CHAPTER 9

THE TREASURY FUNCTION AND CASH MANAGEMENT

A. The Treasury Function

Governments need to ensure both efficient implementation of their budgets and good management of their financial resources. Spending agencies must be provided with the funds needed to implement the budget in a timely manner, and the cost of government borrowing must be minimised. Sound management of financial assets and liabilities is also required.

Financial management within the government includes various activities: formulation of fiscal policy; budget preparation; budget execution; management of financial operations; accounting rules and controls; maintaining a record of historical and comparative data; and auditing and evaluating the financial performance and results of government policies and programmes. Within this broad financial management framework, the treasury function aims to achieve the set of specific objectives mentioned above. It covers some or all of the following activities:

- Cash management.
- Management of government bank accounts.
- Accounting and reporting.
- Financial planning and forecasting of cash flows.
- Management of government debt and guarantees.
- Administration of foreign grants and counterpart funds from international aid.
- Financial assets management.

To carry out these activities, organisational arrangements and the distribution of responsibilities vary considerably according to countries. In some countries, the treasury department focuses only on cash and debt management functions (which are reviewed in this chapter). In a few countries, debt management is performed by an autonomous agency. In other countries, the treasury performs also budget execution controls and/or accounting activities. Often the treasury department is a subordinated agency of the ministry of finance, but in some countries, it is independent of the ministry of finance. In such cases a very close co-ordination between the ministry of finance and the treasury department is required, since budget execution must be based on the priorities stated in the budget. In transition countries, the treasury should be preferably part of, or attached to, the ministry of finance, because co-ordination between government agencies is often weak.
**Figure 9.1. MAIN FUNCTIONS OF THE TREASURY**

**Figure 9.2. ILLUSTRATIVE TREASURY ORGANISATIONAL STRUCTURE**

Figure 9.1 illustrates the main functions undertaken by the treasury (areas within dotted lines are often handled by separate systems). Figure 9.2 illustrates a possible organisational structure for the treasury, with separate areas handling the main functions of cash and debt management, accounting and reporting and budget execution and financial planning.
B. Cash Management

1. Objectives

Cash management has the following purposes: controlling spending in the aggregate, implementing the budget efficiently, minimising the cost of government borrowing, and maximising the opportunity cost of resources. Control of cash is a key element in macroeconomic and budget management. However, for budget management purposes, it must be complemented by an adequate system for managing commitments, and it is not a substitute for sound budget preparation.

For efficient budget implementation, it is necessary to ensure that claims will be paid according to the contract terms and that revenues are collected on time; to minimise transaction costs; and to borrow at the lowest available interest rate or to generate additional cash by investing in revenue-yielding paper. It is also necessary to make payments on a timely basis by tracking accurately the dates on which they are due.

Often in the past, governments did not pay sufficient attention to issues related to efficient cash management. Budget execution procedures and the management of cash flows focused on issues of legal regularity and compliance, while daily cash needs were met by the central bank. Spending units were not concerned with borrowing costs since their interest payments were already taken account of in the budget prepared by the ministry of finance. According to Garamfalvi (1996):

“Central planning has left an institutional and organisational legacy characterised by ill-defined boundaries between the budgetary and banking sectors. There was no appreciation of the fact that idle cash was costly because of foregone interest revenues, nor that borrowing (made necessary by shortages of cash resources at the aggregate level) increased future expenditures in terms of interest payments. The importance of cash and debt management in containing the public sector borrowing requirement and, consequently, in conducting fiscal and monetary policy was also not recognised.”

However, the costs of borrowing, the fact that the credit granted to the government by the banking system is a key macroeconomic target and a performance criterion in IMF-supported financial programmes, and the increasing separation between the activities of the central bank and the government budget make efficient cash management an increasingly important issue. Concerns to improve fiscal performance have also had an impact on cash management and some countries have implemented reforms to make spending agencies more responsible for cash, while strengthening instruments to ensure overall fiscal discipline.

