MF/10/99/C

MF Circular No. 8/2002

MINISTRY OF FINANCE,
South Street,
Valletta.

22nd August, 2002

To : Permanent Secretaries
Directors General
Directors

**GOVERNMENT ACCRUAL ACCOUNTING:
PROCEDURES FOR THE MANAGEMENT OF CASH**

As you are aware, in the context of an ongoing programme for the upgrading of financial management in the Public Service, the Government has decided to replace, in the medium term, the existing system of cash accounting by a system of accrual accounting. The introduction of accrual accounting, in fact, will constitute a major change in the way that the financial business of Government is conducted, a change which will affect all Ministries and Departments without exception.

The introduction of accrual accounting will provide a number of benefits. It will provide more meaningful information and, therefore, enhance the quality of the financial decision making process in Government, it will provide a better and more comprehensive understanding of the overall Government financial situation and it will facilitate long-term financial planning in such areas as asset replacement planning and cash flow projections.

A number of preparatory steps for the introduction of accrual accounting have already been taken over the past few years. These include:

(i) the introduction, in 1999, of revised inventory control regulations (MF Circular No. 14/1999);
(ii) the introduction, in 2001, of procedures for the control of debtors and creditors (MF Circular No. 10/2001);
(iii) the launching, also in 2001, of an extensive programme of training in accrual accounting for officers from all Ministries and Departments. This programme, in fact, is currently under implementation.

It is now necessary to take another important step in this ongoing process for the introduction of accrual accounting in the Public Service, namely the adoption of procedures related to the management of cash within each Ministry and the respective Departments. These procedures, which are outlined in Appendix A to this Circular, in effect have been developed around procedures already introduced by the Treasury and Ministries and Departments should, therefore, not find it unduly difficult to adopt them. Ministries and Departments are henceforth expected to follow these procedures as indicated in the Appendix. Directors of Corporate Services, in particular, are expected to ensure that these procedures are introduced and maintained in the Departments of their respective Ministry.

Efficient cash management allows the Government to secure the maximum benefit from its flow of cash funds. The fundamental objective of cash management is having enough cash available as and when required at an optimum cost. Judicious cash management encompasses more appropriate timing of expenditure decisions, earlier collection and banking of revenue, and more accurate forecasts of cash flows. This process helps to minimise the cost of financing Government expenditure, in particular investment projects, thus achieving the best overall return.

I also want to take this opportunity to inform you that the Ministry of Finance has now commissioned the Management Efficiency Unit to carry out an exercise for the identification of those business processes in the current Government accounting function that would need to be re-engineered in virtue of the anticipated amendments to existing financial legislation, the introduction of accrual accounting and the adoption of new Government Accounting Standards. The revised business processes would then serve as a basis for the development of the information technology systems that would be required for the effective management of the accounting function in the Public Service. I would be grateful if you could extend your support so that this exercise can be conducted successfully.

J. Scicluna
Permanent Secretary
Ministry of Finance

JS/ca

Appendix A

MANAGEMENT OF CASH

1. SCOPE OF DOCUMENT

The purpose of this document is to provide a practical guide regarding cash management concerns. Efficient cash management allows the Government to secure the maximum benefit from its flow of cash funds. The fundamental objective of cash management is having enough cash available as and when required. Judicious cash management encompasses more appropriate timing of expenditure decisions, earlier collection and banking of revenue, and more accurate forecasts of cash flows. This process aids to minimise the cost of financing Government expenditure, in particular investment projects, thus achieving the best overall return.

2. PARAMETERS

There are principally three motives for holding cash:

(a) ***Transaction motive.*** The transaction motive is the need for cash to meet payments arising in the ordinary course of business. These payments include such things as utilities, purchases, labour, refunds, social benefits, debt servicing and others.

(b) ***Precautionary motive.*** The precautionary motive for holding cash is related to maintaining a buffer to meet contingencies and other unexpected cash flows. The more predictable the cash flows of the organisation, the less precautionary balances that are needed.

(c) ***Speculative motive.*** The speculative motive relates to holding of cash in order to take advantage of expected changes in security prices.

The focus of this paper is on the transaction motive. The reasons for this are: (a) the Treasury Department has the necessary legislatively-backed borrowing power to meet emergency cash drains and therefore the need for the precautionary cash balance is significantly reduced; and (b) the Government does not speculate with public funds.

3. TRANSACTION MOTIVE INFLUENCES

Influences on the amount of transaction balances held by Departments and the Government in general include:

(a) The expected net cash flows of the Departments as determined by their cash budgets. These cash forecasts should encompass both the short-term operational expenditure and long term project plans and related cash needs;

(b) Possible deviations from the expected net cash flows. Probability concepts may be applied to the cash budgets to determine the variation in cash flows under different circumstances.

Every effort should be made to take into account the magnitude of possible dispersions by the use of mathematical tools, such as, Sensitivity Analysis;

(c) The maturity structure of the Government's debt;

(d) The Government's borrowing capacity to meet emergency needs beyond the projected requirements;

(e) The efficiency of cash management.

