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Federation of European Accountants
Fédération des Experts comptables Européens

Public Sector

Public Debt and Cash Management

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Standing for trust and integrity

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About FEE

FEE (Fédération des Experts-comptables Européens - Federation of European Accountants) represents 43 professional institutes of accountants and auditors from 32 European countries, including all 27 EU Member States.

In representing the profession, FEE recognises the public interest. FEE has a combined membership of more than 500.000 professional accountants working in different capacities in public practice, small and larger firms, business, public sector and education, who all contribute to a more efficient, transparent, and sustainable European economy.

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1. INTRODUCTION

Public debt management is the process of establishing and carrying out a strategy for managing the government's debt in order to raise the required amount of funding whilst achieving other desired goals, such as minimising risk and / or cost. The strategy may also be designed to meet other objectives, such as developing and maintaining an efficient market for government-issued debt.

Public cash management is the process of ensuring that government has sufficient cash to meet its day to day needs, again whilst achieving any other desired goals, such as maximising a rate of return on its total available cash and / or minimising risks to liquidity and solvency.

The servicing of public debt can form a significant part of a government's expenditure. In the current economic climate, governments have been required to put in place a series of financial packages to ensure the stability of financial institutions, the financial markets in which they operate, and ultimately the stability of their economies. This has resulted in a significant aggravation of budget deficits that need to be financed. This situation is currently highly visible and has been worsened by the funding problems that certain European countries face and the necessity for the European Union to put in place significant support programs. While this is all very relevant and politically sensitive, it has not been covered in this Paper as we thought it would be more informative to address the important issue of debt and cash management on its own outside of any particular context.

Debt management provides a challenge for the public sector and the accountancy profession, as both the instruments used and the associated accounting treatments are complex. With the recent financial packages, it has become even more important that the implications of these measures on the current and future financial health of governments is understood and transparently reported.

FEE has decided therefore to look at public debt management, how it is operated by European countries, and what the accounting and accountability arrangements are. The aim of this Paper is to provide information on how public debt and cash management is performed across Europe, and also how the results of such activities are accounted for and reported. The Paper does not seek to identify one method of debt or cash management as preferred over another. It is a matter of public policy for each country as to the best way to raise financing and manage their cash positions in the most effective manner.

This Paper looks at the following aspects of public debt and cash management:

- The organisational arrangements; including the role of the debt manager, the associated training and guidance, and how the debt manager is held to account;
- The strategies and objectives of public debt management; including what techniques are used to issue debt, manage risk and hedge activities;
- The strategies and objectives of public cash management; including what cash instruments are used and how cash forecasting is used to manage demand;
- How performance of the public debt and cash manager is measured and reported; and
- What accounting and financial reporting frameworks are in place and how trading activities are reflected in accounts, and what independent scrutiny takes place.

Any data presented in this Paper is based on research carried out by FEE during 2009[1], and may not therefore reflect current market conditions.

FEE would be happy to receive any comments on this Paper. Please send any such comments to Sylvie.Romancide@fee.be.

1 This research covered a sample of countries: Belgium, Cyprus, Czech Republic, Denmark, Italy, Slovak Republic, Spain and the United Kingdom.

2. ORGANISATIONAL ARRANGEMENTS

2.1. Organisational Responsibility

Overall responsibility for public debt and cash management rests, in general, with the Ministry of Finance. Commonly, this responsibility includes general policy setting alongside politicians, oversight arrangements for the delivery of the policy, and the setting of the detailed strategies in order to achieve the policy.

It is not common for the Ministry of Finance to be the entity that actually delivers the public debt and cash management. The two most common scenarios are firstly that a separate legal entity or agency exists to manage debt and cash on behalf of the Ministry (for example in the UK), and secondly that the Central Bank of the country concerned is the entity that performs the functions (for example in Cyprus).

Where there is a separate legal entity, there are operating agreements in place between that entity and the Ministry of Finance. Some of these entities operate with more freedom from the Ministry that others, as some are actually divisions within the Ministry itself, but the common feature is that the Ministry always has the overall responsibility for, and oversight of, the functions of debt and cash management.