2. Centralisation of cash balances and the treasury single account

a. Centralising cash balances

To minimise borrowing costs or maximise interest-bearing deposits, operating cash balances should be kept to a minimum. In countries where funds are released through an imprest system, spending agencies sometimes accumulate idle balances in their bank accounts. These idle balances increase the borrowing needs of the government, which must borrow to finance the payments of some agencies, even if other agencies have excess cash. Also, where the accounts of spending agencies are held at a commercial bank, the idle balances can help loosen constraints on credit, by giving the banking sector additional resources for credit.
Cash balances are efficiently centralised through a “treasury single account” (TSA). This is an account or set of linked accounts through which the government transacts all payments. In practice, within the broad concept of a treasury single account, there are a variety of methods of centralising transactions and cash flows. These can be grouped very broadly into the following categories:

- **Treasury single account and centralised accounting controls.** Requests for payment and documents justifying them (e.g. invoices) are sent to the treasury, which controls them and plans their payment. The treasury manages the float of outstanding invoices.

- **“Passive” treasury single account consisting of only one central account.** Payments are made directly by spending agencies, but through a TSA. The treasury, through the budget implementation plan, sets cash limits for the total amount of transactions, but does not control individual transactions.

- **“Passive” treasury single account including several subaccounts.** In such cases, the TSA is organised according to the following lines: (i) line ministries hold accounts at the central bank, which are subsidiary accounts of the treasury’s account; (ii) spending agencies hold accounts either at the central bank or with commercial banks that must be authorised by the treasury; (iii) spending agencies’ accounts are zero-balance accounts, with money being transferred to these accounts as specific approved payments are made, or the banks accept the payment orders sent by spending agencies up to a certain limit defined by the treasury; (iv) spending agencies’ accounts are automatically swept at the end of each day (where the banking infrastructure allows daily clearing); (v) the central bank consolidates the government’s position at the end of each day including balances in all the government accounts. This system allows but does not require diversified banking arrangements. Payments can be made through banks selected on a competitive basis.

Case 1 in Figure 9.3 summarises the model where payments transactions are centralised within the treasury single account, which can play either an active or passive role in the sense described above. Case 2 refers to a “passive” treasury single account including several subaccounts.

When the central bank does not have an adequate network of regional branches, or does not have the capacity to handle the large volume of transactions that are associated with government payments and receipts, the retail banking operations are delegated to a fiscal agent (normally an authorised commercial bank). The fiscal agent makes payments on behalf of the treasury, the central bank recoups all payments made by the fiscal agent that relate to government operations, and the agent makes daily deposits of all government revenues to the TSA in the central bank. These arrangements can be set up both where the payments are channelled through the treasury and where government agencies are directly responsible for authorising payments. (See “banking system” box in Figure 9.3).

In some countries, poor banking and technological infrastructure is an obstacle to combining the centralisation of cash balances with the decentralisation of payments processing. Processing at the central level payment transactions of remote spending agencies is likely to hinder budget implementation. Geographically remote spending units can have separate bank accounts operated by means of imprest advances (meaning that a new advance is provided upon receipt of an account verifying the use of the previous advance). This scenario is illustrated in Case 3 in Figure 9.3.

Whatever the institutional arrangements, the centralisation of cash balances should cover all the government accounts used for payment transactions, including accounts managed by extra-budgetary funds. A Financial Ledger System (described in Chapter 13), in which all transactions are recorded, can fit either decentralised or centralised accounting controls and payment processing systems.
b. Designing the cash management system

From a cash management point of view, these modes of centralising cash balances give identical results. At first sight, the variant that places payment transactions processing and accounting controls under the full responsibility of the treasury department might seem more efficient from the viewpoint both of cash management and expenditure control. However, the centralisation of accounting controls and the central management of float can lead to inefficiencies, and even corruption, in countries with poor governance, particularly where the treasury has responsibility for selecting the suppliers to be paid. For instance, according to Premchand (1995):

"Those who favour reintroducing the treasury system suggest that treasuries would not only scrutinise payments, but would also be responsible for compiling accounts. But such a step could widen the chasm between expenditure responsibility and the power of payment. Moreover, experience shows that treasuries are no less resistant to political pressures than are the commercial banks. Circumvention and politicisation cannot be cured through the reintroduction of the treasury system. Rather, observance of discipline, which is an essential part of effective government financial management must be secured through tighter controls, periodic oversight, strengthened accountability, greater citizen participation and, above all, greater transparency."
The “passive” treasury single account system has the advantage of making the spending agency responsible for internal management, while keeping central control of cash. In transition countries that face difficulties of controlling the cash balances of powerful line ministries and EBFs, a passive TSA consisting of accounts centralised at the central bank will probably ensure better overall cash control than a TSA consisting of several accounts in different banks.

