



# Cash Management Reform in Indonesia:

**Making the State Money Work Harder**



Kementerian Keuangan  
Republik Indonesia



WORLD BANK GROUP



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# Foreword

A decade-long cash management reform by the Government of Indonesia has resulted in reduced costs for taxpayers and better control of cash and public money. This reform is necessary for improving the delivery of public services, increasing infrastructure, lowering financing costs, and curbing corruption. This book, co-authored by the Indonesian Ministry of Finance and the World Bank, and financed by a multi donor trust fund established at the World Bank (PFM MDTF)<sup>1</sup>, aims to take stock of the Indonesian experience in the implementation of cash management reform, consider some of the impacts of these reforms, and identify the ongoing challenges for further improvement, using international practices as a backdrop.

The key impetus for the reforms was the 1997 Asian financial crisis. The crisis revealed entrenched institutional and structural weaknesses in the public management of most East Asian countries. It also highlighted imbalances in the structure and financing of these economies. The Government of Indonesia embarked on a range of reforms to increase the flexibility of the economy and improve its ability to withstand shocks. These included reforms to public financial management, still ongoing, that drew lessons from international experience.

Cash management reforms were a pillar of these reforms in Indonesia. They have allowed the Government to consolidate its cash balances in a treasury single account, streamline the receipt and payment processes, and improve accountability. The result has been lower financing costs and improved control of both revenue and expenditures. The reforms have captured opportunities created by new information communication technologies, especially within the banking system, building on experience from other countries. The PFM MDTF has been supporting the reforms during the past decade and will continue to do so.


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<sup>1</sup> At the time of this work, the PFM MDTF received contributions from five donors: Canada, the European Union, the Netherlands, Switzerland, and USAID.

The Indonesian cash management story is one of success. This book provides lessons to guide the next generation of reforms in Indonesia, its neighboring countries and beyond.

A handwritten signature in black ink, appearing to read 'Marwanto M', with a horizontal line underneath.

**Marwanto Harjowiryo**  
Director General of Treasury  
Ministry of Finance  
The Republic of Indonesia

A handwritten signature in purple ink, appearing to read 'Rodrigo A. Chaves', with a horizontal line underneath.

**Rodrigo A. Chaves**  
Country Director, Indonesia  
The World Bank

# Voices of the Key Implementers

## Challenges During the Early Implementation of Cash Management Reform in Indonesia

**Mr. Tata Suntara** *(The Secretary of Directorate General of Treasury, Ministry of Finance 2011-January 2014; and former Director of Cash Management, DG Treasury, Ministry of Finance in 2008-2011)*

I recall that in my previous position as the Director for Cash Management in DG Treasury and the person in charge of the early implementation of cash management reform, we faced resistance from the line ministry's officials who lost their authority to handle large amounts of state cash under their control. It was difficult for the Finance Ministry to make them understand the need for them to register their bank accounts and consolidate the balances in the TSA since they stood to lose not only the "monetary" benefit in the form of interest but also the "in-kind benefits" commonly provided as part of the commercial bank's marketing strategy.

In my view, the Finance Ministry followed the best possible approach for cash management reform in the Indonesian context. We received full political and technical support from the President, Finance Minister, Minister of Justice, and Bank Indonesia. We implemented the reform through the most acceptable and workable approach considering the number and wide geographical spread of spending units, the capability of banking technology and system, and the challenges in changing the mindset of people.

Some criticized us for the slow pace of reform, but I believe such a reform should be implemented gradually not through a "big-bang" approach and I am thankful that through a step by step approach which allocated sufficient time for learning by doing, now we are reaching a stage where we are poised to enjoy the full benefits of the Treasury Single Account (TSA).

Before cash management reform took place, DG Treasury only acted as the cash (inflow and outflow) administrator without the ability to function as a real cash manager. Before the reform started, the Supreme Audit Agency (BPK) had also notified the government about the weakness in the accountability for managing state cash. In this context and appreciating the need to efficiently manage state cash the Ministry of Finance embarked on implementing the cash management reform in Indonesia.

Looking to the future, I believe some improvements can still be made, particularly of the Treasury Notional Pooling (TNP) mechanism, better cash forecasting by the spending units, and implementation of the reward and sanction mechanism to improve cash plan updates by the spending units. Moreover, the plan to implement the Treasury Dealing Room (TDR) shall soon be realized through close coordination with Bank Indonesia. Current ALMC membership can also be broadened by inviting Bank Indonesia as a member. Finally, there should be a way to consolidate large cash balances currently held outside TSA, including the local governments, and public service agencies. These cash accounts can continue to be managed by the owner of the account but placed in the Bank of Indonesia.

## Cash Management Reform is a Continued and Never Ending Process in Indonesia

**Mr. Rudy Widodo** (*Director of Cash Management, DG Treasury Ministry of Finance from 2011-Present*)

First of all, I would like to record my gratitude for the hard work of the World Bank team and my staff who were jointly writing this book. I believe this book should be broadly disseminated both domestically and internationally to let the general public understand the significant cash management reforms of the Indonesian Ministry of Finance. I trust this book will be useful as a reference for all who take an interest in the implementation of public financial management reform in Indonesia.



As the Director for Cash Management of the Finance Ministry, I would like to thank all MOF's former officials who have contributed to cash management reform since 2004. They have laid a strong foundation to enable the continued implementation of this reform. Now, it is my responsibility, under the guidance of the Director General of Treasury, to continue the reform.

With improvements in our IT system, a close coordination with Bank Indonesia, and the development of the commercial banking IT system, it is now possible for the Ministry of Finance to have real time and online information about its cash balance, which was not possible before the reform. This allows DG Treasury to focus its time on analyzing the cash position and cash flows to support budget financing decisions, rather than on routine tasks such as manual bank reconciliations and consolidation of reports. I am also grateful for the close cooperation with Bank Indonesia regarding the TSA arrangements and the banking services they provide to the Ministry of Finance.

Although many improvements have been made, we should not be satisfied by these since I believe that further improvements are always possible. Some of the planned improvements include: the implementation of a better TNP mechanism, the improvement of cash projection from spending units, and the operation of a Treasury Dealing Room (TDR) in coordination with DG Debt Management.



# Abbreviations and Acronyms

ABP	Annual Borrowing Plan
ABS	Annual Borrowing Strategy
AFP	Annual Financing Plan
AFS	Spending Unit Forecasting Application (Aplikasi Forecasting Satker)
ALMC	Asset and Liability Management Committee
APBN	State Budget
BI	Bank Indonesia (Central Bank)
BIG-eB	BI Government Electronic Banking
BI SOSA	BI Centralized Automated Accounting System
BLU	Badan Layanan Umum (Public Service Agency)
BO	Bank Operasional (Commercial Bank for Expenditure Payment)
BP	Bank Persepsi (Commercial Bank/Post Office for Revenue Collection)
BPDs	Regional Development Banks
BPK	Supreme Audit Agency
BUD	Regional Government's General Treasurer
BUN	State's General Treasurer
CFO	Chief Financial Officer
COO	Chief Operational Officer
CORE	Centralized Online Real-time Exchange
COTS	Commercial off the Shelf
CPIN	Cash Planning Information Network
CSA	Central Statistics Agency or BPS (Badan Pusat Statistik)
CS-DRMS	Commonwealth Secretariat's Debt Recording and Management System
DAK	Special Allocation Fund
DAU	General Allocation Fund
DBH	Revenue Sharing Fund
DCM	Directorate of Cash Management
DGB	Directorate General of Budget
DGDM	Directorate General of Debt Management
DGFB	Directorate General of Fiscal Balance
DIPA	Daftar Isian Pelaksanaan Anggaran (Budget Execution Document)
DMFAS	Debt Management and Financial Analysis System

DMO	Debt Management Office
DMS	Debt Management Strategy
ECA	Europe and Central Asia
ERP	Enterprise Resource Planning
FPO	Fiscal Policy Office
FY	Fiscal Year
GDP	Gross Domestic Product
GEAA	Government Employee Administration Agency (BKN – Badan Kepegawaian Negara)
GFSM	Government Finance Statistics Manual
IDR	Indonesian Rupiah
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
KPI	Key Performance Indicator
KPS	Contract Oil Production Sharing
LKPP	Financial Statements of the Central Government
LTBs	Local Treasury Branches or KPPN
MEFMI	Macro-Economic and Financial Management Institute
MOF	Ministry of Finance
MOU	Memorandum of Understanding
MPN	State Revenue Module (Modul Penerimaan Negara)
NAO	National Audit Office
NDPA	National Development Planning Agency or Bappenas
NTR	Non-Tax Revenue (PNBP)
OECD	Organization for Economic Cooperation and Development
PBB	Performance Based Budgeting
PEFA	Public Expenditure and Financial Accountability
PFB	Planning and Finance Bureau
PFM	Public Financial Management
PLA	Performance Level Agreement
PMO	Project Management Office
PPKD	Pejabat Pengelola Keuangan Daerah or Regional Finance Manager
PPP	Public Private Partnership
PSA	Public Service Agency or Badan Layanan Umum - BLU
RKP	Rencana Kerja Pemerintah (Government Annual Work Plan)
RTBs	Regional Treasury Branches or KANWIL
RTGS	Real Time Gross Settlement System
SAKTI	Institution-Level Financial Application System

SAL	Accumulated Budget Surplus or Excess Cash from Unrealized Annual Budget
SBN	Government Securities
SGCA	State General Cash Account or RKUN
SILPA	Annual Budget Surplus
SLA	Service Level Agreement
SLR	Statutory Liquidity Requirements
SNG	Sub-National Government
SOEs	State-Owned Enterprises
SPAN	State Budget and Treasury System
SPM	Payment Order
SPP	Payment Request
SP2D	Fund Disbursement Order
SSSS	BI Scrip-less Securities Settlement System
SUs	Spending Units or SATKERS
TDR	Treasury Dealing Room
TEPPA	Evaluation and Supervisory Team for Budget Absorption
TNP	Treasury Notional Pooling
TPRP	Government Accounts Orderliness Team (Tim Penertiban Rekening Pemerintah)
TSA	Treasury Single Account
UNCTAD	United Nations Conference on Trade and Development
USD	United States dollar
VAT	Value Added Tax
WB	World Bank
ZBAs	Zero-Balance Accounts

### **Currency Equivalent**

**US\$ 1= IDR 10,000 (for simplification reason only)**

**Fiscal Year (FY): January 1 to December 31**



# Executive Summary

Following the Asian financial crisis of 1997, the Government of Indonesia embarked upon a long-term plan for reform of its public financial management systems. The crisis had sharply increased the government debt level and eroded government revenues, bringing to an end Indonesia's comfortable pre-crisis fiscal position. After 1997, steps were taken to more tightly control the use of public resources and improve the public finances. At the same time Indonesia started a difficult transition from an autocratic, centralized state to a democratic, decentralized system of government when the 2001 "Big Bang" decentralization transferred considerable authority over public expenditures and public service delivery from the central government to over 400 local governments. During this transition Indonesia's achievements continued to be clouded by widespread concerns about the weaknesses of public institutions, a lack of transparency and accountability, and corruption.

The experiences of the 1997 crisis and the public demand for good governance brought a growing recognition in Indonesia of the need for comprehensive public financial management (PFM) reform. A PFM reform strategy was developed in 2003— of which the first milestone was the enactment of a modern Treasury legal and regulatory framework by 2004. A key focus was on cash management. The new regulation led to the creation of the Directorate General for State Treasury (DG Treasury), which was made responsible for disbursing funds to ministries and government institutions, as well as for finding resources to finance the State budget. The regulation stated that the cash management objectives were to ensure (i) availability of cash to cover the state liabilities, (ii) effective and efficient action to optimize returns from a cash surplus or to deal with a cash shortage, (iii) provision of cash to Line Ministries/ Institutions in accordance with their cash flow projections to fund their activities, and (iv) timely payment to suppliers of the Line Ministries/ Institutions in accordance with their schedule of activities.

## **OVERVIEW OF INDONESIA'S EXPERIENCES IN REFORMING CASH MANAGEMENT**

The progress on cash management since 2003 has been impressive. Cash balances previously idle in commercial bank accounts have been consolidated in the government accounts at Bank Indonesia (BI), and coupled with a conservative financing policy have provided a considerable degree of cash liquidity. Efficient systems have been established to support the inflow of revenues and outflow of expenditures, which will be further enhanced with two major system developments now being rolled out. Arrangements have been made with BI to provide remuneration on cash balances beyond those required for daily operations, while the regulations are now in place to support the investment of surplus cash with commercial banks. Steps have been taken to improve the coordination of cash and debt management, while a renewed effort to prepare accurate cash plans is now underway. These set the scene for a more active approach to cash management, which will be a key focus in the coming period.

