Selected Issues in Liquidity Management and Treasury Controls

Tirana, Albania

On May 20-22, 2015, PEMPAL Treasury Community of Practice (TCOP)[1] held a plenary meeting in Tirana, Albania. The workshop was organized as part of the TCOP action plan implementation and was aimed at exchanging experiences in developing cash management practices and applying key elements of treasury controls in TCOP member countries. The topics are of particular relevance for PEMPAL member countries as many have been transitioning from a traditional manual processing environment, with ex-ante central controls, to implementing automated financial management information systems. Countries are now presented with the option of replacing many of the traditional manual controls with system based automated controls. Cash management and forecasting is also an area of particular interest, with automation improving the reliability and timeliness of cash flow information. The event also served as the forum for updating TCOP activity plan for FY2016-2017. The meeting was attended by forty-seven specialists representing 14 countries (Albania, Azerbaijan, Belarus, Bosnia and Herzegovina, Croatia, Georgia, Kazakhstan, Kyrgyz Republic, Macedonia, Moldova, Montenegro, Russian Federation, Turkey and Ukraine). The workshop was facilitated by the World Bank experts, including Mr. Mark Silins, TCOP Public Finance Management Adviser, and the TCOP resource team. Logistical support was provided by PEMPAL Secretariat based at the Slovenian Center of Excellence in Finance.

Ms. Gelardina Prodani, General Secretary of the Ministry of Finance of Albania, formally opened the workshop. She emphasized the importance of the topic for Albania – with a national strategy approved to clear budget arrears by 2017 – and stressed that professionalism of public servants is critical in maximizing the benefits of public financial management reform. In welcoming the participants of the workshop, **Mr. Vugar Abdullayev,** Chair of the PEMPAL Treasury Community of Practice, noted that rapid development of information technology has been driving improvements in government treasury operations – the topics for this workshop very much depend on an effective accounting system for improved quality and timeliness of financial information. **Ms. Elena Nikulina**, PEMPAL Team Leader, the World Bank, reminded the

[1] The Public Expenditure Management Peer-Assisted Learning network (PEMPAL) is aimed at improvement of efficiency, effectiveness and transparency of public expenditures in the countries of Central and Eastern Europe and Central Asia. The program supports activities aimed at uniting practicing specialists in the field of public finance in communities of practice for the purpose of peer learning by means of benchmarking performance results for conducting reforms in the area of public finance. For additional information about PEMPAL, please visit: www.pempal.com.

participants that PEMPAL TCOP leadership group had been established in Tirana in 2009 and thanked the Albanian authorities for the ongoing contribution to the TCOP over the last six years.

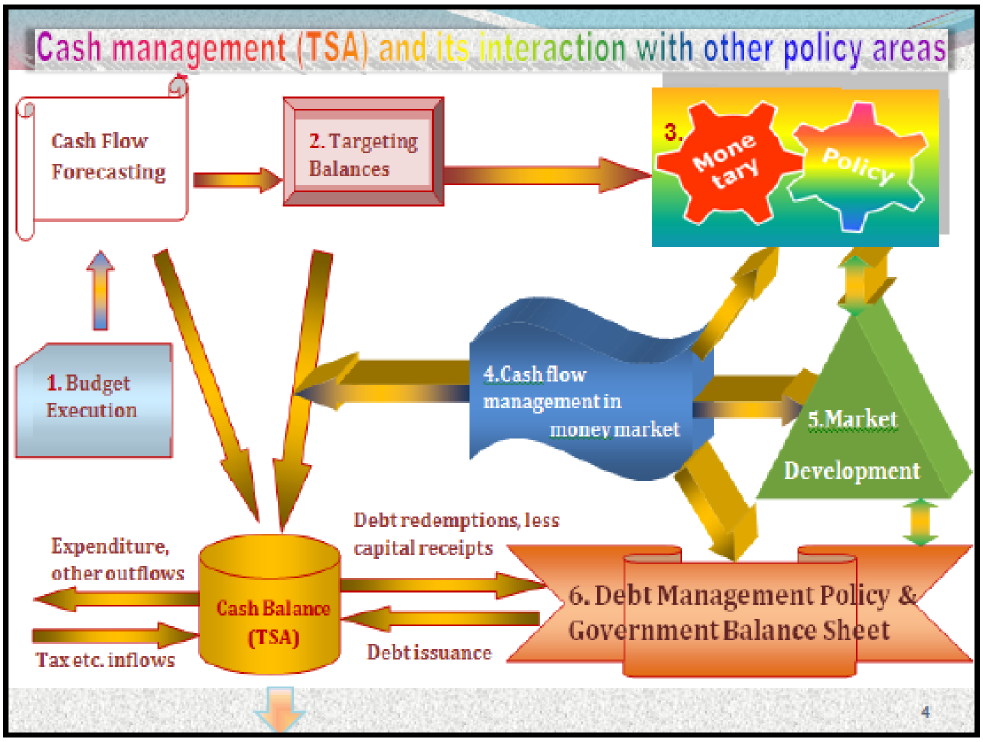
After the welcome speeches **Mr. Vugar Abdullayev** briefed the participants on the implementation of the TCOP Activity Plan for FY2013-2015, which has been developed based on results of a 2012 TCOP member survey and in accordance with the PEMPAL Strategy for FY2012-2017. Mr. Abdullayev emphasized that TCOP has proven to be a valuable platform for country improvements in treasury operations. This has been acknowledged by senior ministry of finance officials from PEMPAL countries on a number of occasions. Additional information on achieved outcomes and performance against key indicators can be found in Mr. Abdullayev's presentation.

