Cash Management

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Cash management by a treasury conjures up images of high-powered officials wheeling and dealing in money and securities markets using the most sophisticated electronic equipment and being in full control of the timing and composition of borrowed funds, the disposal of surplus funds, and the efficient exercise of internal mechanisms for the inflow and outflow of funds. Yet, given the large flow of funds through the central government (usually between 25-30 percent of GDP in any one year), the process of conserving cash, optimizing the flow of cash, and generally raising the awareness of cash costs, collectively referred to as "cash management," is an often neglected area of public financial management. The primary interests of most officials in the budget execution process are issues of raising finance or disbursing funds; the opportunity cost of money is not sufficiently taken into account in the collection of government funds and in disbursement practices.

A number of reasons explain this lack of concern for cash management. First, government departments or spending agencies experience no cost for managing their cash resources poorly or benefit for managing them well. Because of how government is organized and accounts are kept, the system fails to hold accountable those responsible for incurring the expense of interest; departments' cash management responsibilities are limited to depositing public funds and submitting requests for payment. As a consequence, managers are not aware that the cost of borrowing money is a significant element in the cost of their programs or activities. Thus, costs arising from poor cash management (in the form of increased interest charges) are shown as a general budgetary charge as interest on public debt. Second, the main focus of the budget execution process is on the release of funds to spending agencies, and on the obligation of funds by these agencies; the actual spending of money is often not well coordinated with the apportionments of the budgetary appropriation. Third, the primary focus of government accounting systems is the accountability of
funds (propriety) and not the efficiency with which funds are utilized. What follows is a discussion of why cash management is significant in public financial management; the practices and procedures that may hinder the government in managing its cash resources effectively; and some of the requirements of an effective cash management system.

**ASPECTS OF A CASH MANAGEMENT SYSTEM**

The purposes of cash management are twofold. The first is to ensure that a borrower stays well within the limits of credit that policymakers have determined or lenders are prepared to extend. From the borrower’s point of view, the second purpose of cash management is to ensure the payment of as little interest as possible, or from the lender’s point of view, to ensure that he earns the maximum possible on money lent. The importance of cash management was not fully recognized even by the private sector until the late 1960s, when interest rates reached high levels. Corporations and financial institutions developed systems of varying degrees of sophistication to ensure that cash did not lie idle, and that it was quickly used either to pay off obligations incurring interest charges or to generate additional cash by investing in revenue-yielding paper. These policies were supplemented by improved procedures that supported a desire to make cash management more efficient. Thus (1) the movement of cash between creditor and debtor was accelerated by electronic means; (2) banking operations were consolidated to minimize the use of idle funds; (3) payments were consolidated to reduce the cost of transactions; and (4) finance managers and treasurers were appointed to provide expert advice on the borrowing and investment of funds.

Cash management is of importance in the context of Fund stabilization programs. One of the significant aspects, and often a performance criterion, of programs supported by the use of Fund resources, is credit to the central government by the banking system. Significant variations to broaden the scope of this condition may include activities of the central bank, and/or credit made available to selected nonfinancial public enterprises by the banking system. Such performance criteria would imply adherence to target levels, usually at the end of each quarter. Measurement of quarterly performance would, in turn, imply knowledge of the level and adequacy of net credit, that is, borrowings less government deposits held by the banking system. Since deposits are a function both of checks issued and of checks deposited, the measurement of the latter can be critically affected by the time and the quantity (value) of government checks that can remain in circulation before being presented to a bank and thus being
measured as credit to government. The variation of this "check float" can in certain circumstances be significant and affect the net credit position of government. This implies that in certain situations the mere withholding of allotments or checks issued may not in itself be sufficient to meet performance targets, if the "float" itself contracts significantly. Such variations in outflows can, to an extent, be balanced by advancing the flow of funds to the government. Thus, to meet likely critical overshooting of target levels, the government may choose either voluntarily or by discretionary action to advance taxes, license fees, or other unrequired payments, and thereby meet the performance targets. Management of fiscal performance targets necessitates close, careful, and active involvement of the core financial agencies in cash management matters.

