The cash management program

Q 4-03. What are the components of a good cash management program?

Cash management involves nine basic functions. Their locus should be within the treasury. These are:

- Controlling spending
- Receiving funds[1]
- Concentrating funds
- Disbursing funds
- Maintaining appropriate information
- Forecasting future funds flows
- Investment of surplus funds
- Short-term Borrowing
- Managing bank relationships

Q 4-03.01. What is meant by controlling spending?

The *rate of spending* is controlled using financial plans that specify the timing of funding for expenditure programs. The *absolute amounts of spending* are controlled through the budget that sets limits on expenditures for the entire accounting period.

Q 4-03.02. What is the treasury's role in receiving funds?

Funds due as taxes or imposts or as fees for services received from taxpayers or customers must be collected efficiently. The ministry of taxation may be responsible for assessing and auditing taxpayers but the systems for the collection of taxes must be under the control of the treasury in consultation with the ministry of taxation.

Q 4-03.03. How should the treasury manage funds concentration?

The treasury should seek to concentrate funds where they can be most efficiently deployed. The Treasury Single Account concept is generally the framework by which concentration is carried out most efficiently.

[1] The term "receiving" is used here to avoid confusion with the terms "collecting" or "collections" as used in the sense of recovering receivables and indebtedness that are past due.

Q 4-03.04. What is the treasury's role in disbursement?

As disbursement timing affects the treasury's cash position, the systems through which payments are made to vendors, employees and lenders or investors must be under control of the treasury.

Q 4-03.05. What should be treasury's role in data management?

If the treasury is responsible for both disbursement and receipt management, it is in a fortuitous position to manage information about government cash flows. It should then engage in developing and maintaining appropriate information systems for these functions. In addition to using an integrated financial system, the treasury may also use specialized reports from the banking system.

Q 4-03.06. How can the treasury use information from cash flows?

The treasury may use a combination of spending plans and revenue estimates to predict future cash flows. In this case, the treasury is not predicting cash flows so much as it is assembling the cash flow forecast based on information developed from a variety of sources.

The treasury may also develop forecasts using the information it has gained through its information system while managing disbursements and receipts. In this case, the treasury is developing statistical or calendar-driven models to forecast future funds flows.

Q 4-03.07. What can the treasury do with surplus funds?

The treasury may take the lead in investment of surplus funds. The treasury has the advantage of a good forecast of future cash balances that may highlight how much money is available and for how long. When short-term funds are available, the treasury should invest those funds within the guidelines established by a predefined investment policy.

Two possible uses of surplus funds might be to place excess balances back in the economy by collateralized bank deposits or to use cash balances to reduce outstanding short-term debt.

Q 4-03.08. What is the treasury's role in short-term borrowing?

Short-term borrowing may be done by an external agency (such as a freestanding debt office or the central bank) or by the treasury itself, but the treasury should be able to efficiently access those facilities as needed to meet any temporary imbalances in cash flow throughout the year.

Q 4-03.09. What is required of the treasury to manage bank services?

The treasury must monitor the cash management service performance it receives from its partner banks (including the central bank) to make sure that the services provided are being delivered in accordance with the terms of any agreements. Additionally the treasury must also monitor the financial condition of its banking partners to identify financial problems that may jeopardize the safety of government funds held in any bank at any point in time.[2] This review will also lead to policies on collateralization of government funds in transit or on deposit in the commercial banking system

Q 4-03.10. How do cash management and budgetary control differ?

A cash management program should not be confused with budget or accounting control. Budget and accounting controls (quotas and commitments) are intended primarily to ensure budget users' compliance with budget.

The intent of cash management is to manage the government's cash in a cost-effective way that minimizes risk. It should not be seen as a way to compensate for poor budgeting decisions or spending in excess of budget authority.

Many countries control their budgets and facilitate their accounting through the release of funds through various cash accounts. This confuses cash management with budgetary control. Budget revenue and expenditure control must be decoupled from cash management although both budgetary and cash control are needed. Pursuing a program of cash management may offer many advantages for wise use of state resources. Alone, however, such a program is inadequate to protect state resources. Maintaining budgetary control is necessary for fiscal governance. Using cash as a means to enforce budgets misuses a critical state resource.

Q 4-04. What characterizes a strong cash management program?

A strong cash management program relies on clarity in defining operations and functions, efficiency in managing operations, and responsiveness to the

[2] This suggestion should not be interpreted as necessarily implying that the treasury would regulate or audit the serving banks.

environment.

Q 4-04.01. How is clarity achieved among the parties involved?

Clarity is achieved by establishing a network of operations in which what is to be done and who is to do it are clearly understood by all involved parties.

An essential ingredient for clarity is the maintenance of detailed, up-to-date, written policies and procedures specifying each party's responsibilities and how operations are to be conducted for banking, managing investments, handling cash, controlling collections and deposits, making disbursements, and forecasting cash balances.

