held with the RBA. These accounts – which include drawing accounts, advance accounts and receipts accounts – are treated by the RBA as if they are part of one set-off account for the purpose of interest and overdraft calculations. This aggregation is called the "overdraft group" of accounts. In determining the Commonwealth's daily cash requirements, and hence managing the debt program, Treasury focuses on the daily forecast aggregate balance within the "overdraft group".

These arrangements have continued to operate under the new regime with amounts equivalent to the Commonwealth's aggregate cash balances in agency accounts with each transactional banker swept overnight to a Commonwealth central account held within the overdraft group. Funds are no longer drawn through a DOFA Drawing Account.

A Government Banking Services Master Agreement is in place between the Commonwealth and the RBA. This sets out the terms and conditions under which domestic and overseas transactional banking services are provided to the Commonwealth by the RBA, reflecting the new service requirements between the Commonwealth and the RBA. There are separate service agreements/contracts between individual agencies and their chosen transactional banking service provider. This provider may be the RBA transactional banking business or a private sector bank.

Finance Minister delegations allow operation of bank accounts established by agencies with the RBA transactional banking business or with private sector banks. Amendments to the FMA Act have removed the distinctions in the Act between money in the CRF, "drawn money" and "received money" as classes of "public money". As a consequence, official accounts no longer need to be designated as "drawing accounts", "receipts accounts" or "imprest accounts".

Account Structures

Under the new arrangements, the basic account structure for agencies comprise one account for each of:

- administered receipts;
- administered payments;
- departmental receipts and payments.

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The policy of separate accounts for departmental and administered funds reflects the fundamental difference between departmental funds (controlled by the agency) and administered funds (administered on behalf of the Government). The basic account structure is required for the effective operation of incentive arrangements and to meet the requirements of the core protocols.

The efficient drawdown of funds and the operation of the incentive regime rely on establishing a "head office to head office" relationship between DOFA and the agency. Drawdown from the OPA will go to either the agency "head office" departmental bank account or the "head office" administered payments account. Administered receipts will be transferred from the agency administered receipts account to the OPA.

In the interests of efficient cash management, each agency was required to review all its accounts with a view to rationalisation and efficiency, and satisfy itself of the continuing operational need for those accounts. Minimising the number of separate accounts supports administrative efficiency in transaction and reconciliation processes, contains bank fees and charges, and facilitates better cash management.

Bank accounts maintained by the Department of Foreign Affairs and Trade (DFAT) at overseas posts provide the basis for effecting payments and collecting receipts for DFAT and other agencies under third party arrangements. Consolidation of accounts under overseas administrative arrangements provides cash management advantages to the Commonwealth.

Sub Accounts

Agencies can consider using sub accounts, i.e., an internal split of accounts under a main account, to manage transactions. These are not recognised as separate accounts by the transactional banker, who reports on the main account. They are accounts, which are split in a system, whereby cheques and serial numbers (payments and receipt references) can be specified as belonging to particular accounts, and therefore reported as such.

Separate Accounts

Separate bank accounts below the head account also provide a means to partition transactions that need to be separated for accounting or reconciliation purposes. Where these are established, agencies are responsible for moving funds between the head accounts and other separate accounts and incur the additional transaction costs and accounting keeping charges involved. Therefore, it has been recommended that any separate account structures be maintained within agencies' general ledgers, not as separate accounts at their bank. However, provided the core protocols are satisfied, agencies are able to maintain a separate account structure at the bank. This means:

- separate accounts at the bank must "map" to one of the three "head office" accounts and, with the exception of settlement accounts, must contain the words "Official Departmental" or "Official Administered" in their title;

- balances in such separate accounts must be included in overnight sweeping and funds transfer arrangements.

Settlement Account

Some agencies use one "settlement" type account and fund all transactions from the three official accounts to that settlement account. In some circumstances these arrangements may be appropriate. However, the costs and benefits of this arrangement have to be carefully considered when examining agency-banking needs.