The thematic program started with presentations by the host country. **Ms. Mimoza Pilkati,** Director of Treasury Operations Department, delivered an introductory presentation on the organization of the Albanian Treasury. This was followed by **Ms. Aurela Velo**, Director of Business Processing, who delivered a presentation on the functionality of the Albanian Government Financial Information System (AGFIS), which became operational in 2010. AGFIS functionality along with a unified multidimensional Chart of Accounts ensures easy consolidation of government accounts and timely reporting. New functionality, added recently to AGFIS, allows for commitment registration which enhance appropriation controls during the procurement process. Future functionality of the system will include budget planning and deployment of online access to line ministries by 2020[2]. **Ms. Arjana Dyrmishi**, Director of Fiscal Policy Department, next outlined the features of the new E-Tax administration system which became operational in January 2015 and integrated requirements for the tax administration bodies, Ministry of Finance (including Treasury) and taxpayers. The system allows taxpayer obligations to be settled through any bank in the country via the internet. Ms Dyrmishi indicated that it ranks as one of the most modern systems in Eastern Europe.

A series of presentations on Albanian Treasury liquidity management practices followed. **Ms. Mimoza Pilkati** touched upon the role of cash management in fiscal and monetary policy (see **Figure 1**) and explained why consolidation of government funds on the Treasury Single Account (TSA) is a fundamental prerequisite for establishing a proper cash management function. Ms. Pilkati highlighted the importance of political will for TSA reform, and the development of the banking and treasury network and associated technologies as preconditions for the reform.

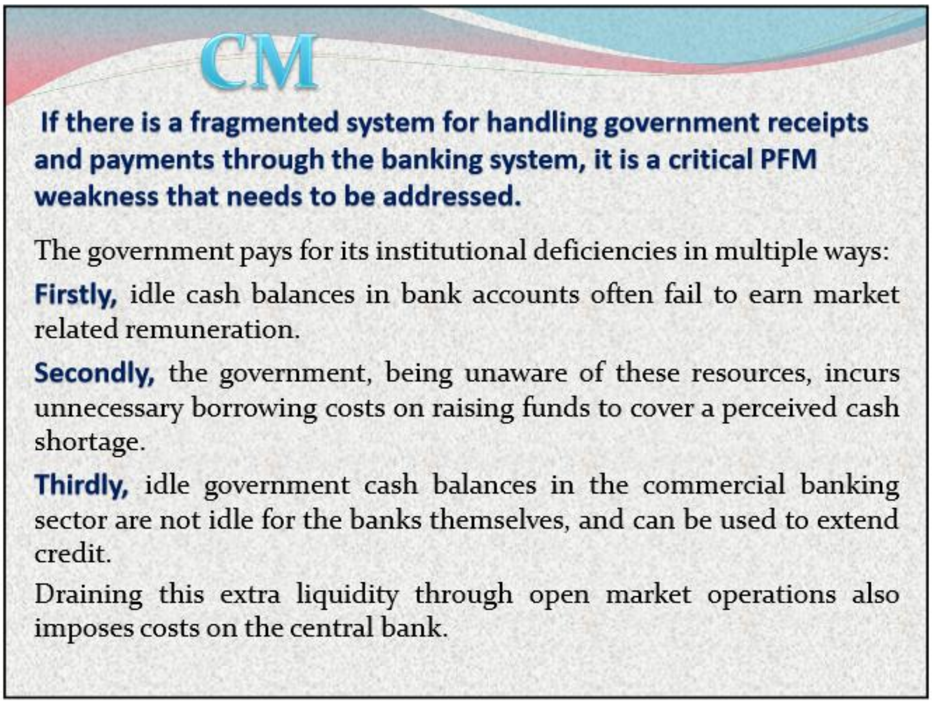
[2] It is envisaged that with the AGFIS deployment around 75 percent of its functionality will be used directly by line ministries and budget institutions.