4. KEY CASH MANAGEMENT PRINCIPLES

The efficiency of cash management will determine the appropriate level of total transaction cash balances for the Government and therefore Departments should give proper attention to the following key principles:

(a) Proactive management of creditors, thus ensuring that payments are made only when they are due except where doing otherwise creates a net advantage to the Government;

(b) Proactive management of debtors, thus ensuring that receipts are collected by due dates and banked promptly;

(c) Preparing appropriate cash budgets which are flexible enough to react effectively to changing circumstances thus realistically forecasting cash receipts and payments;

(d) Ascertaining that cash is available just in time to satisfy the realisation of the budgetary plans of the Departments, including its projected program goals;

(e) Rationalising the number of bank accounts held by Departments. The authority for Departments to open and maintain bank accounts is currently vested in the Minister of Finance. In those instances where a department has the need to open a Bank Account, a request justifying the need, shall be made to the Ministry of Finance, through the Accountant General, who shall evaluate and recommend, or otherwise, such a request. When the Ministry of Finance authorises a department to hold bank accounts, the number of bank accounts as well as their balances should be kept to a minimum and departments are encouraged whenever and wherever possible to utilise electronic banking to speed transfers of receipts to the appropriate Treasury account.

5. PROACTIVE MANAGEMENT OF CREDITORS

Payments should be made only when they are due except where doing otherwise creates a net advantage to the Government. Accounts should be paid on the date specified in the agreement for payment with the supplier. Normal commercial terms are thirty days from the date of acceptance of goods or services and the receipt of a correctly rendered invoice. Such terms should not be improved unless savings may be achieved by:

(a) Minimising inventory levels through the implementation of "just-in-time" delivery mechanisms.

(b) Utilising effectively the national and/or ministerial asset register to define a Departmental asset replacement policy. This is achieved by conducting whole-of-life asset assessments for those assets that are approaching the predicted end of their useful life. Emphasis should be given to those items that have significant ongoing maintenance and other operating costs.

(c) Timing purchases to obtain better value (avoiding emergency purchases).

(d) Negotiating better contract payment terms.

(e) Negotiating discount offerings for making prompt payments once goods and services are accepted.

(f) Taking advantage of free credit periods without jeopardising discount offerings.

6. PROACTIVE MANAGEMENT OF DEBTORS

Proactive management of debtors has the primary objective of ensuring that receipts are collected by due dates and that these receipts are banked promptly. Best management practices for better revenue collection may include:

(a) Issuing claims (and assessments) with the due date for payment clearly specified.

(b) Offering revenue payers a convenient range of cost-effective alternative ways to make their payments, in particular through electronic means. In this respect Officers are referred to MF Circular 7/2002 (Payments to Government by electronic means).

(c) Identifying and adequately preparing for peak workloads and demands, ensuring that claims/amounts are issued in time and ascertaining that payments are made when due.

(d) Recommending and introducing late payment penalties that could be really enforced.

(e) Establishing mechanisms within the Department for taking the necessary steps to pursue outstanding debts, systematically and promptly.

(f) Developing and implementing new ways of reducing the amount of government activities that create debtors, and increasing more those initiatives geared towards immediate cash payments.

6.1 Revenue Collection Mechanisms

There are a number of revenue collection mechanisms that Departments are or should be utilising, these include:

(a) Cheques and over the counter receipts. This method of revenue collection is the most popular mode for the general public to make their payments due to Government. Systems should be designed to ensure that as much as possible of what is received this way, is banked on same day. However, this method is expected to experience a decrease of use, as e-government will gather more and more popularity.

(b) Payment by debit/credit card through the use of EPOS machines as well as the use of detachable remittance slips.

(c) Payments on-line through the internet within the context of an approved system.

6.2 Managing debtors

The Departments are to take all necessary measures to recover each debt falling under their responsibility unless:

(a) The debt has been written off as authorised by the financial regulations. In this respect consideration could be given to the writing off of small amounts which are not economical to pursue;

(b) The debt is not legally recoverable in spite of all necessary efforts being made by the Department.

The key success factors for effective management of debtors include:

(a) The quality of the systems and staff training for dealing with debtors and debt collection;

(b) The documentation that clearly define the procedures staff are required to follow;

(c) Allocating adequate full time resources to actively pursue the debt.

The Ministry of Finance has already issued a circular (MF 10/2001) stipulating the procedures regarding the management of both debtors and creditors. It should be noted that the longer the debt is outstanding, the more difficult it is to collect. The following are critical in the management of debtors:

(a) Early identification of overdue amounts or other outstanding payments;

(b) Having an up-to-date debtors' ledger;

(c) Contacting debtors within 10 days of the debt becoming overdue, by telephone or written notice offering a simple means of settling the debt;

(d) Issuing further notices, with each notice becoming more assertive, following which a judicial letter is to be sent to defaulters;

(e) Whenever authority to negotiate is provided this must be carried out within strictly and clearly defined guidelines as approved by the Head of Department;

(f) Having clear guidelines regarding taking legal action to collect the outstanding debt;

(g) Adhering strictly to relevant procedures regarding the writing off of debts, once it is ascertained that debts cannot be collected.