For the establishment of a separate "settlement" account, it is necessary to ensure that the following core protocols are satisfied:

- any administered receipts need to be transferred from the Settlement Account to the administered receipts account in time for transfer to the OPA (both at the close of RTGS transactions where applicable, and as part of overnight sweeping arrangements);
- any balances of departmental funds or administered payments must be transferred from the Settlement Account to the "head office" departmental or administered payments accounts by the end of the banking day to be included in the overnight sweeping arrangements.

Credit Card Merchant Facility – Nominated Bank Accounts

A credit card merchant facility is an arrangement with a bank or a credit card provider, which allows an agency (the merchant) to accept payment by credit card with receipts being credited to a nominated bank account or accounts. Payments by credit card may be processed as paper transactions or by electronic terminals. Agencies who use a credit card merchant facility need to nominate an official bank account into which receipts can be paid and from which merchant fees and any returns or charge-backs will be debited by the bank or card provider. The nominated bank account need not be held with the Bank that provides the credit card merchant facility.

Central Cash and Debt Management

The AOFM is responsible for the borrowing activities of the Commonwealth and for overall debt management. AOFM's functions in this regard give it primary responsibility for ensuring that the Commonwealth has sufficient cash to meet its needs.

In carrying out its cash management function, Treasury forecasts the Commonwealth's expected daily aggregate "overdraft group" cash balance. The Commonwealth's cash balance forecasts are compiled through the forecasting of (what will be) both administered and departmental revenues and expenditures. In formulating these forecasts, Treasury relies heavily on information provided by agencies.

Treasury requires cashflow forecasts from agencies for all administered and departmental transactions equal to or greater than A$1 million, excluding transfers

of funds to or from the OPA. The sweeping arrangements mean that transactions between the OPA and agency accounts do not affect the daily overdraft group cash balance. For example, in the case of departmental drawdowns it is important for Treasury to be provided with information concerning the date agencies make a payment from their departmental account rather than the date agencies receive their drawdown from the OPA. Required information includes the size of the transaction, the date of the payment/receipt, the payee, the payer, the currency and the method of payment/receipt (direct credit or cheque).

Effective Commonwealth cash management requires that the cashflow information provided weekly to the Treasury has at least a six month horizon as follows:

- Daily cashflow forecasts for the following 3-4 weeks; followed by
- Weekly cashflow forecasts for at least the following 5 months.

Incentive Regime

Agencies are responsible for the management of the funds they receive from the Budget as payment for outputs ensuring, for example, adequacy of working capital and provision for replacement of assets over time and for accruing employee entitlements. The need to resource future asset replacement may result in some agencies accumulating significant balances in the medium term, depending on the size of the asset base and associated replacement cycles. On the other hand, agencies may experience within year shortfalls that require them to access overdraft facilities through the DOFA incentive regime.

In determining their output price, agencies take into account additional costs for bank fees and charges under the new banking arrangements, together with any interest earnings. The benefits of effective cash management translate to a capacity for more competitive output pricing.

Bank Fees

Agencies will bear (from departmental funds) the cost of operating all their bank accounts and are charged directly by their transactional banker, either a private sector bank or the RBA transactional banking business.

Interest on Credit Balances

Under the DOFA incentive regime, agencies earn interest daily on:

- the overnight aggregate credit balances of their departmental bank accounts;
- term deposits nominated by the agency for periods from one week to 12 months.

The payment of interest on departmental cash balances provides an incentive for agencies to make better decisions about the timing of expenditure and improve collection of departmental receipts. By focussing on accurate forecasting of cash requirements and management of payment obligations, an agency can maximise its interest earnings and minimise recourse to overdraft facilities under the incentive

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scheme. Interest rates are determined by the Minister for Finance and Administration, are updated daily and available for viewing in CAMM as follows:

- aggregate positive balances in departmental accounts at a spread below the target cash rate;
- overdraft charges on negative departmental balances are the same as would apply to overdrafts of the Commonwealth as a whole;
- agencies can earn market rates on term deposits for any number of days they wish to specify between one week and one year.