Cash management is also significant for general economic policy in the wider context of a public sector borrowing requirement. If at a time when fiscal and monetary authorities are attempting to keep a tight hold on credit expansion by traditional methods, cash management procedures and practices permit public agencies to build up cash balances in the banking system (that is, lend to commercial banks), such actions can be in conflict with the aims of fiscal and monetary policy. One such situation is where the central government has large cash deficits that it has to finance in an expansionary manner (by borrowing from the banking system), while the rest of the public sector has large surpluses. If these surpluses are held in commercial banks, they could cause additional credit to the private sector, thereby exacerbating the expansionary potential. The situation may become even more distorted if a part of the deficit of the central government or the surplus in the rest of the public sector are due to transfers from the budget to public enterprises. Poor purchasing procedures, unwarranted increases in stocks, or liberal credit policies by public enterprises are actions that could also exert undue pressure on credit expansion in the public sector. An effective cash management system within the public sector would help to resolve some of these issues.

The flow of budgetary receipts and payments has a seasonality that is unique to each country. Thus revenue flows from sources such as income tax or customs duty payments, or the use of funds for social service or transfer payments, or a rush of expenditure at the end of the year as agencies try to utilize their appropriations result in a pattern in the flow of funds that varies from country to country. Such macroeconomic cash management—which is based on a knowledge of the overall budget surplus or deficit and on debt maturity dates—clearly involves forecasts of monthly receipts and expenditures and plans for the placement or withdrawal of short-term, medium-term,
and long-term debt in money and capital markets. In addition to these variations, on any one day, the government may be short of cash to meet its expenditures. Conversely, it may have more cash on one day than it needs, and the problem here is to utilize the surplus appropriately on that day. There is thus a need to monitor, at a micro level, the daily and weekly flows of receipts and disbursements that could reduce idle funds and excess borrowing to a minimum. The concern of cash management at both the macroeconomic and the microeconomic levels is to meet the cash requirements of the government at a minimum cost, including the opportunity cost associated with uninvested funds. Thus interest costs or interest benefits are incurred or accrue to government through (1) borrowings to finance expenditure in excess of cash receipts (financing budget deficits or investing budget surpluses); (2) borrowings to maintain liquidity when receipts do not coincide with expenditure requirements (seasonal financing); and (3) borrowings to ensure liquidity when there are uncertain receipt and expenditure patterns (maintaining minimum liquid reserves).

PROCEDURES AND PRACTICES IMPAIRING CASH MANAGEMENT

For each day that government receipts are delayed in collection and are not held in the form and in the location where they may be spent or invested, the government incurs an interest cost. Thus cash management will be seriously hampered if no central authority or agency is entrusted with the responsibility of managing the cash resources of government. Cash management could also be impaired by the multiplicity of special funds. While the existence of special funds is often determined by law, the number of deposit accounts should be kept to a minimum, with each fund separately identified in a general control account. Thus if control accounts are accurate and timely, actual cash and deposit accounts could be aggregated for cash management purposes.

The use of private banking facilities by public sector agencies could also complicate cash management. One of the principal benefits accruing to banks is the interest they earn on balances left with them by a government agency. The costs and time of transfers are increased when there are unforeseen or deliberate delays in transmitting and crediting revenue receipts to a central or consolidated fund. Delays in payment, transmission, and notification of government obligations are of considerable advantage both to the debtor and to the banking system and in effect constitute credit to these agencies. In general, the maintenance of a bank balance in excess of liquidity needs should be
avoided, as it might lead to increased borrowing by the government at rates of interest higher than the bank may allow on the balances of a public agency.

While the reduced *collection float*, that is, an acceleration of the receipt and processing of cash payments mentioned above, is essential for improved cash management, it does not follow that there should be an increase in the *disbursement float*, which is the lag between the time a check is prepared and the time it is presented for payment. Increases in the disbursement float will almost always increase the time taken for suppliers of goods and services to obtain payment, which in turn would result in the supplier increasing the cost of his supplies by the opportunity cost of the payment due before reimbursement is received. In this situation the government should try to reduce the costs of services provided, by instituting better transfer procedures (including electronic fund transfers), aggregating multiple but small payments, decentralizing payment agencies, and using bank accounts. At the same time a thorough review of ordering, supplying, and payments procedures may be warranted. These procedures would include advance payments (partial or total) of goods bought (including purchases abroad) and delivery time and time involved in the final consumption (use of stocks) of these goods.