The achievements are the outcomes of a challenging journey, which entailed establishing the Treasury Single Account, identifying and managing expenditures and volatile revenue flows, and developing complementary debt financing strategies. In a demanding environment, the commitment and leadership of DG Treasury was essential to the success. The stories behind these reforms are presented briefly below, followed by a short description of the objectives and structure of the book.

## **THE IMPACT OF THE TREASURY SINGLE ACCOUNT**

An early foundation of Indonesia's cash management reforms was the implementation of the Treasury Single Account (TSA). International experience has shown that the TSA helps governments to realize cost savings by reducing borrowing costs—i.e., interest is saved by using cash surpluses from one area of government activity to cover cash shortages in another. Benefits of a TSA include minimizing transaction costs during budget execution by expediting the remittance of government revenues by collecting agencies, and efficient scheduling of the payment of government dues; providing a mechanism for controlling cash outflows in accordance with aggregated cash plans and commitments; and facilitating reconciliation between banking and accounting data. The consolidation



of government cash in a TSA also provides the opportunity to reduce transaction costs by enabling electronic payments to be made directly to beneficiaries and automating bank reconciliation.

The sequencing of the implementation of the TSA in Indonesia has been very much in line with international practices. The preparatory phase involved regulatory and institutional reforms, and setting up the TSA architecture. Government bank accounts were surveyed and expenditure accounts held by line ministries in commercial banks were gradually brought into the TSA held in BI. Thereafter, zero balance clearing accounts were established in commercial banks to expeditiously collect and remit government revenues into the TSA. In January 2009, the Ministry of Finance (MoF) and BI agreed on and implemented a moderate remuneration on government deposits at BI, which though less than the market rate, resulted in a “win-win” situation for both institutions. From the MoF’s viewpoint, BI provides full security at zero risk and any remuneration paid by BI adds to state revenues, although it may imply a lower dividend amount to be paid by BI to the government. While from BI’s perspective, the retention of government money in BI reduces the cost of monetary policy operations to sterilize the liquidity resulting from government cash balances being held in commercial banks.

The overall benefits of the TSA have been positive for the Government of Indonesia; however, it is difficult to accurately measure the full financial and economic returns. In order to make an assessment of the quantifiable benefits of implementing the TSA two approaches have been used in this book. The first approach is to calculate the direct financial benefit to the Treasury of the consolidation of government cash balances and the introduction of a remuneration paid at 65% of the BI rate. The assessment identified gains of IDR 2-4 trillion (USD 200-400 million) per annum in 2012 and 2013, although some of this benefit is accompanied by additional costs to Bank Indonesia. A second approach involves a broader fiscal assessment of the consolidation of idle balances. It identified gains for the Government of approximately IDR 3 trillion (USD 300 million) had the reforms been in place in 2007 – the last year before the substantive TSA reforms. This is approximately 4 percent of the central government financing costs that year. These benefits are in addition to the “non-quantifiable and indirect” benefits associated with the introduction of the TSA (i.e. reduced opportunities for corruption, better security for government cash balances, better coordination between cash and debt management, etc.).

The coverage of the TSA in Indonesia does not include local governments as the law on decentralization gives autonomy to the local governments in managing finances. Presently, the coverage of the TSA in Indonesia is limited to the cash held by the MOF, other line ministries and agencies of the central government, except the cash resources of Public Service Agencies (PSAs) and Special Funds. With the proven success of the TSA at the line ministry level, the MOF could consider further consolidation of the TSA to cover PSAs and Special Funds on a case-by-case basis without affecting the autonomy of their operations.

## **PLANNING OF IN-YEAR EXPENDITURE AND REVENUE CASH FLOWS**

The starting point for the cash plans are the budget projections. In Indonesia, the budget process provides for parliamentary approval of the budget by the end of October for the financial year starting in January. Under this scenario line ministries have sufficient time to finalize their annual cash flow plans for submission to the Treasury well before the start of the fiscal year in January. However, as parliament's review sometimes goes beyond the end of October deadline, (with the appropriations approved but on hold) ministries must take this into account in preparing annual cash plans.

Procedures for cash plans provide for the preparation of quarterly, monthly and daily cash flow forecasts and involve both "bottom up" and "top down" projections. However, despite measures taken to develop the capacity of spending units to update their cash flow projections, a review of the implementation by DG Treasury concluded that the quality of the cash plans was poor. This could be attributed, in part, to the onerous requirements of the new reporting procedures for in-year updates to the cash plans. Based on these findings, the Directorate of Cash Management is planning to apply a simpler procedure by using an "80/20" rule, in which only spending units with large expenditure budget allocations will be required to submit their regular updated cash flow projections.

The accuracy of projections of expenditure flows could be further enhanced by expanding the role of top down projections based on historical patterns. This should be supplemented by more active follow-up on major variances against the plan by Treasury to reinforce to spending units the importance of accurate projections. The MOF's Fiscal Policy Office (FPO) plays an important role in

in-year cash management by setting and updating the economic assumptions and revenue forecasts. These in-year updates prepared by the FPO assist the DG Treasury in integrating their top-down aggregate cash plans and the bottom-up cash flow plans.

Projection of revenue flows presents challenges in Indonesia due to the revenue composition. Revenue flows are heavily dependent on volatile oil and gas prices. Roughly one quarter of state revenue is derived from the oil and gas sector through tax (VAT and income) and non-tax sources (production sharing and royalties). A World Bank study indicates that in the absence of a comprehensive license registry and lack of data on non-compliance of royalty payments, Directorate General of Budget does not have accurate data to evaluate non-tax revenue forecasts, and to provide oversight of non-tax revenue realization.

Cash management has kept pace with the evolution of banking systems. A majority of payments are made directly to beneficiaries through electronic fund transfers from the TSA. Commercial bank accounts held by local treasury branches for making payments at the regional level are zero balanced to the TSA daily. Information on cash balances held by spending units in imprest accounts is available to the Treasury on a daily basis. The State Finance Law and the State Treasury Law provide for the daily sweeping of government revenues into the TSA. The agreement between the DG Treasury and revenue collecting banks provides for the payment of fees for banking services received; obligates the banks to transfer revenue collections to the TSA within one day; and requires banks to provide appropriate information technology to support the smooth collection of state receipts.

## **STRATEGIES FOR FINANCING OF CASH NEEDS**

The Government of Indonesia uses debt and non-debt sources to finance the budget deficit. Non-debt financing sources are the accumulated surplus of cash from unrealized expenditure budgets, amortization of on-lending, dividends from equity participation, and privatization proceeds. Cash inflows to the budget from non-debt financing in nominal terms has shown a steady increase from IDR 4.7 trillion (USD 470 million) in 2007 to IDR 23.0 trillion (USD 2.3 billion) in 2012. However, the major source of budget deficit financing continues to be

foreign and domestic debt. The Government Debt Management Strategy 2013-2016 sets as an objective the optimization of debt funding from domestic sources, while using foreign sources as complementary financing.

Traditionally, the Government's borrowing strategy has been to ensure the availability of cash by mobilizing funds to cover a large part of the projected budget deficit at the beginning of the fiscal year as soon as the Appropriation Act is passed. The expenditure pattern, however, is usually back loaded, with as much as 40% of the budget appropriations being expended in the last quarter of the year. This conservative policy for debt mobilization resulted in a high carrying cost of money for the government because excess funds remained unutilized until the last quarter and were not invested at a market rate of interest. In 2013, the government decided to refine the strategy so as to borrow during the year in line with market development strategies but also as the budget execution requirements emerged whenever possible. Since the requirements tended to be highly uncertain and cash flow forecasts were of limited accuracy, however, in 2014 the conservative front-loading strategy was reapplied. It is envisaged that forthcoming enhanced cash and debt management coordination should ensure that debt market dynamics used in determining the domestic borrowing strategy integrate better with cash management objectives during the year.

There are restrictions on the use of surplus cash to finance the budget which inhibit effective debt management. Between 2007 and 2012 the actual budget deficit was lower than that projected in the budget, largely due to the low absorption of expenditures. This meant that the budget was over-financed - building up cash surpluses which could not be used for future financing without further approval from the Parliament. In the future, the debt financing strategy could be refined by eliminating the rigidities in the use of the cash surplus from the prior year. This could be a topic for future discussions with the budget committee of the Parliament.

In addition to aligning the Annual Borrowing Strategy (ABS) with the annual budget, consistency between the in-year cash financing operations and the debt policy framework is pursued through the regular functioning of an Asset and Liability Management Committee (ALMC). The risk management parameters pertaining to interest rate, currency and roll-over risks are considered by the ALMC when arriving at borrowing or investment decisions. A Cash Planning

Information Network (CPIN) is also used for communication at a working level across the relevant parts of MOF. Much of the focus is on monitoring the adherence to debt portfolio benchmark parameters, such as the share of domestic debt to external debt, and the share of different currencies in order to obtain assurance that the issuance of debts will be in accordance with the predefined borrowing strategies. It would be of great value for this group to discuss cash management and short term cash planning more actively thereby providing focus and leadership to the cash management function.

As part of its preparation for more active daily cash management, DG Treasury has taken steps toward implementation of a dealing room. Once the dealing room is adequately staffed, the Treasury would be able to participate in the money markets to secure financing at market rates. The operation of two dealing rooms by MOF (i.e. DG Debt Management and DG Treasury) raises some risks and it would be important to ensure that financial markets see the operations of the two dealing rooms as complementary and not in conflict. More should also be done to clarify with Bank Indonesia the individual roles and responsibilities.

Indonesia debt management will undoubtedly grow stronger as it completes the configuration of its debt management system (DMFAS) to interface with its integrated financial management information system (SPAN), which will provide real-time access on the status of government cash requirements and the debt portfolio. The electronic interface between these two systems and giving BI on-line access to the integrated database will greatly facilitate the coordination between cash management, debt management and monetary policy.

## **OBJECTIVES AND STRUCTURE OF THE BOOK**

The purpose of this book is to document how PFM reforms in the decade following the implementation of the State Finance Law, have contributed to improved cash management in Indonesia. It takes stock of the sequencing of reforms, successes achieved, and challenges encountered in reforming cash management.

The context of the reform is set against a backdrop of international practices in various aspects of cash management, and wherever relevant, benchmarking the Indonesian experience against such practices. The book is not intended as

a manual for cash managers. Instead, it is likely to be used as reference material by university students, public finance specialists who wish to understand the fundamentals of cash management in Indonesia, and international practitioners who are interested in the technical details and may want to draw lessons to apply in their own countries.

The four chapters of this book describe the legal and institutional framework for cash management; discuss the banking arrangements for handling government cash balances; look at the issues and challenges in planning and managing government cash flows; and explore ways of optimizing budget financing through better coordination between cash management, debt management and monetary policy. Each of the chapters starts with a description of international practices and goes on to examine the related practices followed in Indonesia. The opportunities created in Indonesia through the previous and on-going reforms, as well as the remaining challenges, are highlighted below in this executive summary and further described in detail in this book.

Chapter 1 examines international practices with regard to setting the objectives, and the legislative and institutional arrangements for cash management. It details the objectives and principles of cash management, its links with policy issues, informational technology needs, incentives and sanctions to promote implementation, and the sequencing of the reform. Indonesia's experience in all these aspects of cash management is explained and compared with international practices. The concluding part of the chapter highlights the achievements of the Indonesian cash management reform and describes some of the on-going challenges and future improvements.

Chapter 2 examines the pivotal role of the TSA in cash management. It introduces the concept of the TSA, describes the international experience with TSA banking arrangements and the sequencing of its implementation. The Indonesian reform in implementing a TSA is discussed in the context of a few illustrative examples of international experiences in TSA implementation. This comparison serves to highlight the very practical approach followed in sequencing the reform. It also serves as a backdrop for understanding the rationale behind the choices Indonesia has made in structuring the TSA. The concluding section summarizes some of these choices and describes some reforms planned for the future.

Chapter 3 reviews the impact of each stage of the budget execution cycle on cash management. It brings out the dependency of cash management on the credibility of budget appropriations, and the robustness of the in-year cash monitoring and updating procedures. The concluding section summarizes the strengths of the Indonesian cash planning systems, discusses some of the remaining challenges and looks at the way forward. Deployment of the cash management functionalities of IFMIS can support better the quality and timeliness of bottom up forecasts and disbursement schedules. However the quality of the plans will depend on the way these are integrated into top down plans and the effectiveness with which variances from the plan are followed up.

Chapter 4 looks at the way cash management needs to be coordinated with budget deficit financing and the investment of surplus cash balances. It brings out the importance of coordination of cash management with the management of debt and monetary policy and describes international practices in establishing coordination arrangements. Options for investment of surplus cash balances are described and some international practices discussed. The chapter concludes with a summary of the strengths and challenges of the Indonesian practices related to deficit financing and suggest some improvements.