Figure 1. Cash Management and Its Interaction With Other Policy Areas



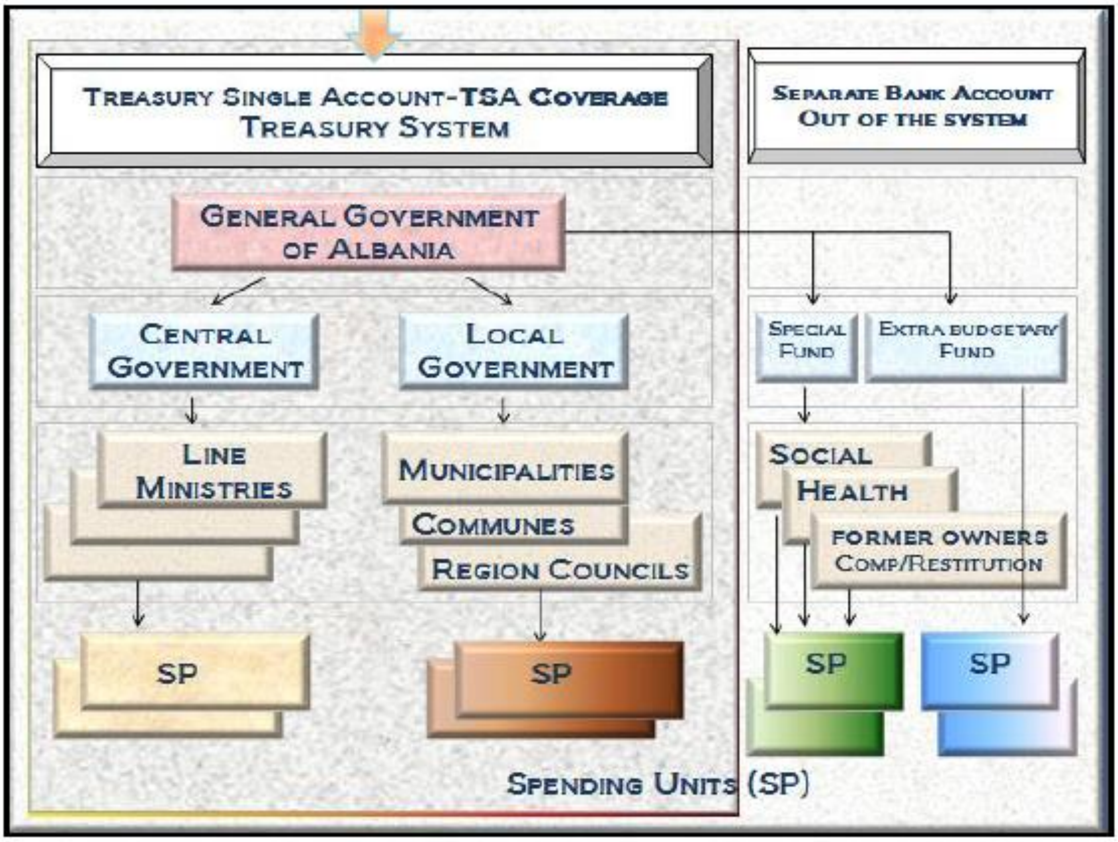
Ms. Pilkati noted that fragmentation of public funds management imposes additional costs on government (see **Figure 2**) and gaining a common understanding of this fact may help in persuading the stakeholders of the necessity for consolidation.

Figure 2. Fragmentation of Public Funds Management Bears Its Costs for Governments



Albanian Treasury has been able to consolidate the majority of public funds on its TSA (see **Figure 3**). It was noted that the few separate bank accounts that do exist outside of the TSA are closely monitored by the Ministry of Finance: special permission by the Minister of Finance is required to open such accounts; regular reconciliation of these accounts is required; and cash forecasts produced by the Albanian Treasury integrate these balances to ensure a complete picture of the overall cash position.

Figure 3. Coverage of the Albanian Treasury Single Account



Ms. Irena Rista, Head of Treasury Single Account Division of the Treasury Operations Department, continued the presentation with an overview of Albanian PFM Reform for 2014-2020. The key reform outcomes are summarized in **Box 1.**

TCOP members discussed selected implications of the reform during the question and answer session that followed. A key area of the discussion focused on improved integration of PFM processes into the AGFIS and the corresponding enhanced role for the Treasury. One major future challenge will be the transition to full accrual accounting and the associated need for enhanced skills and qualifications of Treasury personnel.

In the afternoon session the hosts delivered a series of presentations on the approach to liquidity management **Ms. Mimoza Pilkati** provided an overview of the Treasury processes, **Ms. Arjana Dyrmishi** described revenue forecasting tools, and **Ms. Elona Ajazi** (Public Debt Management Department) delivered the presentation on approaches to public debt management. Presenters highlighted that until 2012 cash management in Albania had been passive and focused on the short-term and cash rationing. Albania implemented a number of reforms including fiscal rules and commitment control, as well as modernization of cash management and cash forecasting techniques. The reforms were supported by a number of donors and the improved functionality of the AGFIS was a key success factor.