Interest incentives operate through a central incentive regime administered by DOFA. The sweeping arrangements required as part of transactional banking service agreements generate zero balances at the end of the banking day for total Commonwealth cash held by each bank (the balances of agencies' individual accounts remain unaltered in this process). Agencies are not able to negotiate interest or overdraft terms with their transactional banker or enter into arrangements contrary to the sweeping of daily balances. Agency CEOs have to periodically certify that the full overnight balances of their departmental and administered accounts have been included in the daily sweeping arrangements involving their transactional banker.

Agencies receive interest on the aggregate overnight balances of their departmental accounts at rates set in relationship to term rates consistent with the objectives of the incentive regime.

Term Deposits

Term deposits of departmental funds are administered on behalf of DOFA by the RBA and follow the conditions set out below:

- agencies are able to place surplus funds for a chosen period from one week to one year;
- interest rates paid to agencies are referenced to market rates and are posted on an AIMS screen each day;
- consistent with commercial banking practice, a penalty is applied if an agency breaks a term deposit:
- an agency breaking a term deposit imposes additional administrative costs and in a fully commercial environment might be responsible for investment losses as a result of its actions,
- there is a cut-off time each day after which it is not be possible to break term deposits for that day – this is to ensure no adjustments are needed to the information the RBA sends to AIMS about interest payable to agencies on maturing or broken term deposits.

These placements are administrative arrangements rather than formal investments with the RBA and are the only investment facility open to agencies (other than specific delegations made by the Minister for Finance and Administration).

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Agencies need to arrange with their transactional banker to transfer the amount of their term deposit to a specific account at the RBA, where it remains until maturity.

On the day before maturity, the RBA advises AIMS of the interest that has been accrued daily (without compounding). The aggregate of these amounts is transferred to the agency's departmental account on the day of maturity, the principal being returned directly by the RBA and the interest being paid from the OPA in accordance with instructions from AIMS.

The DOFA website has a number of guides and manuals readily available to explain the cash management regime: www.finance.gov.au/finframework.

Canada

Responsibility for the Government of Canada cash management rests with the Banking and Cash Management Sector (BCMS) Organization. BCMS is organised into the following directorates and divisions:

Payment Products and Services Directorate

Responsible for Government of Canada as well as joint federal-provincial payments (about 194 million payments a year). Specifically:

- Manages the issue of Receiver General payments made by cheque, direct deposit and EDI. Provides payment services and advice to federal departments and agencies and to a number of provincial and territorial governments.
- Manages the printing of non-payment items (e.g., tax information slips, Canada Savings Bonds) on behalf of departments.
- Provides functional direction to regional responsible sites and manages the responsible site located in the National Capital Area.

Cash Management Operations Division

Manages the flow of federal money into and out of the Consolidated Revenue Fund, tracking receipts, settling for payments, transferring funds for investment and preparing accounting input. Specifically:

- Establishes bank accounts for the purpose of accepting payments made to the Receiver General via federal departments and agencies.
- Performs reconciliations of daily deposit data, transmits the information to departments and records the data in the accounting system.
- Reimburses financial institutions through the Bank of Canada for the redemption value of federal government payments.
- Transfers the federal government's excess cash balances for investment in term deposits. Operates foreign bank accounts for federal payments in foreign currencies.

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Banking Arrangements Directorate

Deals with financial institutions to set up the banking services required by the Receiver General and client departments. Specifically:

- Negotiates or tenders for banking services from financial institutions and implements these arrangements.
- Maintains the float model, a procedure for calculating the cost of the flow of money between the government and financial institutions.
- Calculates the compensation due financial institutions for their services.

Business Infrastructure Support Division

Provides technical advice and support to GOS on information technology matters. Specifically:

- Assists clients test their applications using automated test facilities to detect flaws early and improve functionality.
- Works with the Government Telecommunications and Informatics Service (GTIS) to ensure that desktop software used by GOS is reliable and meets its requirements.
- Provides technical support for developing and managing the Branch Web sites. Helps launch new versions of these sites. Ensures that Treasury Board and PWGSC standards are adhered to in the presentation of material on the Web sites.