Reform of the cash management system must take into account its possible impact on budget management within spending agencies and must also be cost-effective. Implementing a system that centralises cash management does not pose major problems for the central departments of line ministries. But for regional departments, the organisation of the payment system must take into account the system of public administration and banking infrastructure in the country concerned.

In many countries, streamlining cash management could consist of:

- Daily centralisation of transactions made at the central level, through a TSA.
- For remote agencies, a procedure based on imprest advances.

Since most countries use the greater portion of their cash either for transactions at the central level (e.g. debt payments and expenditures managed by the central departments of line ministries) or for payments that are due on a fixed date (e.g. wage payments), such arrangements would allow most cash balances to be centralised.

Apart from the case of remote regions, modern technology allows electronic links to be created between spending agencies, the central bank (or commercial banks), and the treasury. However, in countries with an underdeveloped banking infrastructure, the existence of a large number of bank accounts can hinder the implementation of appropriate daily clearing and consolidation procedures.

Before considering any reform of cash management systems, its effect on the banking system should be assessed. Arrangements for cash management in several countries aim implicitly at supporting ailing banks. Restructuring the banking system in these countries is a policy issue that should be addressed. On the other hand, in a number of countries, entrusting the management of the government’s accounts to commercial banks burden the banks with cash-flow problems, particularly if the treasury is not able to meet its obligations.

Centralising cash flows allows payments to be monitored in a timely manner, but does not release spending agencies from their reporting obligations. This is because the effective supervision of budget execution requires commitments to be monitored and expenditures to be verified.

c. Accounting and reporting

In many countries the treasury is responsible for developing and maintaining the chart of accounts; setting government accounting standards in consultation with professional/international bodies; and developing government accounting laws and regulations. The treasury is also responsible for reporting to the government on budget execution and government finances; preparing other statutory financial reports (e.g. mid-year and end-year reports, reports for the European Commission on the use of EU funds); and producing government financial statistics in conformity with IMF and EC rules.
3. Efficiency issues

a. Tax collection

It is necessary to minimise the interval between the time when cash is received and the time it is available for carrying out expenditure programmes. Revenues need to be processed promptly and made available for use. Commercial banks by virtue of the banking sector infrastructure are often able to collect revenues more efficiently than tax offices, which should therefore focus instead on tracking taxpayers, issuing tax assessments, monitoring payments and reporting results. When revenues are collected by commercial banks, arrangements must be defined to foster competition and ensure prompt transfer of collected revenues to government accounts. Systems of bank remuneration through float, which consists of authorising the banks to keep the revenues collected for a few days are inconvenient. Stringent rules to ensure prompt transfers should be established. Moreover, bank remuneration through fees is more transparent and promotes competitive bidding. An appropriate system of penalties for taxpayers is also an important element in avoiding delays in revenue collection.

b. Payment techniques

Payment methods affect the transaction costs of cash outflows. Depending on the banking infrastructure and the nature of expenditures, various payment methods may be considered (cheque, cash, electronic transfer, debit card, etc.). Modern methods of payment — for example, payment through electronic transfer instead of by cheque or cash — allow the government to plan its cash flow more accurately, expedite payments, and simplify administrative and accounting procedures. However, whether one mode of payment is preferable to another depends on many factors, such as the degree of economic development of the country, the extent and maturity of the banking network, and the level of computerisation. For payments within the government sector (e.g. when a ministry or government agency provides services to another agency), a number of countries use non-payable checks, while others make accounting adjustments. Using non-payable cheques has the advantage of avoiding delays in the preparation of accounts. In some aid-dependent countries, non-payable cheques are used to pay taxes related to imports financed with external aid, in order to avoid loopholes in the tax system created by duty-free imports.

c. Creating incentives

If value for money is to become a working principle in government, a significant start could be made by establishing business-like arrangements between the government and the banking system. The principle that the government 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 (De Zoysa, 1990). Box 9.1 shows an example of a reform aimed in this direction.

Countries where the spending agencies are responsible for making payments could consider implementing an incentive system for cash management at the spending agency level. However, in most transition countries, centralising cash balances should generally be the first measure to consider, since it is likely to give the most tangible benefits.