It is important that the treasury's cash management unit be unambiguously given primary responsibility for managing cash and the processes that support the program. Further, the responsibilities of all players -- treasury, spending ministries, revenue generating ministries -- are clearly defined and do not overlap.

Q 4-04.02. What constitutes clarity with regard to bank relationships?

In accordance with the principle that clarity requires well-understood, non-overlapping responsibilities among the parties, it is critical that the treasury is the owner of and has control of **all** government bank accounts.

A formal structure is essential, but this must be a true working relationship; strong banking relationships are established with the treasury as the driver. The banks are subordinate to the treasury in this relationship. This is emphasized by the formal selection of banks through a tender process based on security, transaction costs, interest rates, and other services. Consequently, there must be written agreements with all banks including central bank. The business-like relationship will mean that the government earns interest on all its available cash balances and, in turn, pays for all the banking services it uses.

Finally, clarity in operations would suggest that the number of bank accounts be kept to a minimum and that cash balances are available to the treasury for disbursement and investment.

Q 4-04.03. What constitutes efficiency in managing receipts and deposits?

Efficiency in all cash management operations drives toward minimizing delays within processes and properly timing events.

Efficient receipts management transfers funds from remitters to the hands of the treasury with minimal delay. This imposes standards on each phase of the funds transfer.

- Remittances due deposited timely through the banking system.
- Deposited funds are available for the treasury's use, for disbursement or investment, no later than the next day after deposit.
- To assist in identifying available resources, deposit accounts are consolidated daily to central government accounts.

These standards are easier to achieve if technology is used so that receipts are collected electronically.

Q 4-04.04. What constitutes efficiency in managing disbursements?

An efficient disbursement system makes payments timely, neither early nor late, and according to payment (or contract) terms. To the extent that timeliness is not violated, disbursement timing is aligned with the timing of cash inflows or spending plans. Further, ministries and agencies should be penalized for making commitments outside of their budget authority.

It is easier to achieve such efficiency when the treasury operates a centralized payment function. In countries where spending is still decentralized, funds are only transferred to disbursing accounts when payments are made.

Technology can also contribute; payments to vendors and employees should be made electronically. In fact, cash disbursements are to be eliminated if possible. If not, they should be minimized.

Q 4-04.05. What can financial technologies contribute to operational efficiency?

Commercial financial institutions have developed many financial tools and services for their clients. The ministry of finance and the treasury, in particular, should examine the array of basic services to see may be utilized to support efficient operations.

Some of the standard services available enable the automated consolidation of funds at the end of day and provide access to receipt, disbursement, and cash balance information electronically in real time. The latter may be enhanced by servicing banks that provide an electronic interface of data from banking system to cash management or treasury software. At a minimum, the treasury should seek services for electronic transmission of payroll and disbursements.

Q 4-04.06. What is environmental responsiveness in cash management operations?

The operations of a cash management program do not take place in a vacuum. The cash management unit should constantly look ahead to anticipate funds flows and balances by a program of disciplined cash flow forecasting and reporting.

Such a program would produce annual, monthly, weekly, and daily estimates of receipts and disbursements to derive forecasts of cash balances. Such forecasts should be updated daily on a twelve-month roll-forward basis and should target a high rate of accuracy and predictability. When forecast errors do occur, the organization should be rigorous in follow-up and analysis on variances.

Q 4-04.07. What characterizes a responsive organization?

The cash management unit should be a demonstrably proactive and professional organization. It should make the best use of available technology and banking techniques, especially to capture information at the point at which each transaction occurs.

With such information, the organization will take action when projections indicate unexpected and unforeseeable cash shortfalls or surpluses or after reviewing forecast variances in foreseeable events.

It is expected that the organization will communicate regularly with key stakeholders.

Q 4-05. What are the likely results of a weak cash management program?

Failure to implement the standards required of a strong cash management program is likely to result in waste of state resources or in additional costs of operations.

The most likely area in which weak cash control appears first is in banking. Weak programs give way to an unwieldy proliferation of both commercial and central bank accounts. With weak banking control, some individually negotiated bank contracts will impose restrictions on the use of cash within those bank accounts. As the treasury loses direct control over these funds, other ministries may take intervene. A multiplicity of actors risks the growth of both idle balances and ill-timed payments. This results in unnecessary borrowing or lost investment income and inefficient and expensive choices about how shortfalls are funded.

The isolation of the Treasury from information on cash balances and control of those balances will generate inaccurate or non-existent information for projecting shortfalls or excess balances. In this case, cash rationing often becomes necessary. The treasury becomes unable to project cash inflows and outflows. The resulting volatility in the government cash balances can thwart the central bank's monetary policy and lead to expensive banking charges coupled with poor or non-existent banking services.