# Chapter 1

## Objectives of Cash Management and the Institutional Arrangements to Underpin the Objectives



## 1.1. INTRODUCTION

During the last decade, a body of common practices has emerged among developing countries on the legal, institutional and procedural foundations to support efficient cash management. These common practices have been reviewed and documented in guidance notes and publications on international practices issued by multilateral institutions like the International Monetary Fund (IMF), the World Bank (WB), and the Organization for Economic Co-operation and Development (OECD). Additionally, frequent peer-to-peer exchanges of experiences between countries have resulted in the continued evolution of cash management practices to leverage improvements in data management, ICT and banking systems.

The first part of this chapter examines international practices with regard to setting the objectives, as well as the legislative and institutional arrangements for cash management. It details the objectives and principles of cash management, its links with policy issues, information technology needs, incentives and sanctions to promote implementation, and the sequencing of the reform. The second part of the chapter describes Indonesia's experience with setting the objectives and institutional arrangements related to cash management, and with sequencing of the cash management reform. The concluding part describes the remaining challenges and suggests the way forward.

## 1.2. CASH MANAGEMENT IN INTERNATIONAL PRACTICES

### 1.2.1. Objectives and Features of Cash Management

With the role of governments across the globe evolving towards promoting and delivering efficient services, the management of cash is becoming the dominant function of treasury departments in ministries of finance. In addition to ensuring adequate cash to cover government liabilities, a Treasury seeks to minimize idle cash balances while minimizing the government's financing costs. Cash balances help in payments, but excessive cash remaining unused reduces returns on government resources.

The often stated objective of cash management is to have the right amount of money in the right place and at the right time to meet obligations in the most effective way. Cash management includes procedures and systems for collection, concentration, and disbursement of cash. Measures to ensure availability of cash and choices exercised to invest or hold surplus cash have both risk and cost implications. Poor practices and fragmented institutional arrangements for cash management increase costs, degrade performance, and hinder the implementation of government policies. Inefficient allocation of in-year cash resources results in an increase in debt amortization costs because the debt will be higher than necessary, a wastage of government resources due to an end-of-year rush of expenditure, and time and cost overruns in investment projects.

The main objective of cash flow planning, which is the basis for cash management, is to determine how much cash is available, when it will become available and for how long it will be available. Efficient cash flow plans facilitate the smooth financing of in-year liabilities, underpin orderly execution of the budget, integrate government borrowing with anticipated cash shortages and promote liquidity management.

The practical aspects of cash flow planning were highlighted in a study conducted by the UK's National Audit Office<sup>1</sup> which identified the following three key factors in managing government cash efficiently and effectively:

- Keeping as much money centrally at the Exchequer as possible. This minimizes government borrowing, reducing interest costs and improving the fiscal balance. By keeping cash centrally, the government also knows how much cash it is holding, and where it is. This allows it to better manage the associated risks of holding cash, and take better decisions about the public finances as a whole, particularly regarding cash shortfalls and surpluses.
- Accurately predicting cash flows in and out of the Exchequer. Improved precision allows the Debt Management Office to minimize the number of last minute transactions on a given day, as it is generally more expensive to carry out or to reverse a lending or borrowing transaction late in the day.
- Minimizing the costs of tendering for and using banking services.

A Treasury Single Account (TSA), which consolidates government cash balances, is a central feature of efficient cash management. The TSA incorporates cash

inflows and outflows generated by revenue collections, expenditures, debt and other financial transactions. A TSA arrangement allows government to better manage the associated risks of holding cash, and take better decisions about the public finances as a whole, particularly regarding cash shortfalls and surpluses.

A timely and accurate forecast of in-year cash flows is a second feature of the effective management of government cash. The accuracy of cash flow forecasts is dependent on the credibility of budget appropriations, robustness of the in-year budget revision procedures, and the transparency of the linkages of cash flows with procurement plans. The US Treasury guidelines<sup>2</sup> on cash management reiterate that proper timing of disbursements to meet government commitments enhances efficiency in the usage of cash. Timeliness of forecasts and disbursement schedules is enhanced through improvements in the functionalities of government financial management systems. The guidelines stress the fact that “central government departments and their sponsored bodies play a critical role in minimizing the risks and costs associated with cash management.”

Optimization of returns from idle cash balances is the third main feature of efficient cash management. Having consolidated government cash balances through the TSA, and instituted processes for planning and managing cash flows, the next step is to ensure the optimal use of available cash balances. Government cash balances lying idle in the central or commercial banks are usually not remunerated, or are remunerated at a lower rate than the government borrowing that may have resulted in the accumulation of the excess balances. The information made available to the MOF through in-year cash planning enables it to choose between investing the surplus, or, using it to retire outstanding obligations. Investment or borrowing decisions require timely and coordinated policy decisions from stakeholders such as the central bank, the treasury, debt management, revenue authorities and major line ministries.

### **1.2.2. Regulatory Framework for Cash Management**

At the highest level of the regulatory framework, the financial provisions in the constitution of a country set out the governance and funding arrangements. The next level of legislation is usually a public finance act, which establishes an account from which expenditures can be made and into which revenues can be deposited; the legislative and institutional framework, and on occasions targets for fiscal responsibilities; high level processes and timeliness for budget management,

accounting, and reporting; and principles for providing incentives and instituting sanctions.

Detailed roles, responsibilities and procedures for cash management are usually prescribed in lower levels of regulations such as decrees and financial instructions. In some countries, there is a hierarchy of lower levels of regulations with decrees issued by the president or the cabinet being considered the highest level followed by instructions issued by the Minister of Finance. The lower levels of regulations establish the coverage of cash management in terms of levels of general government, extra-budgetary funds, semi-autonomous government organizations, state owned enterprises, and special funds. They set out the detailed roles and responsibilities for developing cash flow plans and prescribe the basic formats and time schedules for submitting the cash flow plans to the MOF. Banking arrangements for revenue concentration, payments and bank reconciliation are prescribed through instructions. Procedures for the classification and recording of budget allocations, in-year virement (annual budget reallocation), commitment management, and payments, are further detailed in the MOF instructions. Where investment of surplus funds is permitted, the MOF instructions detail the approach to risk versus return and monthly liquidity requirements.

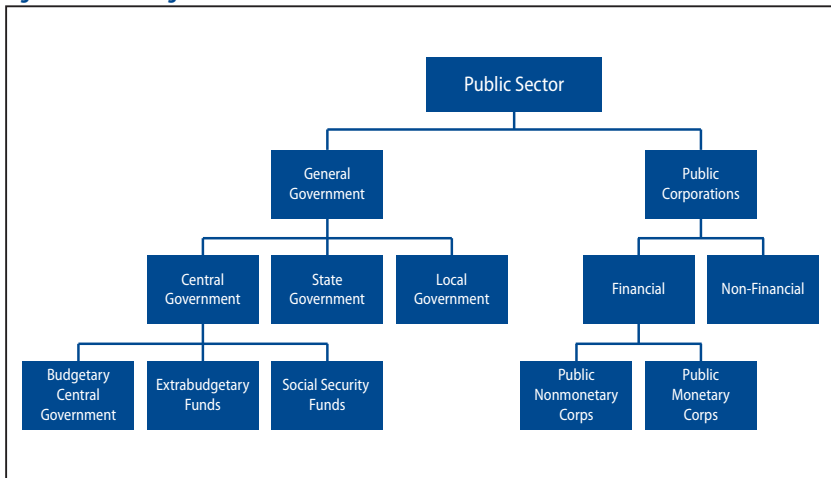
The operational basis for government cash management is usually formally approved cash management manuals or guidelines. The cash management guidelines are supported by system user manuals for the cash management functionality of an Integrated Financial Management Information System (IFMIS) wherever this is implemented. Cash management manuals serve as training and reference materials for cash managers in the MOF as well as for financial managers in budget executing agencies.

Banking services provided by the central bank and commercial banks are formalized through memoranda of understanding (MOUs) or service level agreements (SLAs). The MOUs and SLAs set out the services to be provided and the remuneration for different types of services. Electronic data exchange protocols and standards should also be formalized through mutual agreements. This will ensure the quality and consistency of data exchange between the Treasury, its accredited banks, and the banks of the beneficiaries paid through the Treasury.

### 1.2.3. Coverage of Cash Management

The GFSM 2001<sup>3</sup> is commonly used to present statistical information on the public sector, and provides a useful framework for discussing the coverage of cash management. The structure of the public sector as defined in GFSM 2001 is shown in the figure below:

**Figure 1.1 Coverage of the Public Sector GFSM 2001**



The coverage of the funds available for cash management by the Treasury needs to be clearly defined. There are countries where the coverage is comprehensive and includes the cash balances of local government, and extra-budgetary funds.<sup>4</sup> However the most common practice, especially in countries with federal governments, is for the Treasury's cash management activities to be limited to the cash flows associated with the central government's budget.<sup>5</sup>

In some countries, even though the cash balances of some government entities are held in the central bank outside the TSA, they are considered to be a part of the overall government cash balance by the central bank for purposes of arriving at the daily cash balance of the central government. In others, the MOF has agreements in place with the local governments and extra-budgetary funds for the use of their cash reserves for central government cash management on payment

of remuneration. In low-income countries, expenditures financed by donor grants or multilateral loans may not be included in the annual budget adopted by the parliament. To ensure stability in cash planning, the coverage should be stable and well defined.

### 1.2.4. Institutional Framework for Cash Management

It is common practice to set up a cash management unit within the MOF to review and consolidate periodic cash flow plans provided by spending units. The location of the unit varies from country to country. In some countries the cash management unit is a part of the Budget Department. In others it is located in the Treasury or the Accountant General's office and is a part of the bank reconciliation section. It could also be located in the Debt Management Department and combined with dealing room operations in the money market. The team of officials assigned to the cash management unit is usually quite small (perhaps 3–5 people full-time). Regardless of the location and size of the facility, its main functions usually include:

- Developing and administering a cash management handbook that includes uniform templates for cash projections and time lines for the submission of projections.
- Establishing a schedule of regular cash review meetings with the main stakeholders and lines of communication with other government agencies.
- Arranging for capacity building initiatives in the area of cash management including the organization of regular training sessions and seminars.
- Coordinating submission of prescribed cash flow projections by the cash management committees in line ministries.
- Reviewing, validating, consolidating, and analyzing the projections received from line ministries.
- Reviewing, validating and analyzing cash balances in the bank accounts of government agencies.
- Monitoring and reviewing the alignment of cash flow forecasts with the procurement plans submitted by the line entities and seeking necessary clarifications.
- Submitting cash flow analysis and recommendations on future cash requirements to the liquidity committee.
- Collaborating with those responsible for debt management to ensure that the very short-term focus of in-year cash management is consistent with the more long-term outlook of debt management.



- Collaborating with the Central Bank to ensure that the short-term in-year cash management recommendations are consistent with the monetary policy requirements.
- Interacting with the revenue authorities, major line ministries and the central bank to exchange information on major receipts and payments and the daily cash position.
- Monitoring transfers and subventions to lower levels of the government to ensure that these subventions and transfers are made according to cash plans submitted by these entities and are need based.
- Establishing networks with cash managers in government organizations for continuing evaluation and mitigation of risks to cash management.

One of the goals of cash planning is to provide a plan and target for an investment strategy when cash-on-hand exceeds demand. In a number of countries, the central bank traditionally manages short-term liquidity on behalf of the MOF. Governments often set up high-powered liquidity committees (or debt management committees) within the MOF to take decisions on optimizing government short-term liquidity.<sup>6</sup> The cash management unit functions as the secretariat of the liquidity committee, whose functions include (i) monitoring the macro-fiscal, macro-economic and monetary situation and activating corrective actions in a timely manner; (ii) ensuring coordination and sharing of information among the key stakeholders, (iii) facilitating policy decisions on government debt and short-term investments; and (iv) overseeing the timely and orderly financing of the budget.

The liquidity committee plays a crucial role in coordinating cash management with the budget, debt management and monetary policy. At the operational level, the decisions taken by the liquidity committee on debt and short-term investments are implemented through the Debt Management Office or the Treasury. This role is discussed in Chapter 4 on “Financing the Budget”.

### **1.2.5. Procedural Framework for Cash Management**

The procedural framework for cash management usually provides a mechanism for the integration of bottom-up quarterly, monthly and daily cash flow projections with top-down estimates based on macro-economic variables and historical trends. In many developing countries, compensation to employees, transfers and subsidies form a large proportion of the executable budget. Given such rigidities in budget execution, the bottom-up process of submitting quarterly cash

projections may not add value to the aggregate cash projections derived from top-down estimates. Procedures requiring the frequent submission of cash projections broken down by detailed expenditure items substantially increase the work load in smaller spending units with limited and under-qualified staff. On the other hand, the requirement for submission of periodic in-year cash plans by spending units instills a degree of discipline in the financial management of those agencies. It ensures close and periodic coordination between financial management, accounting, and planning units within the agencies. The additional work load imposed on the spending units could be mitigated by requiring them to submit cash flow plans at aggregated levels of economic classification which are relevant for cash forecasting. Another mitigating measure could be to require submission of frequent cash flow projections only from the major budget users, while others could submit quarterly updates. Prescribed procedures should ensure a trade-off between the effort put in and the outcomes achieved.