7. PROACTIVE MANAGEMENT OF CASH

The management of debtors and creditors will enable Departments to be in a better position to assess their ability to generate cash and estimate the level of cash required to fund their activities. This information would help to predict the amount, timing and certainty of cash. Cash comprises cash on hand and demand deposits with banks. Departments are to take all necessary measures to ensure that cash entrusted to them are used in the most appropriate manner. The following are important in the proper management of cash:

a) Ensuring that any expenditure made was in accordance with the approved budget and within the financial limits authorised,

b) Setting clear guidelines and authorisations for the use of bank accounts other than the public account,

c) Maintaining an up-to-date cash book for each bank account, reconciling monthly with bank statements received ensuring that any discrepancies are taken into account,

d) Monitoring petty cash expenditure to ensure that such cash is used as intended and that expenditure is not material in value,

e) Performing monthly cash counts to ensure that physical cash on hand equals balances as per records held for this purpose

8. FORECASTING AND MANAGING CASH FLOWS

Better cash flow forecasting provides departments with a greater understanding of their financial environment, leading to improved financial management. This ensures that the Treasury Department is continually aware of the Department's monthly cash inflow and cash outflow, in particular of any monthly cash short falls.

Forecasting cash flows is an important planning tool for predicting cash requirements and for improving the financial efficiency of the Department. This requires:

(a) Realistic and integrated budgets of operating activities and capital expenditures, together with significant cash receipts and payments, on a periodic basis and projected for 12 months.

(b) Regular review and monitoring performance indicators of timeliness, cost, quality and effectiveness to identify and seek explanations for variations from projected expectations.

(c) Understanding patterns of cash movements to identify the fixed or variable and seasonal or periodic components so that changing environments can be met with maximum flexibility.

In general, cash outflow of a capital nature is more difficult to forecast due to a number of factors. Some of these factors include the complexity of the project, contractual obligations and deliverables, payment terms and works acceptance criteria. It is therefore important for Departments to carefully plan their projects by using appropriate project management techniques and entering contracts that clearly define the deliverables and payment terms. Project variations should preferably be avoided and kept to a minimum where their avoidance is not possible.

8.1 Cash Flow Forecast Statements

In the light of the above and in view of the forthcoming requirements of Accrual Accounting cash flow statements are to continue to be submitted to the Accountant General in the format and frequency as directed by the Accountant General from time to time (Reference is made to Treasury Circular TR 10/2001). Departments are required to submit to the Accountant General:

(a) Annex 1. This Annex is to be submitted by all Departments.

(b) Either Annex 2 or 3, depending on the group assigned to them in Annex 4.

Annex 4 indicates the specific Cash Flow statement and frequency a particular Department is to submit to the Accountant General. To facilitate the work of the Departments and ensure the accuracy of the cash flow forecast statements, each Department is required to utilise the EXCEL worksheet as shown in Annex 5.

(c) Hence for monitoring purposes, Annex 5 is to be submitted, both as hard and soft copy, to the Accountant General on a quarterly basis within the timeframes specified in the same Annex. The first submission for this year is to include the actuals as from January 2002.

These returns will show actual and projected cash flows for a particular Department. Hence at the beginning of a financial year the cash flow forecast will contain only projections. However, at the end of a specific month, the forecast for that month is replaced by the actual cash inflows and cash outflows for that month. Therefore the cash flow forecast statement will contain actual cash inflows and cash outflows for past months and projections for future months.

9. RESPONSIBILITIES

The sections below describe the responsibilities of Heads of Department, Directors Corporate Services or the Directors, Finance and Administration, as the case may be and the Accountant General.

9.1 Responsibility of Heads of Department

Heads of Departments shall ensure that:

(a) A suitable Officer within the Department is responsible for maintaining and updating cash flow information and preparing the cash flow forecast statement as explained in paragraph 8.1 above.

(b) The Department proactively manages its debtors and creditors as prescribed in MF circular MF 10/2001.

(c) The cash flow forecast statement and supporting worksheet are to reach the Accountant General's office within the stipulated period as specified.

9.2 Responsibility of Directors Corporate Services/Directors, Finance and Administration

Directors Corporate Services, or, wherever it is the case, Directors Finance and Administration, have the responsibility to ensure that all Heads of Department falling under the responsibility of their respective Ministry comply with the procedures as stipulated in this document. It is their responsibility to ensure that the information regarding cash flow forecast and supporting worksheet are to be furnished as defined in this document by the stipulated time frame.

9.3 Responsibility of the Accountant General

The Accountant General should ensure that Heads of Department including Directors Corporate Services or Directors Finance and Administration comply with these procedures, and that cash flow forecast information and supporting worksheets are received in a timely manner. The Accountant General is also responsible to ensure that the information supplied by the Departments is analysed and utilised for projecting cash needs of the Government.