Box 1. Selected Outcome Indicators of the Albanian PFM Reform 2014-2020

Pillar I: Well-integrated and Efficient Planning and Budgeting of Public Expenditure:

a) Introduce multi-year commitment control for multi-year expenditures
b) New AGFIS configurations to disaggregate multi-year commitments by individual year allocations
c) Assign to treasury the responsibility to pay tax refunds from the TSA and to include tax refunds into its cash management plan
d) Developing liquidity forecasting program

Pillar II: Efficient Execution of the Budget:

a) Arrears clearance and force fiscal discipline as a preventive measure
b) Establish mechanisms to control the availability of funds prior to procurement through communication between two information systems: Public Procurement Electronic System and AGFIS for online AGFIS users
c) Make fully functional the electronic system for payroll management and establish the interface with AGFIS
d) Establish the required policies, instructions, management systems, and manuals to ensure proper handling of VAT refunds situations, including putting in place a performance management system

Pillar III: Transparent Government Financial Reporting:

a) Improve the information content and quality of the budget documents
b) Gradual extension of the AGFIS giving the right to GGU's accessing the system for their budget execution and financial reporting
c) Improve procedures and formats for in-year budget implementation reporting
d) Improve formats for a comprehensive government yearly budget execution report including substantive as well as financial information

Key topics discussed during the questions and answers session included:

- In regard to revenue forecasting it was clarified that local governments develop their own daily and quarterly forecasts which are shared with the Treasury for information;
- Participants were interested in the distribution of functions between the Treasury and Public Debt Management Department (PDMD) in regard to new borrowings. The hosts clarified that decisions on the auction schedule and types of financing instruments are made by PDMD based on the cash flow forecasts prepared by the Treasury;
- Further improvements are expected in cash and expenditure management through the capacity to record multiyear commitments in the Treasury.

The final session of day one finished with a group discussion of the experience of Albania and its relevance to member countries. Key comments included:

- Agreement that Albania's experience in TSA consolidation and liquidity management represents a close to "best practice" example;
- There is high level of automation of PFM processes in the AGFIS – the unified Chart of Accounts also ensures reliable information is available on cash flows;
- It was agreed that strong commitment to advance Treasury reforms was the key success factor in Albania.

D**ay two of the workshop** commenced with a set of presentations from the TCOP Thematic Group on Cash Management. **Ms. Nino Tchelishvili**, Deputy Head of the State Treasury Service of Georgia, opened the session with a summary of work that the Thematic Group has undertaken to date, including organization of four thematic video conferences involving 10 countries. During those videoconferences participants had a possibility to get familiar with experiences of five member countries in various aspects of cash management and forecasting.

Mr. Mark Silins delivered the initial presentation and described the evolution of the role of Treasury in cash management which is seeing a shift from the traditional approach of control over spending through monthly cash plans and cash rationing (historically driven by sub-optimal information on cash flows and large dependency on manual controls), to system based controls and automation, enhanced (sometimes "real time") settlements for collection and payments and just-in-time cash management with a strong link to debt and asset/liability management (supported by massive improvements in information technologies and banking systems).