Systems should be set in place to ensure that all significant cash flows are identified, and, if needed, prioritized, and that reasonable projections of planned expenditures are produced. Cash forecasting procedures prescribe the frequency with which cash forecasts are produced and how many of the subsequent weeks are covered; and whether projected flows are monitored against actual flows to assess accuracy. Where surplus funds can be invested, it may be appropriate for monthly projections to be supplemented by weekly and daily forecasts.

Cash planners should be able to recognize which items influence the organization's cash level, and develop strategies that provide for the collection of receipts as soon as possible, and the delay of payments as long as possible. Fixed items such as payroll, rent and outsourced contracts may need priority over discretionary expenditures that may not be as critical to the organization or part of a fixed payment cycle. A forecast for payments should also recognize statutory regulations on prompt payment as well as payment schedules agreed with suppliers. Forecasts should include room for error in accordance with predetermined tolerance limits.

The bottom-up projections provided by spending units are often determined by cash management committees comprising members from the planning, budgeting and financial administration units within the spending units. These projections, as determined by the committees, are based on a review of the actual cash flows during the year; changes in budget allocations resulting from virements and supplementary budgets; past expenditure and revenue patterns; information on

commitments, and transactions initiated but yet to be concluded during the year; and information about changes in the underlying macro- economic assumptions.

### 1.2.6. Information Technology

With the widespread implementation of IFMIS over the last decade, there have been significant improvements in every aspect of government cash management. An IMF publication on Integrated Financial Management Systems<sup>7</sup> mentions that the changes which have been driven by technological advances both in computerized information databases and in telecommunications “have facilitated government banking arrangements such that commercial banks can readily cope with high volumes of electronic revenue and expenditure transactions across large geographical regions. In addition, zero-balancing of accounts can occur on a daily basis and in some cases more frequently, committed amounts for future payment can be automatically included within cash plans, and spreadsheet analysis of actual versus forecast is performed for thousands of line items that comprise annual budget law appropriations. Government cash managers also rely heavily on the availability of complete databases of historical revenues and expenditures to enable better cash planning through the use of trend analysis, often using interfaces with government financial management information systems.”

Another IMF technical note<sup>8</sup> on cash planning cautions that “high-performing IT systems are needed to facilitate the preparation and updating of short-term cash projections and maintaining databases of cash-flow trends.” Countries which use standardized IFMIS solutions across the government have the option of configuring the cash planning modules of the IFMIS solution either (i) in the spending units to enter cash flow plans, validate them against macro-economic indicators, and check consistency with procurement plans; or (ii) in the MOF cash management unit to consolidate and analyze cash flow plans submitted by spending units, and to interface with debt and investment data bases.

Typically, IFMIS provides facilities to automatically reconcile bank transactions with system transactions; retrieve information on cash inflows by accessing the receivables, sales, and general ledger modules; retrieve information on cash outflows by accessing the payables, purchasing, payroll and general ledger modules; and interface with external systems to retrieve information on large tax payer transactions, debt servicing transactions and local government balances. IFMIS also has the capability of generating flow profiles related to different scenarios,

facilitating decisions on the issuance of treasury bills or other short-term lending and borrowing strategies.

Furthermore, IFMIS provides the facility for data entry and validation at source, ensuring the quality of budget execution data used for cash management. The IT processes for handling budget execution in the Treasury vary considerably from country to country depending on the availability of electronic data processing facilities. In a majority of developing countries, the “Request for Payments” from spending units is handled through the submission of paper documents, or electronic documents transmitted through e-mails. In countries where the spending units are direct users of IFMIS, requests for payment are controlled by the system at source, for budget and cash availability. However, even though IFMIS provides the facility for data entry and validation at source, prevailing financial regulations continue to require transmission of paper documents for review so that the electronic approvals at the different stages of the expenditure cycle can also be verified manually. This could delay the recording of transactions and manual interventions after the initial data capture and could result in a deterioration of data quality if changes are made during the manual verification process.

The implementation of automated procurement procedures can improve the timeliness and quality of bottom up cash flow data. IFMIS providers offer procurement modules, which can integrate with the different stages in budget execution. IFMIS providers also offer cash management modules, which can be configured as an integrated component of the overall IFMIS solution. This facility enables straight-through data processing from requisition to payment and can be designed to automatically links commitment data to cash flow plans. IFMIS also maintains detailed supplier data, providing the opportunity to retrieve and review data on the prices of goods and services purchased from each supplier. Spending units can use this data for projecting the cost of procurements planned for the year and for updating standard cost data wherever necessary.

While bottom up data is important for cash planning, an IFMIS cannot be expected to fully resolve the challenge of preparing accurate cash projections. Top down projections based on historical patterns of cash flows supplemented by knowledge of large future transactions usually forms a substantial basis for cash planning. In this environment the IFMIS can play a very useful role in helping to investigate variances in the plan when they occur and identify necessary improvements in the cash planning procedures.

A number of countries using IFMIS have interfaced Treasury systems with the payment systems used by banks to expedite electronic payments and automate bank reconciliation. Data security continues to be a concern with the banks, but with the evolution of IFMIS this concern is being addressed. The use of electronic signatures is commonplace, and data security and data exchange agreements between the Treasury, banks and government beneficiaries have been put in place. While automated reconciliation between the Treasury and its banker is commonplace, the reconciliation between the Treasury and the implementation agencies is rarely automated. This is mainly because countries cannot afford to provide IFMIS user licenses to spending units. Some countries are in the process of developing additional software to interface stand-alone financial management systems operating in implementation agencies with IFMIS. This will automate reconciliation of payments made through the Treasury with the payments requested by spending units and thereby improve the quality of expenditure data used in cash management.

Hence, through utilization of expanded IFMIS functionality, many of tasks comprising expenditure control, forecasting, debt and cash management, and securities issuance and settlement can in principle be linked and synchronized allowing “straight-through processing” of data from the different systems. Good international practice suggests that this would facilitate the integration of debt and cash management functions and encourage the development of a professional team of staff with the specialist knowledge required for these functions.

In summary, the use of IFMIS in government enhances the quality and timeliness of data required for cash management. Advantages include:

- Availability of comprehensive databases of historical revenues and expenditures.
- Straight-through data processing from requisition to payment, enabling automatic access to bottom up cash flow projections which can be used to investigate variances from the cash plan.
- Availability of detailed supplier data, providing the opportunity to retrieve, review and update data on the prices of goods and services.
- Possibility of interfacing IFMIS systems with banks and with systems operating in spending units so as to automate reconciliation of payment data.

### 1.2.7. Capacity Building for Cash Management

Cash management procedures, systems and financial instruments are evolving rapidly in commercial and government environments all over the world. The skills necessary to develop and maintain a cash management operation within the government are rapidly converging to those in demand in the private financial sector. However, government salaries are usually lower than those in the private sector, making it difficult for the government to attract and retain competent staff.

Ministries of finance usually conduct staff training programs in the area of cash management to ensure sustainability. Most of the training needed at the spending units and sub-national levels does not have to be very specialized. Administrators and financial managers at these levels need to have a basic grasp of the overall objectives of cash management and their roles and responsibilities in promoting efficient cash management within their own organization and at the national level. The training programs should be delivered through a regular schedule of programs structured to provide initial training for new staff and in-service training for regular staff. An important condition for attending such programs would be that the trained staff should be required to remain in their cash planning related jobs for a fixed period of time following the training.

Active cash management in the Treasury requires training in more specialized cash management techniques. Active cash management in the money market requires skill sets that are currently lacking in ministries of finance in most developing countries. Qualified staff could be recruited from financial institutions or the existing staff provided with long-term formal training in appropriate educational institutions to build capacity. Appropriate career opportunities and incentives would be required to retain the specialized staff. Front office, transaction processing and operational and credit risk management systems would need to be put in place internally to support active cash management. The decision to develop an active cash management function within the Treasury should be taken after a cost benefit analysis. Many countries prefer to delegate this responsibility to the central bank.<sup>9</sup>

### 1.2.8. Incentives and Sanctions

With the Treasury assuming the responsibility for ensuring availability of cash to meet the budgeted commitments of spending units, their financial managers may

not be motivated to improve their efficiency in planning their cash requirements. They may not appreciate the need to inform cash managers in the Treasury about the timing of large irregular cash flows, or anticipated delays in procurements as long as they have access to their annual budget appropriations. A number of countries motivate accurate in-year cash planning in spending units through incentives and sanctions. IFMIS functionalities can be used by the cash management unit to monitor the deviations of in-year cash plans provided by spending units from the tolerance limits set by the Treasury. Budget institutions that submit accurate projections of cash needs (not simply complying with the requirement to submit a plan) can be provided with the incentive of increased autonomy to manage the spending of their budget appropriations. Some other forms of incentives used in developed countries are briefly discussed below:

In the UK, the Treasury<sup>10</sup> has used a combination of reputational and financial incentives:

- League tables that rank departments' performance are circulated monthly.
- Notional charges based on the accuracy of cash flow forecasts are redistributed to all Departments in the form of End Year Flexibility.
- The notional cost of capital charges is applied to balances held at commercial banks but not to balances held at the Exchequer.

Expenditure planning and control arrangements serve to discourage budget users from drawing cash in advance of actual needs. Budget users are, in effect, charged for their notional use of capital. A budget user agreed expenditure provision is defined in accrual terms and includes an allowance for capital charges, but any unplanned increase in a budget user's working or physical capital will add to the charges, potentially leading to a reduction in the budget user's expenditure on other goods and services.

The 2011 NAO survey of the effectiveness of incentives shows that in the UK reputational incentives are more effective in motivating cash managers. Financial incentives are perceived as too insignificant to change behavior, but are useful to illustrate the importance of good forecasting to non-finance staff, and therefore to improve their performance.

In Sweden, appropriations are deposited into each agency's interest-bearing account, normally at the rate of one-twelfth each month. If an agency spends its

appropriations at a slower rate, it is paid interest on the balance in the account. Similarly, if an agency spends its appropriations at a faster rate, then it must pay interest to reflect the government's cost of borrowing. This system creates incentives to delay expenditures, which may raise operational problems, but it has served to increase cash consciousness in agencies.

A number of developing countries have experimented with sanctions to ensure adherence to cash plans. Sanctions should be carefully crafted to ensure that they do not adversely affect the beneficiaries of the services provided by the spending units. For example, sanctions that prevent disbursement of funds to agencies delinquent in submission of timely or accurate cash plans are likely to affect the clients of the government agency more than the staff responsible for the delinquency. Often, sanctions in the form of holding back disbursement of funds are likely to result in arrears of payments, which affect the reputation of the government agency rather than penalizing inefficiencies in cash planning. It should be ensured that outstanding liabilities resulting from implementing any sanctions are attributable to individuals and not to the government agency.

Performance targets on cash management are often used to sanction or reward cash managers. However, the performance targets often focus on the department's own performance rather than the benefit accruing to the government in terms of reduced borrowing or interest on invested cash surplus. In developing countries (such as Tanzania and Kenya), performance targets for Ministry of Finance staff involved in cash management are sometimes linked to efficiencies in disbursing funds. This may have unintended repercussions if the receiver of funds does not have the capacity to absorb the funds disbursed.

### **1.2.9. Sequencing and Implementation**

An IMF Technical Note<sup>11</sup> on cash management defines four stages involved in moving from primitive cash management to active daily cash management. These comprise (i) addressing fundamentals; (ii) preparing cash plans and developing cash management skills; (iii) going beyond prerequisites and basic cash planning; and, (iv) introducing active daily cash management. The Note also suggests that the speed at which cash management can be improved depends on: (1) the starting point, especially the extent to which basic conditions for effective cash management are in place; (2) the willingness of national authorities to move



ahead, including confronting resistance to reforms that provide full treasury oversight of all government bank accounts, as well as enhancing the transparency of all government operations at the transaction level; (3) the infrastructure available for rapid transfer of funds by electronic means; (4) the degree to which financial markets have developed, including end-of-day bank account “sweeping” and financial market instruments available for daily cash management; and (5) human capacity and organizational arrangements. The IMF Technical Note cautions that relatively long time periods may be required to implement some of the fundamental features and therefore, one has to be realistic in planning the timelines for addressing the fundamentals. A telling example given in the Note is that even in middle-income countries, it may take a decade to establish an operational TSA.

The fundamental features of cash management considered as preconditions for developing effective modern cash management are: (1) centralization of government cash balances and establishment of a TSA structure; (2) a clear understanding on the coverage of the cash planning framework; (3) the ability to make accurate projections of short-term cash inflows and outflows; (4) an adequate transaction processing and accounting framework; (5) timely information sharing between the central Treasury, revenue-collecting agencies, spending ministries and/or Treasury branch offices; and (6) appropriate institutional arrangements and responsibilities.