4. Management of government bank accounts

Whatever the organisation of tax collection or expenditure payment, the treasury should be responsible for supervising all central government bank accounts, including any extra-budgetary funds. When
C. Financial Planning and Forecasts

Financial planning and cash flow forecasts are needed both to ensure that cash outflows are compatible with cash inflows and to prepare borrowing plans. As indicated in Chapter 7, cash planning must be done in advance and communicated to spending agencies to allow them to implement their budgets efficiently. Moreover, reducing uncertainty about a borrower’s debt management programme is generally rewarded with lower borrowing charges. Therefore, it is also important to prepare and announce borrowing plans in advance (Ferré Carradeo and Dattels, 1997). Financial planning includes the preparation of an annual cash plan and a budget implementation plan, monthly cash plans, and in-month forecasts.

1. Budget implementation plan and cash plans

a. In-year financial planning

In some countries, the budget department prepares a budget implementation plan, which shows forecasts of expenditures, and then the treasury department prepares a cash plan. The budget implementation plan is sometimes a requirement for commitments or requests for payment, while cash is controlled through the cash plan.\(^4\) In other countries, there is only one financial plan prepared by the treasury.
Whatever the method used, the budget implementation plan and cash plan should be prepared for the entire fiscal year, and regularly updated and rolled over. The budget implementation plan shows expenditure forecasts by quarter (or six-month period) and should be rolled over every quarter (or six-month period).

The cash plan shows monthly forecasts of financial flows before taking into account new borrowing, including reimbursements of loans or bills due from the government, repayment of arrears, and drawings on loans already contracted. The cash plan must be consistent with the budget implementation plan. It should be updated every month. Borrowing plans are derived from the monthly forecasts of cash inflows and outflows.

Although the budget implementation plan, even in a cash-based budget system, is not necessarily on a pure cash basis, monthly cash plans should be on a pure cash basis. These plans should be updated every month. This updating should be made on technical grounds, taking into account developments in exchange rates and interest rates, changes in the payment schedule of investment projects of a significant size, and outstanding obligations, among other things.

The preparation of monthly cash outflow plans requires thorough monitoring of both payments and commitments. The plans are used to define monthly cash transfers within an imprest system or cash limits for payments within a treasury single account. Except in particular circumstances, these limits should conform to the budget implementation plan.

The preparation of the cash plan and its updating require close co-ordination between the treasury, the budget department, and the tax administration department. Preparing monthly cash outflow plans is more of a treasury task than a budgeting task. However, the treasury should co-ordinate with the budget department, in case any adjustments to the budget implementation plan appear necessary.

b. Budget implementation

To ensure effective and efficient implementation of the budget, the following principles should be adopted in preparing the budget implementation and cash plans and in implementing these plans:

• To prepare the implementation of programmes, agencies should know in advance the funds that will be allocated to them.

• Funds must be released in due time, without delay. In case of cash problems, the plan for releasing funds must be revised, but the revised plan should be communicated to the line ministries instead of making a non-transparent revision by delaying the release of funds.

• Particular attention should be given to agencies located in remote geographic areas. This needs adequate planning of the release of funds and good co-ordination between the central departments and regional offices of the ministry of finance and/or the line ministry concerned.

Budget implementation plans and cash plans must be carefully prepared and realistic. Hence, when preparing these plans, the following elements should be taken into account:

• The financial needs of ongoing commitments need to be included.

• Regulating cash flows without regulating commitments generates arrears. In many countries, when monthly cash limits are established, it is unclear whether spending units are allowed to make commitments up to the ceiling given in the budget appropriations or up to the monthly cash limits.
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- The budget implementation plan and the cash plan should take into account the timing of payments and payment obligations arising from commitments over the fiscal year. A number of countries merely slice the budget into four quarterly parts, or release one-twelfth of the budgeted amount every month. This is not satisfactory. For example, the monthly schedule of disbursements for investment projects can be highly variable depending on various factors such as contractual payment schedules or the physical advancement of works.

- Adjustment of commitments needs time. Imposing monthly limits is generally more of a regulation of cash payments through float than a regulation of commitments, since even for non-personnel goods and services, one month may be too short a period to adjust commitments. To avoid arrears generation, monthly cash limits should be consistent with quarterly cash and annual commitment limits. A period of at least three months is needed to regulate non-permanent commitments, while issues related to permanent commitments should be addressed during budget preparation.