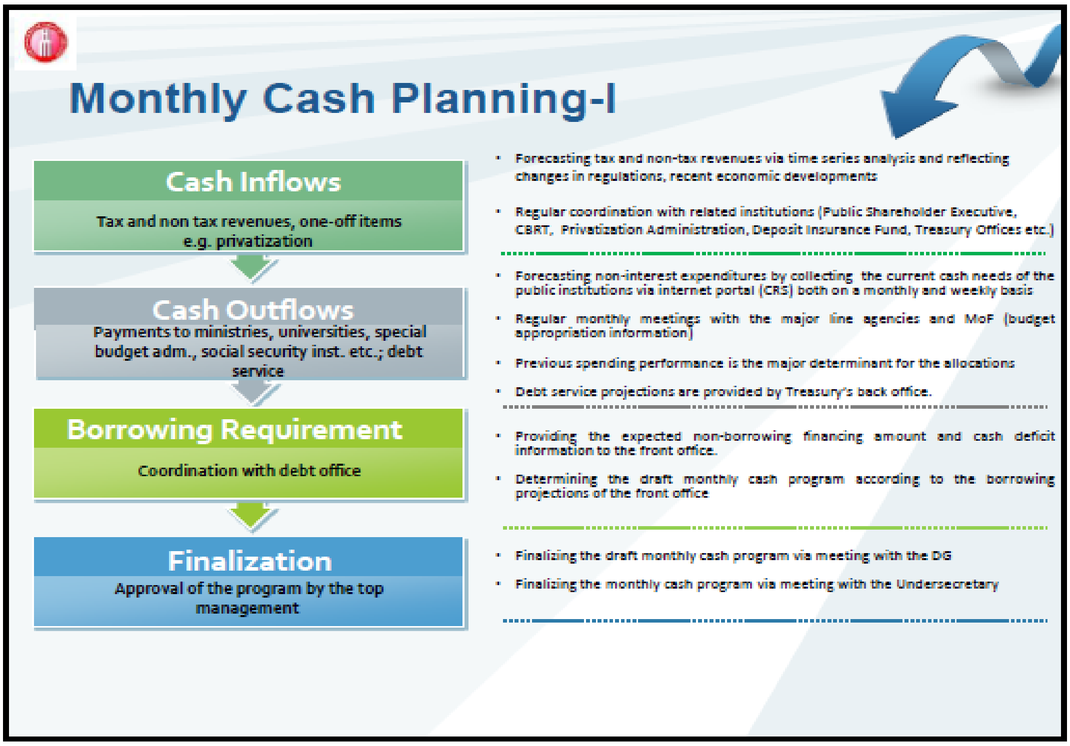
Mr. Silins noted that taking into account IT development, decentralization of processing and delegation of the majority of controls to line ministries through distributed FMIS, the cash control function is unlikely to survive and the future of the Treasury functions lies in cash forecasting and management. A number of fundamental elements are required to build an effective cash management function:

- Treasury Single Account;
- Integrated Financial Management Information System;
- Registration of commitments and accounts payable;
- Daily settlements systems;
- Integrated Chart of Accounts, including cashbook accounting;
- Cash management unit to actively monitor and analyze cash position (instead of budget execution control); and
- Strong links to debt management.

Mr. Silins's presentation stirred many questions from the participants. One issue discussed was the common problem of resistance to consolidation of extrabudgetary fundы balances. Mr. Silins commented that it is important to keep in mind that extrabudgetary funds (EBFs) are still part of government's resources and consolidation of balances not just cash but within the budget preparation process would contribute to better decisions regarding the allocation of scarce resources. He also noted that consolidating cash overnight through tools such as zero balance accounts can ensure a clear separation between cash management by the Treasury and retaining control over spending decisions in the respective EBFs.

Mr. Illyas Tufan, Head of the Cash Management Department of the Turkish Treasury next delivered a presentation on his country's practice. The annual cash program is prepared by the end of October based on budget projections with revenue forecasts allocated by month based on seasonality and other factors. Monthly cash outflows are based on requests of the information from around 200 public institutions as well as from a number of central and regional accounting offices (see **Figure 4** for more details). Daily cash planning is supported by the Public Electronic Payment System (which contains budget appropriations figures and allows public institutions to enter their daily cash requests) and Public Treasury Information System (which gathers information on cash reserves of budget institutions and helps to determine if an institution is really in need of cash). Mr. Tufan explained that monitoring is an important element of cash management in Turkey – deviations from the daily cash program are examined and reported to the top management. Average monthly deviation in the total revenues and expenditures is one of the key performance indicators for the Cash Management Department which is subject to Turkish Court of Accounts audits. As part of the monitoring process spending units' cash performance is also evaluated and this information is being shared across government.

Figure 4. Monthly Cash Planning in Turkey



Turkish Treasury envisages the need for improving their cash management practices and the main challenges identified in this regard pertain to: (i) development of the legal and technical infrastructure for an extended TSA; (ii) fostering specific autonomous institutions to develop their own TSAs; (iii) improving the information sharing between Treasury and other institutions;

(iv) moving beyond spreadsheets and fostering automation; and (v) development of institution-specific and econometric modelling expertise.

Mr. Vugar Abdullayev presented on Azerbaijan's experience with TSA consolidation and cash management. A prerequisite for transition to a centralized TSA was the implementation of the new IFMIS. The TSA covers the majority of public funds (with the exception of the State Oil Fund and State Social Insurance Fund) and the Treasury operates as a participant of the payment system. The State Oil Fund of Azerbaijan (SOFAR) was set up in 1999 as a fund for the current and future generations and it operates outside of the TSA. At the same time budgeting of its resources is aligned with the state budget: revenues are projected based on macroeconomic indicators of the state budget and its revenues and expenditures are included in consolidated budget reports (with the exception of expenditures to operate the fund).