### **1.3. CASH MANAGEMENT IN INDONESIA**

#### **1.3.1. Background**

After the crisis in 1998, the new government of Indonesia faced sharply increased government debt levels and eroded government revenues, bringing to an end Indonesia’s comfortable pre-crisis fiscal position. Recognizing the need for PFM reform, a 2001 White Paper<sup>12</sup> stated that transparency in government budget preparation and accountability in treasury management would strengthen the responsive, efficient and effective allocation and use of resources, and constitute an essential element of Indonesia’s anti-poverty program.

With regard to cash management a fundamental reform was the reorganization of the Ministry of Finance in September 2004 by splitting the erstwhile Directorate for Budgetary Affairs into the Directorate General for State Treasury (DG Treasury), and the Directorate for Budgetary Affairs and Fiscal Balance. The then Finance Minister, Boediono, while inaugurating the new organizational structure explained that “This is important to create a check and balance system, as the planner and executor of the state budget is not the same (directorate). It’s a common international practice.”<sup>13</sup> The DG Treasury was made responsible for the management of state funds. This included the authority to disburse funds to ministries and government institutions, and responsibility for finding resources to finance the state budget (until 2007 when the DG Debt Management was established and took over from DG Treasury the responsibility for finding resources). Since then, the DG Treasury has been expected to function as a fund manager including identifying and managing any cash surpluses.

During 2003–2005, new laws relating to the state finance, national planning, treasury, and external audit were adopted by parliament. The Treasury Law provided a legal basis for the “fund manager” responsibilities of the Treasury including the responsibility for the rationalization of government bank accounts, many of which had been established by spending ministries and were outside the supervision of the MOF. A number of decrees and financial instructions were issued to implement the TSA regime and to establish the cash management function. These are explained later in this chapter.

These timely and comprehensive PFM reforms helped Indonesia to recover from the economic crisis of the late 1990s and establish robust financial management systems that withstood the economic downturn of 2008. The IMF Article IV Consultation Staff Report of 2012 noted that a fundamental reform of the policy framework over the past decade had left Indonesia in a stronger position when the global economy turned sour after 2007. The gross debt of the general government as a percentage of GDP declined from 76% to under 25% between 2000 and 2011.<sup>14</sup>

An important lesson learnt from the crises of 1998 and 2008 was that the management of state cash in Indonesia had become increasingly important, since the country would lose credibility if the government did not have the liquidity to meet its expenditure commitments. The conservative fiscal policy followed by the government over the last several years has contributed to the accumulation of

cash surpluses. The cash surpluses resulted from tax revenue coming in at or above target and under-spending of budget appropriations resulting in a lower than projected deficit while borrowing continued at the maximum ceiling permitted by the fiscal targets. This can be seen from the illustrative table below, which shows the annual cash surplus balances at end of year known as SILPA (annual budget financing surplus or excess cash from unrealized budget) providing a considerable degree of cash liquidity, but at the same time resulting in negative carrying costs due to the fact that the remuneration on this excess cash is lower than the cost of borrowing (yield of the state securities – SBN).

**Table 1.1 Cost of Carrying Excess Funds 2010-2013**

(in IDR/USD)	2010	2011	2012	2013
SILPA	IDR 44.7 trillion (USD 4.47 billion)	IDR 46.5 trillion (USD 4.65 billion)	IDR 21.8 trillion (USD 2.18 billion)	IDR 26.1 trillion (USD 2.61 billion)
BI rate (average for 1 year)	6.50%	6.50%	5.75%	7.50%
Net SBN (Bonds) Issuance	IDR 91.1 trillion (USD 9.11 billion)	IDR 119.9 trillion (USD 11.99 billion)	IDR 159.7 trillion (USD 15.97 billion)	IDR 224.6 trillion (USD 22.46 billion)
SBN avg. yield for 1 year	8.00%	7.50%	6.50%	8.62%
TSA remuneration (65% of BI rate)	4.25%	4.25%	3.75%	4.87%
Negative spread	-3.75%	-3.25%	-2.75%	-3.75%
Cost of carrying excess Funds for 1 full year	IDR 1,676 billion (USD 167 million)	IDR 1,511 billion (USD 151 million)	IDR 600 billion (USD 60 million)	IDR 841 billion (USD 84 million)

Moreover, as can be seen from the table below, the nominal amount of cash managed by the Government in its budget for the last 9 years (2004 to 2013) has increased significantly (more than three times).

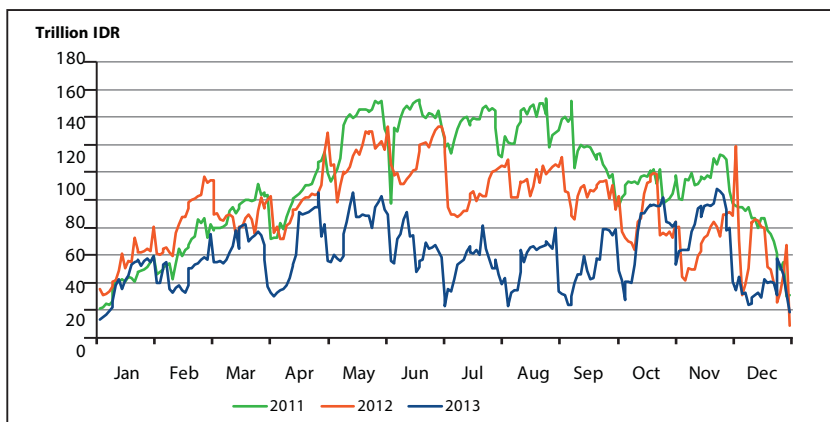
**Table 1.2 Nominal Amount of Cash Managed by the Government**

State (Cash) Budget	FY 2004	FY 2013	% growth
Revenue and Grant	IDR 495 trillion	IDR 1,529 trillion	308.9%
Expenditure	IDR 509 trillion	IDR 1,683 trillion	330.6%
Debt Financing (net)	IDR 11 trillion	IDR 153 trillion	1,390%

Given the prudent fiscal policy followed by consecutive governments over the last decade, shortage of cash has never been a challenge during budget implementation in Indonesia. The 2013 budget deficit reached 2.15 per cent, up from 1.14 per cent in 2011 and 1.86 in 2012, but still under the fiscal target of 3 per cent of GDP. Indonesia has, by law, set fiscal targets for general government (including sub national governments) of a budget deficit of no more than 3 per cent of GDP and a net public debt of no more than 60% of GDP.<sup>15</sup> In addition, the government usually has cash balances of around 1-2 per cent of GDP. The motivation for better cash management in Indonesia, therefore, relates to more efficient management of excess liquidity rather than shortages.

As seen in the figure below, in a typical year, the Government's total cash balance held in the Central Bank grows to a large surplus in the first half of the year, remains at this level for a few months, and then declines late in the year, with an average daily balance of around IDR 94 trillion during 2012 and IDR 60 trillion during 2013.

**Figure 1.2 Government's Cash Balance Held in Central Bank**



These large cyclical surpluses are caused by three main factors. First, DG Debt Management's annual 'front loading' strategy for state securities (SBN) issuance means that the majority of the financing for the budget is done in the first half of the year, which is aimed at reducing uncertainty in obtaining funds from the less liquid domestic bond market in a developing country such as Indonesia. Second, the majority of tax revenues are collected in the first half of the year. And third, the majority of the government's expenditure occurs in the fourth quarter of the year. The combination of these factors results in the government holding significant cash surpluses for a large part of the year. While all countries require a 'cash buffer' to cover unexpected and/or volatile expenditure, more accurate cash controlling and forecast would allow DG Treasury to provide advice on ways to smooth the cash profile—and hence reduce the cash buffer—through the debt issuance and redemption strategy. Reducing the average 'cash buffer' on the Indonesian account will reduce the costs of unnecessary debt issuance, and will also allow for 'term' investing.

### 1.3.2. Objectives of Cash Management in Indonesia

The principal objective of state cash management in Indonesia is the efficient and effective use of funds possessed by the state. This can be achieved by, among other things:

- Determining the optimal amounts of funds needed to ensure that all government activities can be funded;
- Obtaining the most economical and efficient financing (either domestic or external) to pay for government activities;
- Minimizing the amount of idle cash and undertaking short-term investment of this idle cash to provide additional revenue to the state;
- Speeding up the depositing of State revenues so that they can immediately be available for use in funding government activities; and
- Making payments at the right times.

### 1.3.3. Regulatory Framework for Cash Management in Indonesia

The promulgation of the State Finance Law and the State Treasury Law provided the basis for detailed regulations in the area of cash management. As stated in the regulation, cash management objectives are to ensure (i) availability of cash to cover the state liabilities, (ii) effective and efficient action to optimize returns from cash surplus or to deal with cash shortage, (iii) provision of cash to Line Ministries/Institutions in accordance with their cash flow projections to fund their activities, and (iv) timely payment to suppliers of the Line Ministries/ Institutions in accordance with their schedule of activities.

The Law on State Finance<sup>16</sup> establishes the Minister of Finance as the General State Treasurer. This is further elaborated in the State Treasury Law,<sup>17</sup> which authorizes the Minister of Finance to regulate and organize government accounts; save state money in the account at the central bank; and open the accounts of revenue and expenditure at commercial banks to accommodate state receipts and expenditures for financing government activities.<sup>18</sup> The Treasury Law<sup>19</sup> also stipulates that the central government obtain interest<sup>20</sup> from the government account at the central bank at the rate set on the basis of the agreement between the central bank Governor and the Minister of Finance.

The implementing regulation on cash management<sup>21</sup> defines the authority of the Finance Minister to:<sup>22</sup> (i) establish the system for receipts and expenditures in the state cash account; (ii) appoint banks and/or other financial institutions in the context of managing state budget revenues and expenditures; (iii) ascertain requirements for the state budget, and arrange the funding needed to implement it; (iv) deposit state funds; (v) place state funds and manage/administer investments in the context of managing cash through the purchase of State Securities;<sup>23</sup> (vi) make payments from the state general cash account based on the requests of budget users; and (vii) provide information on state finances. The regulation empowers the Minister of Finance to function as a cashier, financial supervisor, and financial manager of the state. The implementing regulation also makes the Minister of Finance<sup>24</sup> responsible for cash forecasting and setting the minimum cash balance, while obligating State ministries/institutions and parties associated with State Budget receipts and expenditures to provide periodic projections<sup>25</sup> of receipts and expenditures to the Finance Minister as the State General Treasurer.

Following up on the implementing regulations, the MOF issued an Instruction on cash planning.<sup>26</sup> The Instruction established the framework and objectives of central government cash planning; responsibilities for cash planning; procedures for submission of cash flow projections; and processes for the consolidation of cash flow projections by regional treasury offices and DG Treasury. It set the scope of cash forecasting to cover the forecasting of state receipts, state expenditures, and the balance of the State General Cash Account in the context of the implementation of the State Budget. In order to regulate the management of cash surpluses, the Finance Minister has also recently issued a specific regulation<sup>27</sup> to manage placement of state cash at the commercial banks on the basis of forward cash plans.

The recent issuance of a Government Regulation<sup>28</sup> has further specified the duties and authority of the Ministry of Finance in managing the receipts and spending of State Cash through the State General Cash Account at the central bank in order to better manage the implementation of the State Budget. The regulation details the duties and responsibilities of the Treasurers of Receipts and Payments with regard to the deposit of revenues in the State General Cash Account and for making direct electronic payments from the State General Cash Account. It permits Public Service Agencies (PSAs) to use their own revenues without depositing them in the State General Cash Account. It regulates the end-of-year provisions for the carry forward of budget allocations and for payments for goods and services that have been ordered but not received.

#### **1.3.4. Coverage of State Cash Management in Indonesia**

The public sector in Indonesia consists of (i) Central Government, including ministries, other state non-ministerial agencies, and Public Service Agencies (PSA) subordinate to line ministries; (ii) Regional (provincial) Government; and (iii) Local (districts/ municipalities) Government. However, government cash management is currently implemented at the central government level only. Within the central government a notable gap is the lack of coverage of PSAs. These are entities with more operational independence than line ministries but which are largely financed by the Government. It would be more transparent and less risky to have their cash resources managed by DG Treasury.

With the introduction of regional autonomy, there is now separate management of state cash at the central and regional levels. The Law on State Finance provides a foundation for the implementation of decentralization and regional autonomy, particularly for matters connected with financial management. This book focuses primarily on cash management at the central government level. The arrangements for regional government cash management are briefly described in Chapter 2.

### **1.3.5. Institutional Framework for Cash Management**

In accordance with Law No.17 of 2003 Regarding State Finance, the Minister of Finance, as an aide to the President in the field of finance, is the Chief Financial Officer (CFO) of the Government, while the head of each institution/minister is a Chief Operational Officer (COO) in the different sectors of government operations.