Payment Standards Division

Monitors, sets and implements the standards used in producing all Government of Canada payments, whether these are made by cheque or EDI. The Division is also responsible for controlling the cheque stock inventory for all Receiver General payments. Specifically:

- Sets and implements standards used for Receiver General electronic payments, cheques and envelopes, and departmental bank accounts.
- Procures cheque stock and envelopes for Receiver General cheques. Monitors inventory and ensures that production centres have the required stock.
- Works to ensure the security of Receiver General payments by monitoring security issues, conducting quarterly reviews on security, coordinating the Receiver General response to thefts and counterfeiting, and communicating with financial institutions on security concerns.
- Manages the GOS Electronic Commerce and Government Online Secretariat.

More details are set out in http://pwgsc.gc.ca/recgen/text/bcmsanrep00-e.html.

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NEW ZEALAND

Prior to 1990, government banking was primarily undertaken through the Public Account, a bank account held at the Reserve Bank of New Zealand (RBNZ). The primary means for a Ministry/department making a payment was via Regional Treasury Offices. Departments had little control over the cash management process. The need to make small and/or immediate payments, where cheque raising through the Regional Treasury Office was too slow, led to many departments maintaining imprest accounts at private sector banks that were funded to an agreed limit and reimbursed periodically. The use of imprest accounts rose dramatically as departments strove to exercise greater control over the timing of payments. By 1986, there were estimated to be over 600 imprest accounts in government departments, which were being used to make over 13 million payments per year. The lost interest in idle balances was estimated to be costing the government over NZ$10 million per annum.

Following a review in 1988, reforms were introduced so that:

- department's control over the day-to-day management of cash would increase, consistent with them assuming greater responsibility of their accounting and finance functions that were part of the wider public sector reforms instigated by the State Sector Act 1988 and the Public Finance Act 1989;
- the government did not lose the use of money through departmental idle balances, and the keenest financing rates were obtained. To achieve this, it was accepted that a degree of centralisation was desirable so that:
  - bank balances maintained by departments could be netted and aggregated;
  - consolidated cashflow forecasts could be prepared to allow full use to be made of funding opportunities.

Incentives were also introduced to encourage efficient cash management. The key features are:

- a capital charge that is payable by each department at the end of each half-year. The charge is levied on the net taxpayers' funds as recorded in departments' audited financial statements for each half-year and annual reporting period. The capital charge rate reflects the weighted average cost of capital appropriate to the department. Recovery of the cost of capital is needed to reveal the full cost of producing outputs and encourage departments to minimise their employment of capital;
- interest is payable at market-related rates on term deposits placed with the NZDMO, for a term of up to one year, and subject to a penalty in the event of early withdrawal. Initially, interest was also payable by NZDMO on the net overnight balances of departmental bank accounts held at WestpacTrust, with the return being greatest where overnight balances equal the level of forecast by departments (the overnight interest regime was terminated in the mid-1990s as overnight balances were being accurately forecast by most departments

and as they were unable to spend the interest earned, there was no need for this incentive).

The key at the time to the incentives for effective cash management was that the interest rate and capital charge aspects of the regime were adopted simultaneously, i.e., departments could not earn interest in the absence of a capital charge.

NZDMO is required to monitor government departments' funding requirements, disburse funds to departments and fund the aggregate departmental requirement in the domestic debt market. NZDMO has four areas of responsibility:

- **Banking**: NZDMO is responsible for the banking arrangements that enable centralised cash management for all government departments – the government has a contract with WestpacTrust to provide transaction banking services for all departments;
- **Forecasting**: RBNZ as agent for the NZDMO obtains accurate and timely forecasts from departments in order to manage the governments' net revenue/expenditure position and integrate cash and debt management;
- **Incentives**: to encourage departments to exercise good cash management and working capital control disciplines, incentives are available for departments to deposit surplus funds with NZDMO;
- **Foreign Exchange**: departments are responsible for identifying and managing their foreign exchange transaction exposure under their own departmental policy drawn up within the guidelines approved by the Minister of Finance. NZDMO monitors the overall counterparty exposure that arises both from its own activities in managing public debt and from departments. NZDMO is responsible to the government for managing the credit and settlement risks created by undertaking transactions with authorised counterparties.