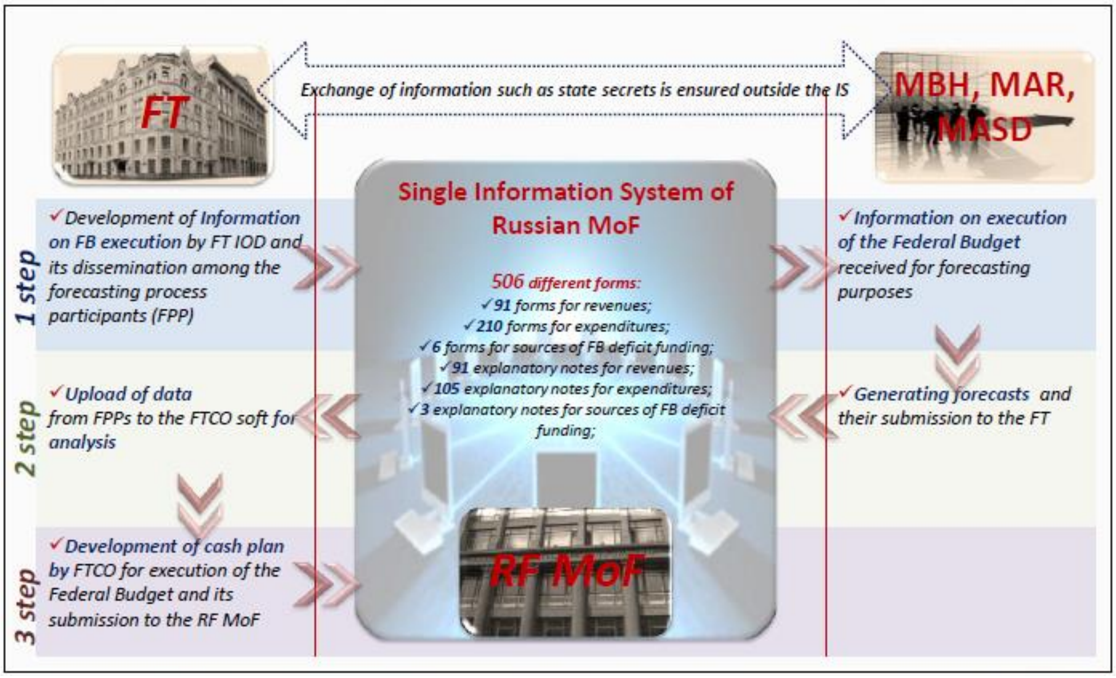
The peculiar element of the Azerbaijan experience relates to the introduction of the VAT Deposit Account which supports the operation of electronic VAT invoices. The Account is administered by the tax authorities, with subaccounts opened for every taxpayer. Treasury has the right to invest the balance of the VAT Deposit Account to optimize the investment of cash balances. Consolidation of VAT payments on a single account helps to increase transparency over VAT transactions and improve the cash position of the government by accumulating VAT advance payments.

The session continued with a presentation on the Russian Federation (RF) experience delivered by **Mr. Stanislav Prokofiev**, Deputy Head of Treasury, and **Ms. Oxana Pavlyukova**, Deputy Head of Federal Budget Execution Directorate of the Treasury. **Mr. Prokofiev** described the architecture of the Russian TSA which comprises 86 regional accounts of Federal Treasury Directorates and the set of instruments currently used for active cash management (deposits, budget loans to RF entities and municipalities for the period of up to 30 days, REPO operations) and ones that are planned to be introduced in the future (overnight loans, DEPO operations, currency swaps). **Ms. Pavlyukova** continued the presentation by providing the detailed description of the new (introduced in 2014) procedure for federal budget cash planning and forecasting (see **Figure 5**), which is prepared in a dedicated information system.

Ms. Pavlyukova also briefed the participants on the Russian Treasury's plans of further development cash planning and forecasting techniques. The plans are part of the Russian Treasury Strategic Roadmap and imply the transition from forecasting of cash accounts of the federal budget to forecasting of daily cash balances of the Treasury of Russia TSA.

The second day of the workshop finished with a group discussion session, during which each country presented their approaches to TSA and cash management. Reports from the group discussions were presented at the beginning of the day three by Ms. Maria Popović (Montenegro), Mr. Erekle Gvaladze (Georgia) and Ms. Lyudmila Guryanova (Belarus). The main conclusions of the discussions that took place in the groups are summarized in **Box 2** below.

Figure 5. Cash Planning and Forecasting of the Federal Budget Execution



Summarizing the discussions Mr. Mark Silins noted that different countries may utilize different models of TSA (centralized, decentralized, or even hybrid ones), and the key to proper cash management lies in the daily centralization of cash balances to optimize borrowing and investment decisions. It is also important for countries transitioning to a more active cash management approach, to understand the importance of separating cash forecasting and management from any traditional role of the Treasury in terms of spending controls.