The separation of delivery of the functions from the Ministry is a relatively recent one. In most cases the separate legal entity was set up in the 1990s or 2000s. There are some indications, however, that the trend is reversing, with for example in Cyprus where the Ministry is taking back the delivery of the functions from the Central Bank from August 2010.

2.2. The Role and Accountability of the Debt Manager

All public debt managers have the same basic role; to meet the financing requirements of the government both today and into the future. This is, however, not the only role as there are other features which are factored in to the objectives of the body performing the functions.

The main additional objective is that the primary objective must be met whilst taking account of cost and risk. This Paper does not seek to provide a detailed analysis of cost and risk and the complex management strategies that are needed to manage them. It suffices to say that cost and risk are two variables which are linked; there is a trade off between the two, and finding the optimal balance between the two is the task of the debt manager in satisfying the appetite for risk as set out in the debt management strategy and policy.

The research done by FEE suggests that a majority of public debt managers are set objectives which look to minimise cost. Cost is an input factor and is therefore much easier to control than risk, which is a less tangible variable. This is not to say that risk is not included within the strategies just that it is harder to define. For example in the UK, the objective is to minimise cost whilst retaining an acceptable level of risk, whereas in Belgium the strategy is to optimise the position between both cost and risk.

It is too early to tell what the implications of the recent economic situation and the associated government financial backing to financial industries will have on this profile. What is common to all countries is that the overall strategy, and therefore the risk appetite, is a matter for the policy setters and the politicians.

There is often a third element to the role of the public debt manager; namely the maintenance of an efficient market in the country. This ensures that there is a liquid market into which the government can place its debt, and in some cases the public debt manager has a degree of control over access to the financial markets (for example in Italy, where the debt manager also monitors the debt and exposure of local authorities).

All public debt managers are ultimately accountable to their Parliaments. This may be directly or indirectly through their responsibilities to the Ministry of Finance. This accountability generally takes the form of one or more of a) budgets that need to be approved, b) accounts that are audited by the Supreme Audit Institution, and c) other reports at the request of Parliament designed to provide more operational information. Each country's requirements are slightly different, and tend to be a combination of the above, but in general there is strong accountability to the legislation over the public debt management. There is also external responsibility, with for example the reporting on public debt levels to Eurostat.

2.3. The Training and Experience of Public Debt Managers

The employees of the public debt managers tend either to be Civil Servants or recruited directly from the banking sectors. A degree or equivalent education is expected, and as a minimum a considerable amount of experience with the banking industry is considered desirable. A range of backgrounds are evident, although the predominant discipline found in these organisations and activities is economics.

One of the reasons why there has been a recent trend towards moving public debt management out of the Ministry of Finance is to have operations closer to the banking sector. In the UK, the debt manager is structured in the same way as a merchant bank, and more generally the debt manager is able to recruit relevant banking skills and experiences more easily if the debt manager is more closely identified with the financial markets.

3. Debt Management Strategy and Operations

3.1. The objectives of debt management

As previously described, the main objective of debt management is to ensure that finances are in place continuously to meet the financing requirements of the country. The objective is carried out taking account of the factors of cost and risk, with some debt managers seeking to minimise one or other of these, and others seeking to optimise both. Risk appetites are generally a matter of policy decision.

Objectives are ultimately set by the Government and the Ministry of Parliament. It would be expected that all countries would react to shocks or other significant events in the very short term, but in terms of formal reviews of strategy there is some variation in the frequency of such reviews. For many, for example the UK and Italy, this follows and annual cycle. For others, such as the Czech Republic and Denmark, this is a quarterly process, and in some cases the strategy is subject to even more frequent review (for example in the Slovak Republic, where it occurs monthly, and in Cyprus the objectives are kept under constant review).