The legal framework authorizes the line ministries/agencies as the COO to carry out an action that results in the generation of a commitment of state expenditures; the verification and authorization of invoices submitted by the vendors to the ministry/ agencies in connection with the realization of commitments; and, requesting Treasury for payments those vendors or collecting state revenue receipts that arise as a consequence of budget implementation. Meanwhile, the Minister of Finance, as the CFO, has the authority to implement the Treasury's cash management responsibilities. It also authorizes to verify the commitments and expenditures request incurred by the ministries/agencies; release the payment to the vendors and to verify and reconcile the revenues collected by them.

### **The Finance Minister as the State General Treasurer**

A fundamental reform, which underpinned cash management in Indonesia, was the reorganization of the Ministry of Finance in September 2004. The DG Treasury was established in 2005 to integrate the functions that were fragmented across several other DGs before the reforms. The reform also rationalized the responsibilities for managing state finance by establishing other new DGs including: (i) DG Fiscal Balance in 2006, for management of transfer funds to local governments; (ii) DG State Asset Management in 2006 for the management of state assets and receivables; and (iii) DG Debt Management in 2007, for the management of foreign and domestic loans.

The current organizational structure of the MOF is shown in the figure below:



Figure 1.3 Organizational Structure of MOF

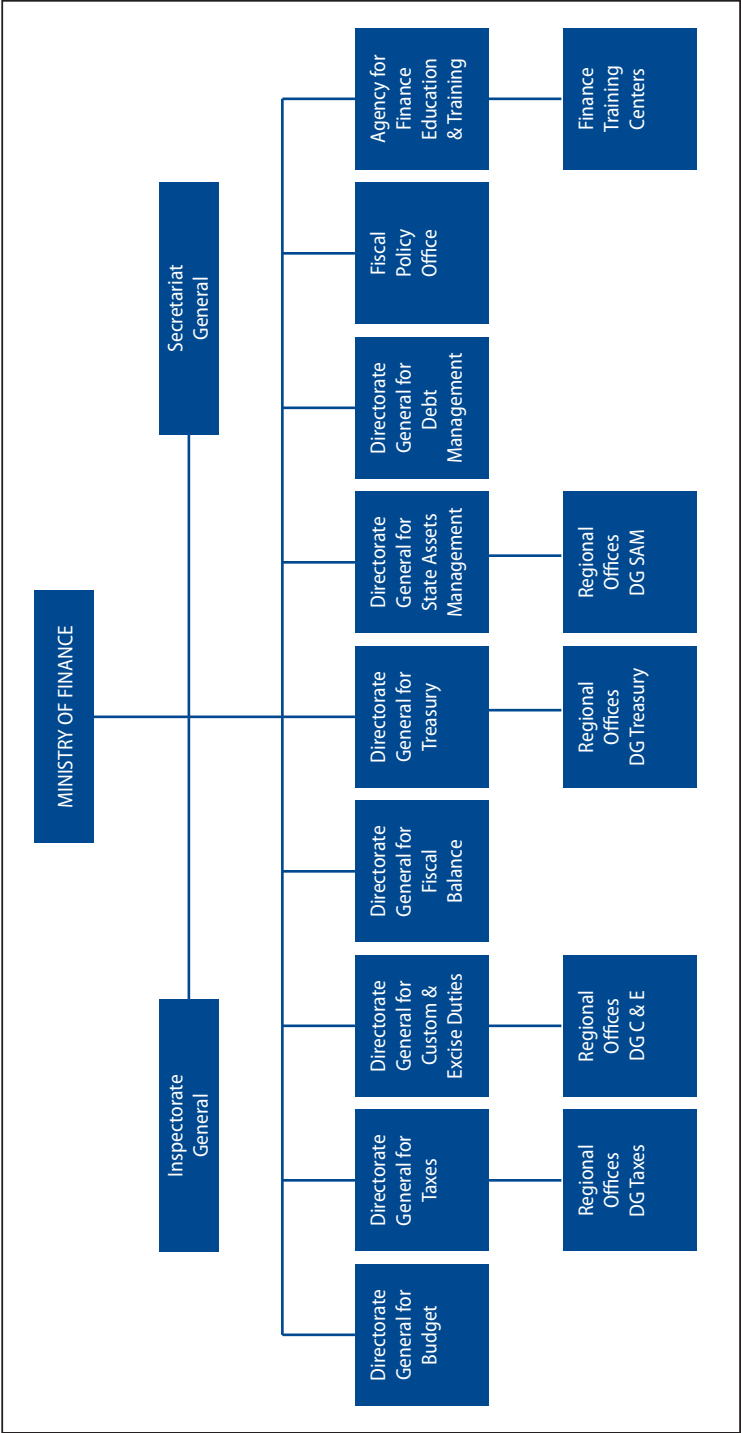
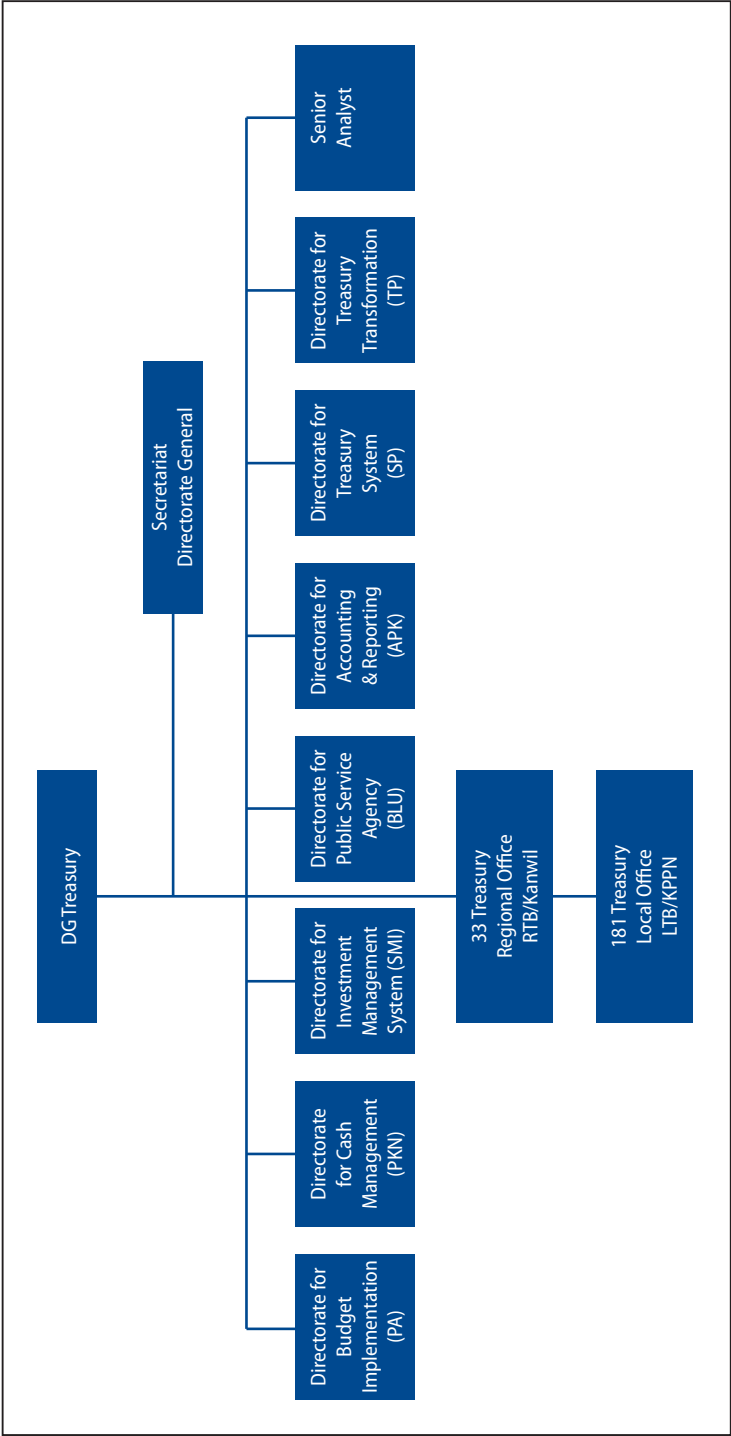


Figure 1.4 Organizational Structure of DG Treasury, MOF



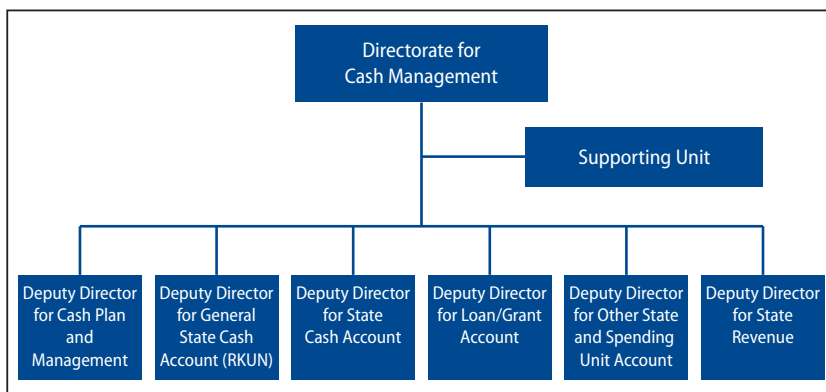
## **The Directorate General of Treasury, Ministry of Finance**

The main role of the DG Treasury is to execute the state treasury responsibilities, especially for raising the efficiency, effectiveness, and control over the State's cash flow. The Finance Minister regulation No. 184/2010 on the organization and job descriptions of the MOF set up DG Treasury with seven technical directorates and one Secretary DG in the headquarters. Meanwhile, DG Treasury has 33 Regional Treasury Branches (RTB/KANWIL) and 181 Local Treasury Branches (LTB/KPPN) across Indonesia. The RTBs are located in each of the provincial capitals while most of the 181 LTBs are located in the capitals of regencies and cities. Although the number of RTBs and LTBs are less than the total number of provinces/regencies/cities in Indonesia, these regional and local treasury offices are assigned to service more than 24,000 spending units of the central government's line ministries across Indonesia. With the decentralization, DG Treasury is, however, not responsible for managing the treasury operations of the Sub-National Governments. In total, DG Treasury has around 8,000 employees, with more than 6,000 people located in its regional and local treasury offices.

## **The Directorate of Cash Management, DG Treasury, Ministry of Finance**

Given the coverage of the regional offices of DG Treasury, its responsibilities with regard to government banking, and the availability to DG Treasury of real time data on budget execution, it was considered appropriate to locate the cash management function within DG Treasury. In the future, when all preconditions are in place, the focus of the Directorate of Cash Management (DCM) of DG Treasury can then be shifted to active daily cash management so that it coordinates more closely with DG Debt Management (DGDM) to facilitate smoother debt and liquidity management operations, and possibly lead to DCM and DGDM being combined.<sup>29</sup>

At present, DCM is entrusted with defining the policy for cash management and implementing the policy. DCM has around 100 staff equally distributed and assigned to the following sub-directorates: (i) cash plan and management; (ii) management of general state cash accounts; (iii) management of state cash accounts; (iv) loan and grant accounts; (v) management of other state cash accounts and spending unit treasurer accounts; and, (vi) management of state revenues.

**Figure 1.5 Organizational Structure of Directorate for Cash Management, DG Treasury**

### *The Sub-Directorate of Cash Plan and Control*

Among the six sub-directorates, the responsibility for preparing the cash plan and cash management strategy is that of the sub-directorate for cash plan and management, which is responsible for:

- formulating the cash (daily, weekly, monthly) plan, including preparation of the borrowing and investment plan;
- preparing the cash management strategy, including conducting market analysis, risk management, distribution of cash, and liquidity management;
- optimizing the use of idle cash (including deciding on the investment/ placement of idle cash, and monitoring the investment/ placement performance) and other cash resources; and
- setting the ideal amount of cash to be kept in each of the state cash accounts, monitoring and evaluating its implementation, and reporting the budget realization (red book) and cash balance position (blue book).

### *The Sub-Directorate of Management of General State Cash Accounts*

This sub-directorate is responsible for:

- administering the general state cash account/sub-accounts, placement account in Bank Indonesia/commercial banks, and central treasury expenditure accounts;

- conducting the transfers from the TSA and operating the Government Electronic Banking system;
- administering, accounting and recording the cash transfer transactions; and
- consolidating the cash flow reports of the treasury branches

### *The Sub-Directorate of State Cash Account*

This sub-directorate is responsible for:

- formulating the technical policy on the management of government revenue or expenditure accounts at banks, post offices, and other financial institutions;
- selecting the banks/post office to implement the state revenue and expenditure; and
- calculating the refund, paying the banking service fee and collecting the interest income.