Box 2. Main Conclusions from Day 2 Group Discussions

Treasury Single Account:

a) political will is a key to expanding TSA coverage
b) development of IT and banking infrastructure is a prerequisite
c) some countries experience problems with application of the TSA model (zero-balance account method is not applied to all balances)
d) mitigation of concerns related to potential loss of independence should be done
e) assessment of potential benefits needed in order to gain support

Sources of Data and Its Use:

a) data sources are similar but usage of cash plans differs – different stages of transition from traditional treasury controls to cash flow forecasting
b) annual and monthly plans are applied everywhere, and many countries also prepare daily forecasts, but generally for a short-term horizon (not more than a month)
c) quality of forecasts prepared by revenue administrators is an issue
d) staff engaged in forecasting require further training

Tools for Managing Cash Deficit:

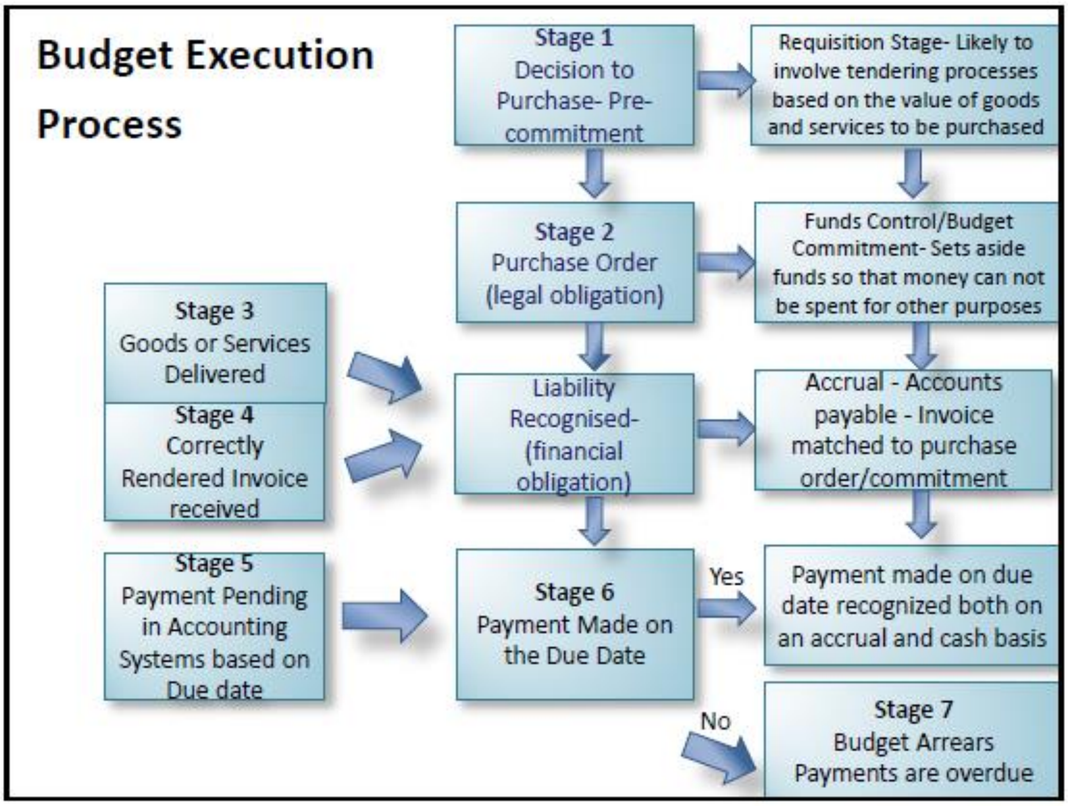
a) countries with no reserves have little choice but to delay (postpone) payments
b) sufficient cash buffer needs to be created before it will be possible to shift the focus from cash rationing to cash flow forecasting
c) gradual extension of IFMIS giving the right to budget entities to access the system for their budget execution and financial reporting

Tools for Efficient Liquidity Management:

a) not every country in the group has possibilities to apply methods of active liquidity management
b) establishing cash buffers is not practiced by the countries presented at the meeting – but there is high interest in the methodology for developing the buffer mechanism

The morning session of the day three continued with a presentation on the results of a TCOP survey on the management of commitments and arrears by **Mr. Mark Silins**. It was noted that commitment, accounts payable and arrears controls are fundamental to effective cash management and budget execution control, but these concepts are understood differently in different countries. The presentation by Mr. Silins focused on the generally accepted definitions (see **Figure 6**) and benchmarked PEMPAL countries practices against those definitions, based on responses to the survey.

Figure 6. Expenditure Commitment Controls as a Part of the Budget Execution Process



Key results of the survey included:

- Most countries have a pre-commitment and commitment stage. Timing for the recognition of commitments is however, varied;
- Only half of the countries recognize goods and services delivery – this has implications for forecasting payment dates and more broadly accrual accounting;
- Only half of the countries match invoices to commitments – this presents some challenges for budget control;
- 9 countries recognize accounts payable, however the point of recognition is not consistent;
- 8 countries have a due date and 8 also report on budget arrears.