In all cases, the objectives are very specific. They include detail on the amounts to be raised, the methods to be used, what markets will be used, the maturity and characteristics of the instruments to be issued, as well as overall objectives on portfolio profiles. There is variation as the amount of consultation on the objectives. In some cases, there is a lot of consultation which is publicly available (for example in the Czech Republic, the Slovak Republic and the UK). In other cases, the market is extensively consulted but minutes of these meeting are not made public (for example in Italy and Denmark). Some countries consider the strategy and objectives to be market sensitive and restrict the amount of information that is publicly available (for example in Belgium).

3.2. The Methods of Debt Management

Most countries have a pool of primary dealers (mainly merchant banks) who are tasked with making the market for government debt (e.g. Belgium and the UK). The most common form of issuance is through auctions, primarily to the market makers but on occasion these are also open. Auctions are by far the preferred option for domestic debt, although Denmark uses tap sales in preference to auctions. The most preferred option for issuance of foreign debt is through syndicated issues. Other methods are used depending on the type of instrument and the financing needs of the debt manager. Commercial paper is used extensively, and private placements are sometimes used. In the UK, conversions are also offered to the market, and retail debt is also issued on demand.

The two main instruments offered are government bonds (being generally of maturities greater than one year) and government bills (being of maturity one year or less). Bonds are generally offered as either fixed rate or at a floating rate linked to an appropriate index. Bills are generally offered at a discount and are bought back by the debt manager at their face value on maturity. There is considerable variation in the maturities offered on government bonds. Most countries offer maturities of as little as 2-3 years, however it is the long term where differences emerge. The Slovak Republic offers a maximum life of 20 years to its bonds; Italy goes to 30 years, whereas the UK typically offers bonds with maturities of 50 years (and has some undated bonds in issue with fixed rates).

There is considerable variation in the proportion of debt portfolios issued in the home currency of the country concerned when compared with foreign currency debt, and in the maturity profile of the debt portfolios. Just under a quarter of the debt portfolio in Belgium and Cyprus is due to mature within 12 months (taking the middle of 2009 as a base). The UK and the Slovak Republic have much less of their debt maturing in the short term, with the latter having short term debt of just 4.4 per cent. The profile between domestic and foreign debt also shows variations. In Cyprus, 72 per cent of total debt is domestic; in Italy this is 95 per cent and in Denmark it is 81 per cent, whereas in the UK it is just 65 per cent and in the Slovak Republic this falls further to 59 per cent. In Belgium, just 2 per cent of the debt is issued in currencies other than the Euro.

3.3. Risk management and hedging

The public debt managers of most countries make extensive use of hedging and risk management. The exception was Cyprus, which said that speculative operations were avoided and that risk is managed by not borrowing in foreign currencies and by managing the sources of borrowing and the maturity composition of the debt. Swaps are the most common technique used to manage interest rate risk and foreign exchange risk; extensive use is made of these by all of the other public debt managers. Most debt managers use some form of cost at risk model, or value at risk model, in determining the level of risk in their portfolios.

Sensitivity analysis is extensively performed, with a common technique employed being the calculation of how government liabilities would be affected per changes of 1 basis point in interest rates. This is the same analysis as required under International Financial Reporting Standards, and is an example of where a new accounting disclosure requirement has aligned with the common practice of the areas concerned.

4. CASH MANAGEMENT STRATEGY AND OPERATIONS

4.1. The objectives of cash management

In principle the objectives of all public cash managers are the same; to ensure that the government has enough cash to meet its day to day costs as they fall due. This can be succinctly described as managing effectively the cash position of the state.

Secondary objectives (for example in Cyprus, Denmark and the UK) include maximising interest received from the market from the lending of cash on a short term basis. In respect of Cyprus this is a new objective; before 2008 any short term excess cash was deposited with the Central Bank and did not attract interest. Further considerations are also the liquidity and solvency both of government organisations and the monetary markets themselves. Governments will have an objective not to minimise cash towards zero, but to have a level of contingency which can be drawn on immediately if needed.