The preparation of the budget implementation plan should be driven by the budget, not by cash management concerns. In an emergency situation, strict monthly cash limits are needed, and should be preferred to day-to-day rationing. However, it must be keep in mind that regulating cash on a monthly basis is not sufficient to address problems related to overcommitment. Except in emergency situations, monthly forecasts of cash outflows should be derived from quarterly forecasts. Hence, the cash plan will be updated and rolled over in two phases: (i) every quarter for the entire fiscal year; (ii) every month, for the quarter under implementation, in conformity with the quarterly cash outflow limits. This process can ensure consistency between a cash plan and a quarterly budget implementation plan, when two distinct plans are prepared.

c. Revenue forecasts

Forecasts of the monthly distribution of revenues should be prepared. These forecasts should be updated regularly, preferably every month, since changes in the macroeconomic environment or in the tax administration system may affect revenue collection.

The preparation of monthly revenue forecasts requires economic analysis as well as management expertise, in order to take account of changes in the tax administration system. This exercise should be carried out by the tax and customs departments, in close co-operation with the treasury and the departments responsible for macroeconomic analysis. In some countries, monthly forecasts prepared by the tax administration departments are stronger on administrative detail than economic analysis. They show the distribution of budgeted revenues over the fiscal year but do not take into account fiscal and economic developments after the budget has been adopted by parliament. The government may therefore have to strengthen the forecasting capacities of tax administration departments.

A good monitoring system is a prerequisite for effective forecasting. Thus, revenue collections need to be monitored on the basis of the major tax categories and adjusted to reflect changes in the assumptions underlying the forecasts. In-year revenue forecasts should be based on revenue assessment and tax collection reports, the results of economic surveys, etc. Short-term forecasting tools, such as short-term macroeconomic models and tax forecasting models, are also helpful.

The revenue forecasts must also include forecasts of non-tax revenues prepared by the treasury in close co-ordination with the agencies responsible for the management and collection of these revenues.
2. In-month forecasts

The in-month distribution of cash flows must be estimated in order to determine the timing of treasury bill and government bond auctions and the date on which transfers of funds to agencies within an imprest system are made.

In-month forecasts of debt servicing and wage payments do not pose major problems. For other expenditures, there is a need to maintain an appropriate record of commitments and expenditures at the verification stage, including the date on which payments are due. In practice, only spending agencies can do this. Within a centralised payment system, and without appropriate tracking of commitments and verified expenditures, the treasury should focus on making forecasts of large payments (e.g. some investment projects), based on information from spending agencies, and prepare only rough estimates of other payments.

The preparation of in-month revenue forecasts is better undertaken by the tax administration department than the treasury, since factors related to tax administration or taxpayers’ behaviour affect strongly the in-month distribution of revenues.

In-month forecasts should be reviewed and updated every week. For this purpose a number of countries have a treasury committee that meets weekly. Such arrangements can improve cash management, provided they do not slip into day-to-day budget management or the setting of priorities on political grounds.

D. Management of Government Debt

1. General issues

a. Legal and budgetary arrangements

To avoid uncontrolled indebtedness, legislation (e.g. the organic budget law or a separate public debt management law) should provide that only one government authority should be authorised to borrow. It should be the authority responsible for fiscal management (i.e. the ministry of finance).

Regulations can also provide for a limit to be placed on the amount of borrowing each year, which must conform to the annual budget. The budget should outline the annual borrowing plan.

The legislation should provide guidance on the types of instruments and selling techniques that the government can use. However, the law should be sufficiently flexible to adapt to developments in the financial markets and information technology systems.

b. Transparency and predictability

The objectives of the government’s debt management policy should be clearly stated and made public. The basic objectives are to finance the budget deficit, or specific projects (for project loans), and to minimise the costs of borrowing. Governments also pursue other objectives in debt management, such as the development of financial markets, support for monetary policy, and the encouragement of saving. The development of a large and liquid market for government debt facilitates monetary management and the development of financial markets.
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As indicated above, reduced uncertainty about the borrower debt programme is generally reflected in lower borrowing charges. Many countries announce their borrowing plans in advance. Taking into account uncertainty in revenue collection, the size of future auctions can be presented in public borrowing plans within a range of +/- 10-20% and, for example, the precise characteristics of a particular auction can be announced the week before it takes place. The results of an auction should be published shortly after it takes place.