While some consistent themes emerged, there remains significant differences across PEMPAL counties as well as in comparison to good practice. Mr Silins felt that it may be useful to examine country responses in light of two key reforms. Firstly, the degree of integration of all of these processes into a country FMIS; and secondly, the status of the country in relation to adoption of accrual accounting.

The topic of commitments and arrears management was further explored during a final group discussion session. Ms. Zaifun Yernazarova (Kazakhstan) and Ms. Aurela Velo (Albania) presented on the main conclusions of the discussions which are summarized in **Box 3** below.

Box 3. Main Conclusions from Day 3 Group Discussions

We Recognize Commitments and Accounts Payable:

a) Lack of registration (or delayed registration) of liabilities is a risk because it can lead to emergence of unsecured liabilities, arrears and accompanying problems with suppliers
b) Incomplete accounting of liabilities represents a risk for liquidity management as it jeopardizes the quality of forecasts and leads to unpredictable situations
c) Without proper reflection of accounts payable it is impossible to ensure adequate accrual accounting
d) Expanding the horizon of commitments registration helps to prevent accumulation of arrears over the years (registration of multiyear commitments)
e) Helps to improve the quality of supplementary budgets

Challenges in Recognition of Commitments and Accounts Payable:

a) Tension between traditional budget execution controls and commitment registration may force the latter outside of the system
b) There are items which are difficult to plan/register. What should be the solution: to improve planning methodologies or address policy issues?
c) If terms of payment, stipulated in a contract, are not reflected in the Treasury system, problems with tracking overdue arrear might occur
d) There are cases when contracts do not stipulate any terms of payment, which puts them down the payment priority queue when the country has a cash deficit

Recognition of Due Date and Budget Arrears:

a) Proper recognition of due date and budget arrears helps to monitor budget execution, as well as provides information for audit
b) Budget institutions should be held accountable for managing their budgets - if you allow institutions to avoid controls the risk of arrears accumulation could arise
c) Integrated controls over all stages of the payment process decrease the necessity for cash rationing

Summarizing the discussions Mr. Mark Silins noted that:

- Cash management and forecasting is enhanced by ensuring systematic control over commitments and accounts payable. A due date also provides absolute certainty over the timing of cash flows once you record the accounts payable. The payments are no longer a forecast – these payments are now certain as to value and timing;
- Effective budget execution control, even for budgets appropriated on a cash basis, is only possible if you record commitments, accounts payable and the cash payments;
- All of these elements in combination with a due date also contribute to improving management of arrears and reducing cash rationing;
- Variations from a government's standard due date should reflect proper cash management decisions – it should be a decision based on cost. If you pay early it is because you get a discount, if you pay late perhaps you should pay penalties as with any other formal borrowing.

Mr. Silins also added some comments in relation to the whole event:

- Unrealistic budget estimates are a challenge for forecasting both revenues and spending – There is no value in forecasting in accordance with an unrealistic budget. Cash forecasting models should reflect estimates of what is likely to happen;
- Government's generally ensure only one entity can borrow, maintaining control and concentrating expertize in one place. Effective cash management is equally as challenging and should be concentrated in a single function. Consolidation of cash and ensuring government has a single cash manager is therefore important;
- The TSA should be expanded as far as possible without affecting the autonomy of the consolidated entities. Zero balance accounts are one tool to facilitate this process;
- Treasury must ensure that its traditional cash control role through monthly cash plan (ROSPICE) is not confused with cash management and forecasting; and
- Targeting a minimum cash balance and cash buffer are tools for more active cash management and will help in reducing cash rationing.

The final session of the workshop was devoted to discussion of further plans related to work of the TCOP. In order to identify members' priorities for the future TCOP events' topics and formats, an internal survey has been conducted in Tirana among the community's members. The preliminary analysis of the survey results highlights that in addition to the 4 main topics discussed within the TCOP (Public sector accounting; Use of IT in treasury operations; Cash management; Treasury control), some new might be considered for the community's agenda in the next 2 years. In particular, issues related to the strategic development and evolving role of the treasury have been highlighted by participants as topics of high interest. While face-to-face meetings continue to dominate the TCOP members' preferences for the format of the events, a strong vote for thematic videoconferences has been expressed by the members and this format will be used more frequently in the future. A more detailed analysis of the survey conducted in Tirana will be made shortly and posted on the PEMPAL website.

The next PEMPAL TCOP plenary meeting will be held during the first half of 2016 (place to be identified).

All workshop materials could be found at the PEMPAL web-site:

http://www.pempal.org/event/eventitem/read/142/377