The New Zealand framework has been very innovative because the cash management function has been separated to clearly distinguish between compliance and operations. For example, the Financial Management Branch of the Treasury acts as financial controller whereas the NZDMO acts as the central treasury function to ensure maximum efficiency around government's cash management. This separation has had the benefit of NZDMO being seen as the transaction agent by each department and not the compliance or control agent. In this way, NZDMO has won the support of each government department to ensure an open level of communication between all parties, particularly in terms of forecasting and managing day-by-day cashflows.

New Zealand has been fortunate that it has been able to move the government's transaction banking services to WestpacTrust, a commercial bank (i.e., away from the RBNZ although the government stills retains a Crown Account at the RBNZ). This has certainly improved the transaction processing efficiency, although by choosing only one bank, it has eliminated competition and ongoing innovation.

The New Zealand approach has a strong risk management framework as it consolidates credit exposures including elimination of any overnight exposure to the

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commercial banks, manages foreign exchange risk and integrates cash management with the government's debt program.

UNITED KINGDOM

The UK Debt Management Office (UK DMO) primarily focuses on government's overall liquidity management. The UK DMO took over responsibility for cash management from the Bank of England (BoE) in 1998. The reasons for transferring the debt and cash management functions from the BoE to the UK DMO followed the government's decision to give the BoE full independence and therefore the responsibility for setting short-term interest rates. Three reasons were given, namely:

- **Inside Information**: If one authority is responsible for both setting short-term interest rates and providing advice on debt management, the market may read monetary policy signals into debt management decisions. The market may also charge a premium if debt management is believed to be influenced by inside information on interest rate decisions and could be used to the detriment of investors.
- **Possible Conflicts of Interest**: Debt management may be a distraction for the monetary policy authority's central counter-inflationary task. Conversely, its debt management policy advice might be influenced by monetary policy considerations. This could conflict with the debt management objective of minimising the cost of government financing subject to risk.
- **Transparency of Operations**: The risk of holding sterling assets should diminish if it is clear that monetary policy operations to establish short-term interest rates are for monetary policy reasons, rather than to meet the Exchequer's financing needs. Consequently, money market operations needs to be distinguished from those involving government cash management to avoid confusion over monetary policy signals. Also, transparency would be brought to the sources and costs of the Exchequer's short-term financing since these are currently bound up with the BoE's monetary policy operations.

The key factor in shaping this change was the desire for clearer accountability for policy functions and the allocation of responsibilities. Therefore, the UK took the decision to create a division of responsibility between the institution charged with the setting of short-term interest rates and government's debt manager.

The aim of the UK DMO is to smooth the daily cashflows that occur across the private sector, i.e., central government divide at the BoE. In essence, for cash management purposes, the UK DMO operates a stand-alone treasury function with responsibility for managing outstanding Exchequer sterling short-term assets and liabilities while simultaneously working to minimise day-to-day net cashflows. The intended result is to neutralise changes in the Exchequer aggregate cash position across the government's accounts at the BoE.

The BoE acting as agent for the UK DMO continues to operate the Exchange Equalisation Account through which the foreign exchange transactions of the government take place. The UK DMO's main objective is to smooth Exchequer cashflows that are shown up in the forecasting process.

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The UK DMO's focus is to smooth, in a cost-effective way, the forecast net daily cashflows across the central government accounts at the BoE. This is managed firstly through the structured (i.e., weekly) Treasury bill programme and then through daily market operations. The UK DMO plans to run down the Treasury bill stock in months of positive cashflows and then increase it in months of higher net expenditure.