4.2. The methods of cash management

The overriding principle from all responses is that the government will lend to the market when it has surplus cash and will borrow from the market when it is short of cash. In borrowing from the market, the most common instrument and method is via auction of government bills, usually offered at a discount and with maturities between 1 and 51 weeks.

In lending to the market, the most common method is via short term deposit (this can often be an overnight deposit). Where a Central Bank performs the role of cash manager, this is done by inter-bank lending.

Critical to effective cash management is having accurate and up to date information on the current cash position, and in addition accurate knowledge of future cash inflows (from tax receipts and return of short term deposits) and future cash outflows (from government running costs and maturity of debt). In all cases, the general aim of the cash manager is to keep a positive cash balance but not one that is too high. Forecasting is done very frequently, with all countries having some form of real time up to date information on the levels of cash held. Formal forecasting is also held regularly on timeframes from daily to projections of cash requirements over a number of years; this longer time frame is of course to support the debt management strategy and operations.

5. MEASURING AND REPORTING PERFORMANCE

In general there are a significant number of performance measures and indicators in place at all public debt managers. Some of these measures are common to all debt managers, although some have more extensive and more wide-ranging performance measures. Operational indicators are the most common, with indicators covering, for example, the time taken to publish auction results, the cover and the amounts issues (for example in Belgium and the UK).

The overall picture is also a common indicator, with performance against the expected mix of the portfolio in terms of amounts, types of instruments in issue and maturity profile being the significant measures. The actual average interest rates incurred are also used, for example in Cyprus and Denmark, where the actual costs of borrowing are compared against a benchmark. In Cyprus the costs of payments are compared as a percentage against annual total payments, revenue and taxes.

In general, the performance measures selected are used by the Ministry of Finance to assess whether the debt manager is being successful in meeting its strategy and objectives. The frequency of these assessments is variable; in Denmark there are quarterly meetings which is fairly representative.

Performance is also reported to other bodies. In Belgium, the Court of Audit has access to all information and holds a meeting every two months with the public debt manager to discuss performance. The Court may then report to Parliament if it chooses. Parliaments do not, however, generally get too involved in assessing performance. The UK notes that it is not clear to what extent performance information is used or understood by Parliament. In Italy, Parliament does not have any specific performance information by which to assess the Public Debt Directorate of the Ministry of Finance.

Most commonly, performance against indicators is included in the annual reports of the public debt managers (for example in the Slovak Republic and Denmark). Risks and strategies are also often included within these reports.

More frequent performance information is generally available on the websites of the debt managers. In Italy, statistics on debt composition, average maturity, and cost at issue are available online on a monthly basis. The Czech Republic publishes quarterly reviews on its website. In Belgium and the UK, the operational results against performance indicators are published as they happen (for example the results and timings of auctions).

6. ACCOUNTING AND FINANCIAL REPORTING

6.1. Accounting and Financial Reporting

The accounting and financial reporting requirements on the public debt manager are closely aligned with the general accounting requirements of the country concerned. So, for example, if the country adopts the cash basis of accounting then the debt management activities are also presented on a receipts and payments basis.

Where accounts are presented on a cash basis, only the movements in cash are shown in those accounts. It is difficult, therefore, for the liabilities of the government to be made visible to others in this way. In Cyprus, the cash basis is modified to include borrowings on the statement of assets and liabilities at the year end. In Italy, no such statement is made, but the Parliament is asked to approve the budget one year in advance and a forecast is made of future cash movements to enable the Parliament to do this.

Some countries account on an accruals basis but budget on a cash basis. This makes it difficult for those approving the budgets (the Parliament) to have all of the information, for example hedging transactions cannot be fully reflected in a cash budget.

There is also variation as to whether accounts are produced solely for the debt management activities, or whether these transactions are shown in the wider Ministry of Finance accounts or national accounts. Where there is a separate legal entity operating as the debt manager (e.g. UK) then separate accounts are prepared. Belgium is also moving to a point where a separate account showing debt management activities only will be prepared.