### *The Sub-Directorate for Loan and Grant Accounts*

This sub-directorate is in charge of administering the loan and grant imprest accounts to finance some development projects that are funded by the World Bank; Asian Development Bank; other bilateral and multilateral agencies; and domestic creditors/grantors.

### *The Sub-Directorate for other State Accounts and Spending Unit Treasurer Accounts*

This sub-directorate is in-charge of administering the spending unit treasurer accounts and other state accounts.

### *The Sub-Directorate of State Revenue*

Lastly, the sub-directorate of state revenue is responsible for reconciling the data, preparing the report, and accounting of the state revenue income collected by the government accredited bank/post office.

## **Treasury Regional (RTB/KANWIL) and Local (LTB/KPPN) Offices**

Local treasury offices (LTBs) were reorganized in 2007 into a modern front, middle and back office administrative structure.<sup>30</sup> The back office was given responsibility for accounting, reporting, reconciliation, and maintaining the internal and external cash position of the treasury branch. The capacity of Treasury staff was enhanced to be able to deliver services in accordance with the new legal and regulatory framework. Greater emphasis was also placed on the Treasury-Client relationship with the spending units. Standard operating procedures of the local treasury offices prescribed specific time limits to process and approve payment documents presented at the front office.

The work of cash management itself, such as disbursing the state funds, managing state revenue and expenditure from the state cash accounts, and administering the cash transactions of the spending units of the central ministry's agencies, is done by the local treasury.<sup>31</sup> The main responsibility for monitoring cash flow requirements is that of the back office in the local treasury. The back office is also entrusted with the task of advising spending unit staff, including providing them with guidance and assistance in the preparation and submission of cash plans.

In the future, with the IFMIS in place, the disbursement and receipt functions will be highly automated, requiring less involvement of the DG Treasury regional office staff. It is intended that the main role of Regional Treasury Offices (RTBs) will be shifted to provide technical support, guidance and capacity building in the implementation of cash management at the levels of the local treasury branch and the line ministries' spending units in the regions. RTB staff will be also expected to assist in developing the capacity of the local government finance unit staff in managing their regional government money.

## **The Directorate General of Debt Management, Ministry of Finance**

The Directorate General of Debt Management (DGDM) was established in 2007 as a result of the reform that required the government to establish a dedicated unit to integrate debt management functions and manage foreign and domestic loans and grants, state securities (SBN), and sharia financing portfolios. DGDM is responsible for planning and implementing the financing of government budget deficits, refinancing and investments. DGDM is also responsible for the management of exposure to contingent liabilities; this includes improving

the government guarantee program, and recording and monitoring outstanding government guarantees. The responsibility for managing on-lending also rests with DGDM.

### **The Directorate General of Fiscal Balance, Ministry of Finance**

Established in 2006 as the result of the public finance and decentralization reforms, the DG Fiscal Balance has a role to play in implementing the intergovernmental transfer policy and in the projection of cash transfers (Balance Fund; Revenue Sharing; General Allocation Fund; Specific Purpose Fund; Special Autonomy Fund & Adjustment Fund) to the regions.<sup>32</sup>

The Law on Fiscal Balance<sup>33</sup> prescribes the following roles for DG Fiscal Balance:

- In collaboration with the Fiscal Policy Office, establishing the limits for the cumulative deficit of the local budget and maximum borrowing to ensure that the total of central and local deficits is under 3% of GDP and the total borrowings do not exceed 60% of GDP. This is to ensure fiscal policy sustainability at national and subnational levels;
- Working together with the Budget Committee of parliament to set the budget allocation for transfers to the regions;
- Signing the on-lending agreement for a loan from an overseas lender to the local government;
- Setting up a regional finance information system on a national basis; and
- Granting permission for the issuance of regional bonds.

### **Asset and Liability Management Committee (ALMC)**

A joint WB-IMF mission in 2009 on “Improving the Management of the Republic of Indonesia’s Balance Sheet” recommended improved management of financial assets and liabilities through closer coordination across debt management, cash management, risk management (liquidity and market), contingent liability, and public investment management.

Taking into account the WB-IMF recommendations and the need to have a better cash flow projection to finance budget allocations, an Asset and Liability Management Committee (ALMC) was set up in February 2013. The ALMC is chaired by the Minister of Finance, with the Vice Minister as the Deputy Chair.

Members include DG Debt Management (Secretary), Secretary General, Head of FPO, Expert Staff of MOF, DG Treasury, DG Budget, DG Tax, DG Customs and Excise, DG Fiscal Balance, and DG State Asset Management (members). The ALMC meets at least once every month or more frequently at the request of the Minister of Finance. Two-thirds of the members constitute a quorum. The ALMC may invite other participants at the request of its members. The chair takes decisions based on consensus. The tasks of the ALMC are described in chapter 4.

### **Cash Planning Information Network (CPIN)**

To improve the accuracy of the monthly cash forecast, an inter-directorate committee called CPIN (Cash Planning Information Network) has been established. CPIN's members are technical staff from the various DGs and directorates (DG Budget, DG Treasury, DG Debt Management, Fiscal Policy Agency, and others). CPIN holds periodic discussions and releases a monthly cash forecasting report for the MOF. This committee meets at least once every month and more frequently if needed.

### **Line Ministries of the Central Government**

The Planning and Finance Bureau (PFB)<sup>34</sup> within each spending ministry plays the main role in harmonizing the budget with the procurement plan and the cash disbursement plan. During the fiscal year, the PFB conducts monthly expenditure reviews with the major spending units and their respective DGs to compare the actual procurements realized with the disbursements and timeliness of the procurement packages included in the budget documentation. Some PFBs, such as the MOF PFB, use a budget disbursement tool<sup>35</sup> to monitor revenue, expenditure, and procurement progress.

Line Ministries are required to submit detailed monthly rolling cash flow plans to DG Treasury. The rolling plans include cash flows for the upcoming quarter broken down by months; and for the upcoming month broken down by weeks.

#### **1.3.6. Procedural Framework for Cash Management in Indonesia**

The Minister of Finance has the authority to perform cash management functions, which, according to regulations, should include cash planning through to cash



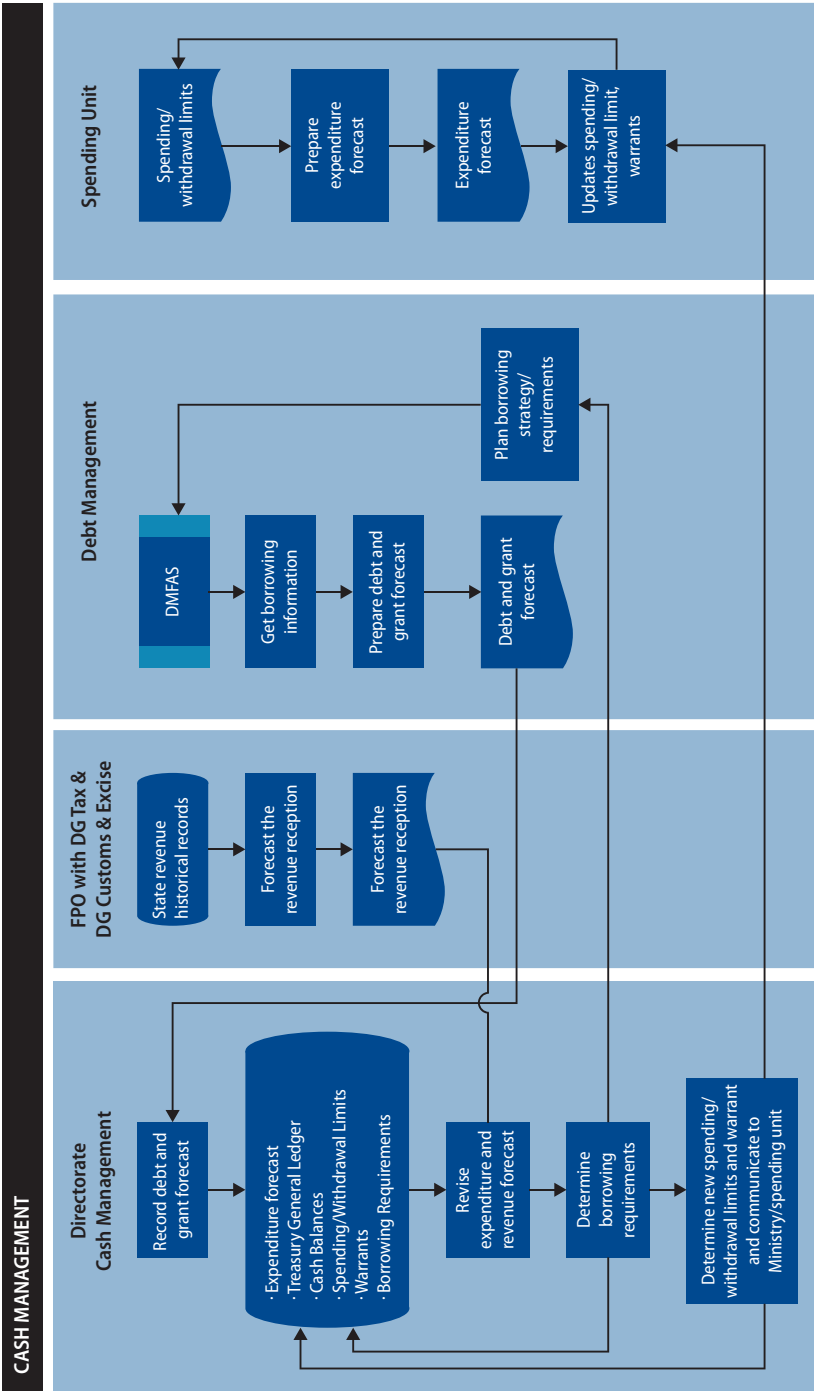
forecasting, cash inflow, cash outflow, cash surplus and cash shortfall, as well as implementation of a TSA. In addition, the management of bank accounts, government collections and payments, and the remuneration of idle balances are also part of cash management. In practice, the MOF delegates its authority by appointing DG Treasury as the proxy of the Finance Minister to perform some treasury functions. This authority includes setting up a government collection and payment system, appointing operational banks and/or financial institutions for the disbursement of the state budget, raising and managing the state funds needed to execute the budget, and depositing/saving cash. In addition, the state treasury also has the right to manage the placement of idle cash, manage the government's investments, and execute payment based on requests from spending units.

Under government regulations, the MOF is responsible for holding a minimum cash balance, as well as developing a proper cash management policy to handle cash shortfalls or to optimally use the cash surplus. In order to conduct cash planning, through a bottom up process from its spending units, the line ministries, state institutions, and other parties related to collections and expenditures of the state budget must submit a projection of their updated collections and expenditures on a monthly basis to the MOF. The updated cash plan data from those spending units must be confirmed by the secretary general or respective Director General of the line ministry prior to being submitted to the LTB as the basis to update the MOF's financial management database. The Finance Minister's regulation<sup>36</sup> provides for the splitting of annual cash flow projections included in the budget documentation, into monthly, weekly and daily proportions. It provides for periodic updates to the daily, weekly and monthly projections from all the spending units (more than 24,000) to be used as the basis for budget execution.

LTBs are the focal points for receiving cash flow projections from the Spending Units (local offices of line ministries) and submitting them to their Regional Treasury Offices (RTBs). RTBs are responsible for receiving and consolidating the cash flow projections of LTBs in their region and submitting the consolidated plans to the Directorate of Cash Management (DCM). The DCM is responsible for compiling and updating the cash flow plans received by the MOF and for submitting the updated consolidated plans to the ALMC.

The institutional responsibilities for cash management processes as prescribed in the regulation are shown in the figure below:

Figure 1.6 Institutional Responsibilities for Cash Management.