The government should provide parliament with regular and detailed reports on its indebtedness and its debt policy, and publish statistics on the government debt, including details of government guarantees and contingent liabilities.

Debt management has two main aspects: (i) central bank borrowing operations as part of monetary policy; and (ii) government borrowing to finance the fiscal deficit. The use of government securities as instruments of monetary policy is seen as a stimulus to the development of the financial markets. However, it requires adequate support arrangements, such as co-ordination between the monetary and fiscal authorities regarding the amounts to be issued; protection against overfunding of the government budget for the purpose of monetary management; and sharing the cost of this funding.

c. Debt policy and responsibilities

The initial step in formulating debt policy for financing the budget deficit is to set borrowing objectives in conformity with fiscal targets. The second step is to determine strategic choices.

Concerning borrowing in the financial markets (issues related to project loans are reviewed below), the formulation of debt policy includes strategic and tactical policy choices relating to the selection of instruments, currency, targeted markets, etc. The choice of a suitable mix of these instruments should be based on the needs of investors, risk factors, and the objective of promoting the liquidity and overall development of the market. The choice of maturity is important in balancing the debt profile, adjusting the volatility of debt, and exploiting investor preferences. Targeting the wholesale domestic market reduces interest costs, but the development of the retail market may promote household savings.

In transition economies, extreme caution is required before considering certain instruments that increase volatility in debt service (such as index-linked and currency-linked instruments). Although portfolio theory suggests that borrowing in a variety of currencies diversifies risks and reduces the cost of borrowing, borrowing in foreign currency presents higher risks and costs in many transition countries. The use of derivatives requires a high degree of expertise and presents substantial risks. Apart from some exceptional cases, this technique should not be considered in such countries.

Responsibility for the formulation of debt policy, and for financing the budget deficit, should rest with the ministry of finance, but close co-ordination with the central bank is required, and the effects on monetary policy should be considered. In many countries, central banks are more knowledgeable about the functioning of the financial markets than ministries of finance. The distribution of responsibility for implementing the debt policy should be established according to technical capacities within the ministry of finance, the degree of development of the financial markets, and the objectives pursued. In several countries, the central bank is responsible for executing the debt policy and securities management. In developed countries, there is, however, currently a move toward placing debt management fully under the responsibility of the ministry of finance, with a view to avoiding any policy conflict between debt and monetary management.
2. Medium- and long-term external debt management

In middle-income countries, increased openness of financial markets tends to diminish differences between external debt and domestic debt. Market rating covers both external debt and domestic bills or bonds which may be issued in foreign currency and held by foreign lenders. However, the management of project and programme loans needs specific procedures. In low-income countries, project loans and programme loans make up the major part of external debt.

Systems and procedures for managing medium-term external debt should cover the following features and functions:

- **Contracting loans.** Only one government authority (the ministry of finance) should be authorised to contract external loans and grant guarantees.

  Programme loans (support for the balance of payments and/or the budget) should be included in the financial plan annexed to the budget. In some countries the signing of these loans is subject to the approval of parliament. This increases transparency, but may cause delays. Global authorisation of the financing plans might be preferable, but this depends on circumstances and the legal and constitutional framework of the country.

  Project loans should finance only projects included in the multi-year estimates or the public investment programme (PIP), if such documents are prepared. The amount of project loans should be presented in these documents. A list of project loans should be annexed to the annual budget. This list should show the total amount of such loans and their terms. As mentioned earlier in Chapter 1, project loans or, at least, the total amount of the projects that the government intends to authorise over the fiscal year, must be approved by parliament.

- **Recording transactions.** Every loan transaction should be recorded, including loans contracted and guaranteed, disbursements, payments due, rescheduling, debt remission, cancellation of the non-disbursed part of a loan, and changes in the terms of a loan.

  To facilitate comparison and accounting, it is better to register individual transactions than aggregated data. For example, it is easier to compare individual drawings expressed in foreign currency with actual expenditures expressed in domestic currency, than to compare monthly aggregated data. The average exchange rate for a month is rarely equal to the exchange rate weighted by drawings made within the month.