The UK DMO and BoE work together to avoid clashes in the delivery of their respective objectives. The UK DMO will not therefore take speculative positions on interest rate decisions by the BoE nor hold certain operations, which could be perceived to clash with the BoE's open market operations (OMOs).

Although the UK DMO conducts its cash management operations in accordance with the provisions in a published Operational Notice, it acts at all times in accordance with it s published objectives and operates as required in order to achieve these objectives.

The UK DMO operates its own Debt Management Account (DMA). Treasury bills issued after the transfer of cash management are issued from, and are liabilities of, the DMA. However, this does not change the fundamental nature of the instrument, as they continue to be negotiable, bearer, zero-coupon obligations of Her Majesty's Government, with recourse to the National Loans Fund and the Consolidated Fund.

More details can be obtained from: www.dmo.gov.uk/cash/index.htm.

USA

In the United States, the Cash Management Improvement Act (CMIA), passed by the Senate in 1990, ensures efficiency, effectiveness, and equity in the transfer of funds between State and Federal Governments. Major provisions of CMIA include:

- Federal agencies must make timely fund disbursements and grant awards to States.
- States and Federal agencies must minimize the time between the transfer of Federal funds to States and the presentment of States' checks/warrants or settlement of EFT payments for program purposes.
- With minor exceptions, States are entitled to interest from the Federal Government for the time State funds are advanced for program purposes pending Federal disbursement. The Federal Government is entitled to interest from the States for the time Federal funds are in State accounts pending presentment of checks/warrants and settlement of EFT payments for program purposes.
- Treasury may charge responsible Federal agencies if they are found to be egregious or repeatedly incur Federal interest liabilities. Interest charges will be paid from agency operating budgets and not amounts available for program funding.

Treasury is committed to improving Federal cash management by encouraging, and in some cases requiring, agencies to use electronic methods. For example, agencies are required under Federal law to make most of their payments by

electronic funds transfer (EFT). 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 on time and to collect debts on time. The US Government cash management policy is "zero float." In order to eliminate the float, the United States is using electronic funds transfer (EDI), electronic benefits transfer (EBT), credit cards for collections and payment cards for travel, fleet management and small purchases. Also, there is the ability to do offset without inconveniencing the payor or the payee. The following are some specific examples:

- The Fixed Contract Payment System provides for automatic payment of fixed amounts at regular intervals without submission of an invoice or receiving report.
- The International Merchant Purchase Authorization Card (IMPAC) is a commercially issued purchase card for federal purchases. The IMPAC card allows for streamlined acquisition of goods and services under $2,500, eliminating the need for petty cash purchase orders.
- Electronic benefits transfer uses debit cards to deliver cash and in-kind government-funded benefits such as food stamps, welfare and social security to individuals.
- The Department of Treasury employs a service called "Quick Pay," where invoices under a certain dollar amount are paid prior to certification of receipt of goods and services.
- The Rural Development Finance Office has initiated a project to implement digital signature electronic invoicing for certain project cost payments.
- Pre-authorized Debit (PAD): General Services Administration (GSA) has recently begun offering debtors the option of paying by PAD. To the extent that debtors choose this method of payment, collection is assured because the amount due is automatically deducted from the debtor's account. Also, the costs of paperwork are minimised by using electronic transfer of funds.
- The Paperless Information Exchange (PIX) Payment System allows GSA to receive electronic invoices from a vendor, pay the invoice through the automated clearing house (ACH), charge the correct account, and notify the office that their bill has been paid, all without manual data entry. Reconciliation is handled on an exceptional basis.

The US Government has extensive information on the US Treasury website, providing agencies with an easy-to-use guide to ensure good cash management by the Federal government. The guidance provided in the website is established by rules, regulations, policies, and other guidance relating to cash management. Currently, the guide applies to billings, deposits, collections, disbursements, and cash held outside Treasury. In the near future, other aspects of cash management will be added.

More details can be obtained from:

www.fms.treas.gov/cashmanagement/index.html.

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