**ELEMENTS OF AN EFFECTIVE CASH MANAGEMENT SYSTEM**

Four essential elements would make a cash system more effective.

**Cash Flow Forecasts**

The total of receipts and expenditures outlined in the government budget is an indication of the government's overall borrowing requirements for the fiscal year. However, these aggregative figures do not reveal the seasonality of either receipts or expenditures that occur during the fiscal year and that are a critical factor in the government's ongoing cash and debt management operations. One of the most serious weaknesses in existing cash management is the absence of planning and the inadequate procedures for cash flow reporting. What is required is not only a monthly, but also a weekly and daily forecast of receipts, disbursements, and the resulting cash balances within the government financial system, including all funds that the government could use on a temporary basis. Such forecasting should,

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1 Based in part on Rasheed O. Khalid, “Budget Execution and Cash Management” (unpublished; Fiscal Affairs Department, International Monetary Fund, 1982).
of course, be continuously reviewed against actual plans, and the causes of variations fully analyzed, so that forecasting techniques and practices do not become unsatisfactory for determining cash needs. A review of the institutional arrangements (centralizing the responsibility for preparing such forecasts, continuous consulting with the monetary authorities, and regular review procedures) should also be undertaken.

Cash Inflow Control

From the point of view of cash management, the purpose of cash inflow control is to minimize the time between when money is due to be received and the time when money is available for spending or investment. Accelerating the flow of receipts is useful therefore only if payments are promptly processed and deposited in the appropriate bank account, and arrangements are made, in turn, for the prompt transfer of credit balances in commercial banks for use by the government. All revenue departments should have a collection plan that is part of the cash flow forecast. The causes of significant variations from planned collections should be evaluated and adjusted where necessary. In times of credit stringency or rising inflation the tendency would be to delay payments, increase appeals to avoid payment, or slow the payment process. In such situations, the cost and kind of penalties both for payers and financial intermediaries should be carefully reviewed and strictly enforced.

Cash Outflow Control

As with inflows, outflow control begins with the terms of payment and continues to the time that the funds are charged to the payee’s account. A weakness in outflow management is to ignore the disbursement float and to treat funds as no longer available on the day the check is written. Unless the reasons are compelling, payments should be made only when due. As mentioned earlier, both late and premature payments should be avoided. Procedures should be established for regular comparison of actual with planned disbursements.

Determination of Cash Balances

Operating cash balances should be kept to a minimum. As a part of this aspect of cash management, it has sometimes been suggested that procedures should be introduced for charging interest to individual agencies for funds used or for crediting them for funds not used. The existing arrangements between financial intermediaries and the government and nonfinancial public enterprises should also be re-
viewed. If value for money is to become a working principle in government, a significant start should be made by establishing a businesslike arrangement between the government and the banking system. The principle that the government (including other public sector agencies) should earn interest on all its deposits and that it should, in turn, pay for all the banking services it receives should be seriously explored.

The preceding four elements are the requirements for a central authority responsible for arranging the government’s borrowing, for prompt and efficient investment of temporary balances, and for controlling rather than simply monitoring the flow of spending. In addition to such overall cash management requirements are the cash management concerns of individual programs, with the need to monitor spending compared with the budget, to stay within the available budget, to coordinate spending with apportionments made at a higher (central government or departmental) level, and to obtain best value for money. Countries vary in the extent to which the central financial agency delegates authority to spending departments to take their own decisions once annual appropriations have been enacted by the legislature, and in how actively they monitor departmental management. In an increasing number of countries the trend is toward devolving more responsibility from the center to the spending agencies; the quid pro quo is a strict cash limit on these appropriations backed up by reliable and up-to-date information on actual spending.