  A crucial problem is the collection of information. In many countries, data on drawings are not readily available. The debt management office often records disbursements only on the basis of information communicated by lenders, but not every lender transmits this information in a timely manner. Consequently, as stressed by different supreme audit institutions, national auditors cannot perform audits satisfactorily since data on debt cannot be compared with budget execution reports. Information dissemination between line ministries, project managers, and the debt management office is often inadequate. Drawings on guaranteed loans are not systematically communicated to the debt management office. Procedures for disseminating information need generally to be strengthened, by establishing, for example, a monthly system of reporting by project managers and beneficiaries of guarantees to the debt management office. Data from lenders and users must be systematically compared. This needs appropriate bookkeeping for special accounts of projects financed by IFIs and adequate treatment of exchange rate variations in the accounting system.
• Managing debt. Future payment schedules and drawings, and the impact of rescheduling operations, should be kept and regularly updated, to provide a basis for macroeconomic forecasts and debt policy.

Payment forecasts are based on the terms of the agreements. However, determining the exact amount of payments due requires additional information. Many countries rely solely on the claims from lenders. Often the debt management office does not know exactly how lenders calculate payments (for example, when the amount of payments depends on the value of a currency pool). Debt accountants must be trained, and basic information on methods of calculating payments must be obtained from lenders.

In the same way, some debt management offices do not take full control of the payment schedules for rescheduling agreements. To forecast rescheduling, a simple spreadsheet model is sufficient. To manage rescheduling, the schedule of payments related to the rescheduling agreements must be calculated accurately. This problem is currently being addressed through the implementation of debt management systems that incorporate the management of rescheduling. Often, public enterprise debts and even private debts are passed on to the government through a rescheduling operation. The government should account for this operation and be reimbursed by the entity that benefited from the rescheduling. Normally, rescheduling agreements should benefit only the government, and enterprises should pay back the government on the basis of the initial payment schedule.

• Reporting. The reporting system for debt transactions should fit the needs of macroeconomic analysis, negotiations with lenders or with countries, the preparation of financial programmes and budget monitoring. For this purpose, loans must be properly classified. The system of notification to the World Bank gives a basic framework for debt reporting, but should be supplemented to take into account other needs related to financial monitoring and forecasting, notably for the preparation of financial programmes or debt negotiations.

• Accounting. Countries with a cash accounting system generally also monitor debt service obligations, but this is not sufficient. A double-entry accrual accounting system is required. Payments are made not only in cash from government bank accounts, but also through debt operations (rescheduling, remissions, etc.). An increase in liabilities (e.g. drawings from external loans) may correspond to an increase in financial assets (e.g. through an on-lending operation concerning an external loan contracted by the central government for financing the investment of a public enterprise). The risks related to guarantees and on-lending should be assessed and accounted for. Accounting procedures should be based on recognised accounting standards, not on debt policy objectives. For example, an expected rescheduling operation may be taken into account in a financial programme, but should be accrued into the accounts only when it takes effect. Non-compliance with accounting standards, confusion between forecast data or policy objectives and actual data, and confusion between new operations (such as debt remission) and revisions in actual data, create difficulties in the interpretation of many debt management reports. Accounting methods used for specific operations, such as debt remissions, should be indicated in the debt reports.

In several countries, organisational arrangements within the government for the management of external debt are fragmented. The ministry of finance, the ministry of planning (or the ministry of economy), the ministry of foreign affairs, etc., may all be involved in debt management (Husain, 1990).

The ministry of finance, which is responsible for fiscal management, should also be responsible for debt policy and debt management. This will involve reviewing draft agreements, verifying whether the terms and conditions of loan agreements match the needs of debt policy and budgetary policy, assessing the future impact of debt servicing costs, conducting financial negotiations, and keeping books and the debt recording system.
In several countries, statistics on debt are kept by the central bank. Although the government is responsible and accountable for debt management, this organisational arrangement is acceptable. It should ensure more comprehensive coverage of transactions, since every payment is made through the central bank. However, where such a distribution of responsibilities is made, the statistics unit of the central bank should also report to the ministry of finance, which is responsible for managing and implementing the medium-term external debt policy. The existence of two statistics units, one at the central bank and one within the ministry of finance, is often a source of confusion.

A distinction should be made between functions related to debt management, budgeting and investment programming on the one hand, and aid management on the other hand. Budgeting and investment programming consist of prioritising expenditure programmes, and the debt management office should not interfere in this aspect of public expenditure management. On the one hand, in principle, project loans should finance only those projects included in the budget or multi-year expenditure programming documents. If detailed authorisations to commit, based on multi-year estimates, or investment programmes are not prepared, the ministry of finance should verify whether the project loan is compatible with government policy and medium-term fiscal targets. On the other hand, every loan should be submitted for the scrutiny of the debt management office.