The costs of borrowing are reflected in accounts depending on whether cash or the accruals basis of accounting is used. Where the cash basis is used, interest payments are considered an expense in the year of payment. Where the accruals basis is used, discounts and gains on bonds are recognised over the life to maturity of the relevant bond. Interest is accrued or accumulated on an ongoing basis.

As well as annual accounts, there is a wide variation of other information provided on debt management activities by those countries that responded. Belgium provides monthly reports of the current state of the national debt. In Cyprus, significant additional information is provided within the accounts, covering borrowings, interest rates, maturities and promissory notes at the end of the relevant period. In Italy, a quarterly report is provided to the Court of Accounts.

In the current economic climate, with national debt increasing significantly in many cases, it becomes more important that politicians are able to take decisions in full possession of the facts. The cash basis of accounting may mean that the full impact of the measures taken is not entirely visible either to decision makers or to the wider public.

6.2. Audit or Independent Review

The reports and accounts of the national public debt managers are generally subject to a full audit or independent review by the Supreme Audit Institution (SAI) of the country concerned. The SAI may also conduct any investigation into the affairs of the debt manager, according to the terms of reference and powers of the SAI in each country. For example, in Italy the Court of Accounts has the freedom to perform any work on the quarterly debt management reports that it sees fit.

Reports are also, in general, provided to the Parliament of the country who are empowered with scrutinising those documents and investigating the debt management activities. This is a further example of the strong scrutiny over, and accountability of, the public debt and cash managers.

APPENDIX: GLOSSARY OF TERMS USED*

Cash Management	The process of ensuring that government has sufficient cash to meet its day to day needs, again whilst achieving any other desired goals, such as maximising a rate of return on its total available cash and / or minimising risks to liquidity and solvency.
Commercial paper	A promissory note with a fixed maturity date; generally sold at a discount to face value and bought back at face value on maturity.
Cost at risk	A model which examines the predicted results of varying the levels of cost and risk in the debt manager's portfolio, so that that desired outcomes can be best achieved.
Debt auction	A common method of issuing debt, where authorised primary dealers (usually merchant banks) make bids to purchase government debt instruments. Those bids with the most beneficial interest rates (from the issuer's perspective) are successful.
Debt Management	The process of establishing and carrying out a strategy for managing the government's debt in order to raise the required amount of funding whilst achieving other desired goals, such as minimising risk and / or cost.
Government bills	An instrument, generally with maturity less than one year, which entitles the holder to the repayment of its face value on maturity, and is issued at a discount on that face value.
Government bonds	An instrument, generally with maturities in excess of one year from issue, which entitles the holder to a fixed cash payment at regular intervals, until the bond matures at which point the face value of the bond is payable. Bonds may also be traded on markets once issued.
Hedging	A method of protecting oneself from changes in market conditions, such as changes in interest rates or currency rates.
Liquidity	The degree to which an instrument can be bought or sold without affecting the price of that instrument. A liquid market can be said to carry lower risk for an investor as it is easier for that investor to realise the value of the investment.
Retail debt	Debt provided direct to citizens rather than to institutions.
Sensitivity analysis	An analytical tool used in risk management to identify the costs of benefits associated with movements in variables beyond the entity's direct control, such as interest rates or currency rates.
Solvency	The ability of an entity to meet its short and long term obligations.
Swaps	A tool for managing risk, commonly used to ensure that changes in interest rates or currency rates do not adversely impact on the cash flows of the entity.
Syndicated issue	A method of issuing debt where determined amounts are made available to particular primary dealers (the syndicate).
Tap sales	A method of issuing debt where the instruments are available on a more continuous basis, as opposed to the auction method where debt is only available at certain points of time.
Value at risk	Similar to cost at risk, value at risk provides a measure of the risk of loss on a portfolio of assets, usually in the form of a probability of percentage losses to the value of the portfolio given certain conditions.

* The above definitions are those used by FEE in its research and the preparation of this Paper.

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