3. Grants

As noted earlier, expenditures financed by foreign grants, including grants in kind, must be budgeted, recorded and accounted for. A central system of recording foreign grants and related transactions is needed, and should be linked to the government’s overall accounting system. Special reporting mechanisms may be needed to monitor grants (e.g. comparing reports from spending agencies with data from donors). But in terms of broad principles, arrangements for accounting transactions made from grants are similar to arrangements for debt accounting and monitoring. A central registry of grants should be maintained by the treasury (or the central accounting department if separated from the treasury).

The special issues related to the management of EU pre-accession funds are reviewed in Chapter 10.

E. Management of Government Assets

Government financial assets consist of shares in enterprises, loans granted by the government, payments of guarantees not honoured by debtors, etc. The treasury has to record and account for these assets. It should manage the loans granted by the government, notably by authorising disbursements and tracking payments. It should gain access to financial information on enterprises in which the government has shares, monitor the dividend payments, and deal with the financial aspects of privatisation.

In a similar way, a register of real property assets should be maintained and regularly audited, either by the treasury, or another department of the ministry of finance. Every acquisition and disposal of state property should conform to standards and regulations issued by ministry of finance (or the treasury) and be budgeted.

F. Relationship with the Central Bank

The central bank is, in most countries, the main cashier of the government. Even where spending agencies hold their bank accounts at commercial banks, funds are released from a treasury account at the central
bank. More generally, central banks are the fiscal agents of governments and perform activities in such areas as government issuing, public debt management and intervention in the secondary market for government securities.10

In many countries, the central bank provides the government with overdraft facilities. However, to avoid assigning responsibilities to the central bank that could conflict with its monetary policy objectives (e.g. many central banks have a mandate to achieve price stability), more and more countries set stringent limits for government borrowing from the central bank or forbid it. In the EU, the Maastricht Treaty forbids such borrowing. From the cash management point of view, prohibiting borrowing from the central bank requires an active policy of issuing government securities in the capital market and also intervening in the secondary market. The prohibition may be unrealistic in the short run for countries with underdeveloped markets,11 but borrowing from the central bank needs to be strictly regulated in conformity with monetary and fiscal policy objectives.

In principle, profits or losses of the central bank are, in most countries, transferred to the government, although actual practices vary. Often, losses of the central bank are not included in the government accounts (see the discussion on quasi-fiscal expenditures in Chapter 1). To encourage the government to optimise its cash management and to limit non-transparent quasi-fiscal expenditures, commercial terms should be applied to overdraft facilities granted by the central bank to the government. For the purpose of transparency, profits or losses of the central bank should be treated as revenues or expenditures in the budget. On the other hand, adopting these rules requires the central bank to reimburse the treasury deposits on commercial terms.
NOTES


2. This concept dates back to a British Act of Parliament of 1787 (George III) establishing the so-called Consolidated Fund that exists to this day.

3. Instruments for payment are described in Premchand (1995), page 25 (table 1) and page 27 (table 3).

4. In Turkey, for example, the budget department prepares the budget implementation plan and regulates the tahakkuk, which is an administrative stage before payment, while the treasury prepares cash plans. Similar approaches may be found in other countries that have a budget system derived from the French system.

5. In Canada, a borrowing bill that sets an annual ceiling on borrowing is prepared at the same time as the budget and submitted to Parliament (Miller, 1997). In Thailand, foreign borrowing under the law cannot exceed 10% of the annual budget (Premchand, 1993).

6. For example, in the United Kingdom, the Treasury announces each financial year in its annual debt management report the details of financing requirements, auction plans, and the maturity structure of the stock of gilts issued by the government. In Turkey, the borrowing plans are announced every quarter.


8. See, for instance, United Kingdom, HM Treasury (1997c).

9. As with UNCTAD's Debt Management and Financial Analysis System (DMFAS), the Commonwealth Secretariat’s Debt Recording and Management System (CS-DRMS), and the systems developed by a number of countries. The Debt Sustainability Model-Plus (DSM+) developed by the World Bank imports data from debt management systems to analyse external financing requirements and to quantify the effects of debt relief operations.