### 1.3.7. IT Systems Supporting Cash Management in Indonesia

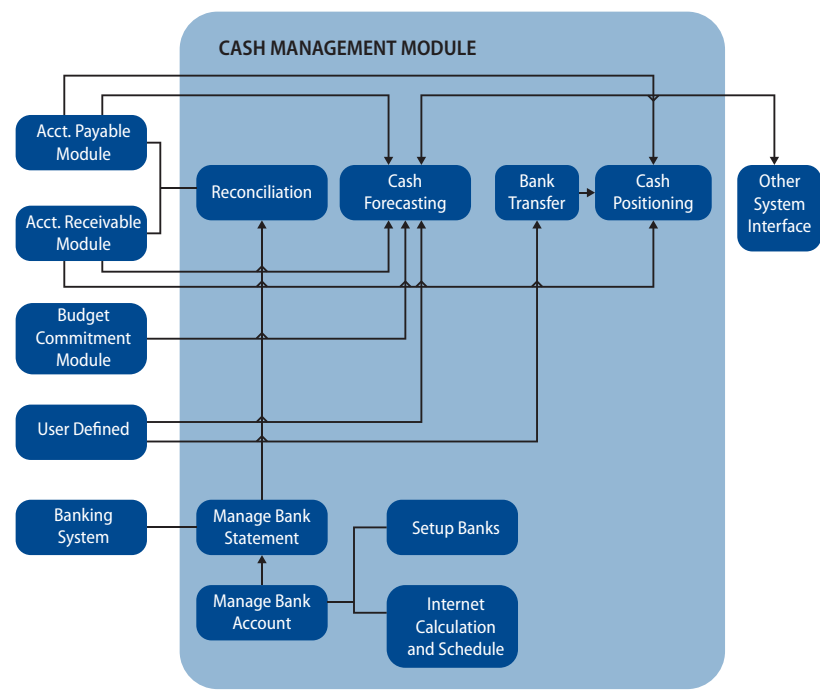
In addition to the institutional processes shown above, active cash management in Indonesia is facilitated by frequent data exchange with the following:

- i. The Central Bank of Indonesia (Bank Indonesia – BI) systems related to the conduct of the Treasury Dealing Room Settlement System includes:
  - BI Government Electronic Banking (BIG-eB) system to provide an internet banking connection for the Government.
  - BI Centralized Automated Accounting System (BI SOSA) to provide administration and accounting of the Government account managed by the central bank.
  - BI Real Time Gross Settlement System (RTGS) System to provide real time on-line fund transfer of government money to the commercial banks as the government partner banks for revenue collection and expenditure payment.
  - BI Script-less Securities Settlement System (SSSS) to manage settlement of the government bond issuances in the primary and secondary markets, in close coordination with the DG Debt Management.
- ii. The DG Treasury in-house developed IT application, called Aplikasi Forecasting of Spending Units (AFS), was developed and distributed to each spending unit in 2010 to facilitate the submission of the periodic cash updates to the daily, weekly and monthly projections from all the spending units to be used as the basis for budget execution. The plan of MOF was to link the updated cash plan with budget execution so that if the data is not updated the funds cannot be disbursed. However, wish sanctions not imposed by MOF this has not happened in practice.
- iii. DG Treasury uses another in-house developed software application called e-kirana to consolidate the daily funding needs of the LTBs and transfer funds to their bank accounts to cover daily payments to the spending unit suppliers.

One of the recent reforms undertaken by MOF is the development of an integrated budget preparation and treasury payment system called SPAN.<sup>37</sup> SPAN is now being rolled out to all the local treasury branches. The functionalities of cash management in SPAN include: Account management, Cash Forecasting and Daily Funding, Fund Transfer, Bank Reconciliation, Accounting and Reporting,

and the Cash Management of different DGs that manage non-line ministry budgets. The diagram below shows the standard features of the SPAN Oracle cash management module, which interlinks with the other modules.

**Figure 1.7    Standard Features of SPAN Cash Management Module**



Starting in mid-2014, the SPAN Oracle COTS solution will be available not only to the DG Treasury headquarters but also to the different units in the Ministry of Finance including DG Budget, DG Fiscal Balance, and DG Debt Management as well as to the regional and local treasury branches. Spending units will interface with SPAN through integrated financial application software called SAKTI being developed by the MOF. This new software will integrate all the currently used stand-alone applications at the spending units and function as a feeder application for SPAN. The SPAN cash management module will then have access to timely and accurate financial information as a result of this direct interface with SAKTI. The box below brings out the salient features of SAKTI.

**Box 1.1 Salient Features of the IFMIS (SPAN) Feeder Application SAKTI**

- In parallel with the development of SPAN that will be operational at the Treasury Headquarter and 181 Treasury branches (LTBs), MOF decided to develop a new application, called SAKTI, as a middle layer application which would serve all the needs of the 24,000 Spending Units (SUs) across Indonesia.
- The objective of SAKTI is to improve the quality of data input to SPAN, by integrating the SPAN application and database which will be used by DG Treasury with the Spending Units. SAKTI will cover the entire process of financial management at the Spending Unit level, from the budgeting, to execution and reporting, including asset register and other information support for accrual accounts.
- SAKTI is being designed in such a way that it could be used either online, off-line or a LAN environment.
- The data would be piped into SPAN via a portal.

### 1.3.8. Capacity Building to underpin Cash Management in Indonesia

As part of the responsibility to improve the capacity of Spending Units to do cash forecasting, in 2011, DG Treasury conducted capacity building and dissemination on cash forecasting procedures for all the spending units through a series of training and workshop activities.<sup>38</sup> These were conducted in more than ten provinces for staff from over 3,157 spending units, and around 200 regional and local treasury offices, and DG Treasury Headquarters. Realizing that it would be time consuming and expensive to train the staff of all the spending units, the MOF followed the approach of prioritizing the training of staff of spending units whose total budget covers at least 70% of total appropriation, and particularly staff in the biggest spending ministries that are managing large infrastructure projects, since their reliable cash plans would have a significant impact on the management of cash by DG Treasury. Spending unit staffs that are not yet trained are those that manage smaller budgets, primarily for routine salary and operational expenditure. The positive impact from the training program was reflected in an increased awareness of the Government's staff regarding the importance of cash planning and the increased number of spending units that submitted their updated cash forecasting to the DG Treasury. However, compliance with the submission requirement is still low because of weak enforcement of the policy on sanctions for those who do not submit the updated plan.

### 1.3.9. Incentives and Sanctions

The daily and monthly cash ceiling projected by the spending unit is the maximum cash that can be withdrawn by that spending unit during that period.<sup>39</sup> Consequently, if the spending unit did not submit its updated and revised cash forecasting plan, its request for payment is not processed if the ceiling of the month has been exceeded. This sanction is, however, difficult to implement since, in practice, for the last few years more than 60% of spending has occurred in the last quarter (October–December); hence, by just denying the payment without encouraging the spending units to update their cash plan prior to requesting for payment, DG Treasury would be blamed for impeding budget disbursement. In line with international practice, the sanction is imposed at the line ministry level (budget users) and/or program manager (director general) rather than at the individual spending unit level.

The implementation of a new module on commitment management in SPAN will facilitate the monitoring of cash flow plans received from the spending units. Comprehensive and timely information about commitments will supplement the historical trend data used in cash forecasting with forward cash planning information based on the expenditure that has been committed. Hence, it will be possible to record commitments and their projected payment dates, and accurately predict the cash needed to pay the committed expenditure, to monitor the schedule of payments and to resolve issues regarding any delays in payments.

Currently there is no system of incentives in place to promote better cash planning. DG Treasury proposed a possible incentive by offering an additional cash allowance (honorarium) for the spending unit's staff who regularly prepare and update the cash plan to improve the compliance and accuracy of the cash forecast. However, this allowance, which is proposed to be budgeted from the spending unit's operating budget, has not yet been implemented.

The MOF has attempted to introduce efficient management of budget disbursement as one of the criteria in the performance evaluation of government staff. However, it is not easy to attribute responsibilities for inefficiencies in managing disbursement due to the existence of impediments at different levels of government. Moreover, the performance indicators for programs included in performance budgets are not always consistent with the indicators included in the employee performance evaluation indicators.

### 1.3.10. Sequencing and Implementation

The sequencing and implementation of cash management reforms in Indonesia followed the traditional international practice of getting the basics in place before migrating from primitive cash planning to active daily cash management. The enactment of the State Finance Law and the Treasury Law provided the foundation for the cash management reform. The reorganization of the MOF set the institutional structure for the reform. The establishment of the TSA (which is described in chapter 2) and the inventory of government bank accounts provided a consolidated picture of government cash balances which are available for funding government operations. The annual budget law provides the basis for budget allocations which determine the annual cash requirements of the government. In-year cash management procedures were implemented to finance the expenditures included in the annual budget law. The procedures and institutional arrangements are now being refined to move to active placement and/or investment of the idle cash, based on the forecast of the idle cash on TSA balances in the coming period.

A comparison of the implementation of Indonesia's cash management reform with the IMF Generic Milestones for Implementing Cash Management (see Appendix 1) shows that most of the milestones have been achieved. It will be seen from the table in appendix 1 that Indonesia has almost achieved all the milestones related to addressing the fundamentals of cash management. However, further improvements are needed. For example, with improved cash management skills and better prepared cash plans, the second phase of cash management needs to focus on improving the comprehensiveness of the cash management function and promoting compliance with the new regulations. The on-going implementation of IFMIS will further help to automate the cash flow plans process through timely and accurate data exchange between the treasury regional offices and the spending units. The training of cash managers in the spending units is an on-going exercise which has now been firmly established. While most of the government cash balances are now consolidated into the TSA, there are a few remaining balances that have to be reviewed and policy decisions taken on their consolidation into the TSA.

DCM of DG Treasury has started to improve the quality of its daily cash forecasting through including its performance in making cash projections as a key performance indicator (KPI). This KPI will be used as the basis for measuring the work performance of the unit. Therefore, it is important for DCM staff to ensure

that the accuracy of their cash projections is high, with minimum deviation between forecast and actual. The table below on the deviation between the DCM monthly cash forecast and actual realization over the last two years shows that their accuracy in forecasting still needs to be improved.

**Table 1.3 Deviation on Revenue and Expenditure Forecast**

Month	Deviation of Realization From Revenue Forecast		Deviation of Realization From Expenditure Forecast	
	2012	2013	2012	2013
Jan	-10%	5%	-3%	1%
Feb	5%	2%	6%	2%
Mar	3%	10%	10%	13%
Apr	-9%	14%	2%	0%
May	-1%	-1%	3%	0%
Jun	-6%	3%	-3%	2%
Jul	0%	1%	10%	-2%
Aug	4%	5%	4%	13%
Sep	3%	4%	4%	0%
Oct	7%	6%	7%	2%
Nov	6%	18%	4%	1%
Dec	2%	2%	-1%	2%

While continuing its efforts to improve cash forecasting quality, Indonesia is now planning to move to active daily cash management. As will be seen from the table in Appendix 1, the coordination of cash and debt management is always challenging and complex, but it is now being improved through regular ALMC and CPIN meetings. The preparation of the Treasury Dealing Room (TDR) is underway although as explained in chapter 4 there are a number of important matters to address to ensure that its operations do not conflict with those of DG DM and of BI. Once the TDR is operating the Treasury will be able to participate in the money markets to obtain a better rate of remuneration from the cash that will be placed/invested in selected commercial state-owned banks and to trade the short-term instruments (i.e., 90-day T-bills) in the money market. The Treasury



continues to refine cash flow projections to improve the accuracy of projections, the period of projections and the exact timing of large-value transactions. Coordination between the cash manager, the government debt manager, and the monetary authorities needs to be further strengthened by including central bank representatives in the ALMC.

### 1.3.11. PEFA Findings on the Cash Management Practices in Indonesia

The Public Expenditure and Financial Accountability (PEFA<sup>40</sup>) assessment for Indonesia was undertaken twice by a team of World Bank and bilateral donor staff with the close involvement of counterparts from the Government of Indonesia; the original assessment was conducted in 2007 and a repeat assessment in 2011. Compared with the first assessment, there have been some significant improvements in the cash management processes found in the repeat assessment. Improvements have been made in the recording of cash balances and debt, particularly as the TSA and cash forecasting have continued to be strengthened (Table 1.3). New IT systems and procedures have strengthened the management of personnel and payroll information at the line ministries and local treasury office (LTB) level. However, weaknesses remain in reconciling the information at the central government level and in the procedures at the sub-national government level.

**Table 1.4 PEFA Ratings for Recording and Management of Cash**

Indicator	Score 2007	Score 2011	Performance Change
<b>PI-17 Recording and management of cash balances, debt and guarantees (M2)</b>	<b>D+</b>	<b>B+</b>	
(i) Quality of debt data recording and reporting	<b>D</b>	<b>B</b>	Debt management and reporting has improved significantly, records are now complete, with minor reconciliation problems.
(ii) Extend of consolidation of the government's cash balance	<b>C</b>	<b>B</b>	In practice the cash balances of nearly all government bank accounts have been identified with most consolidated, albeit with the "virtual pooling" of some balances
(iii) Systems for contracting loans and issuance of guarantee	<b>C</b>	<b>A</b>	The MOF has exclusive authority to enter in to loans and to provide guarantees on behalf of the government. The budget exposure is now disclosed and limited for PPPs by the creation of PII.

## 1.4. CONCLUSIONS

Regulatory frameworks for implementing standard features of an effective cash management system are in place in Indonesia. The promulgation of the State Finance Law and the State Treasury Law provided the basis for prescribing detailed regulations in the area of cash management. Detailed presidential decrees and MOF instructions define the roles, responsibilities and procedures for government banking arrangements, arranging funds to execute the budget, entering into commitments for the acquisition of goods and services, making centralized payments from a TSA, and managing cash and debt. There are formal agreements with banking service providers for handling government revenue collections and payments. Together, these regulations effectively underpin cash management and are in accordance with modern international practices. Remaining challenges mainly relate to improving the comprehensiveness of the cash management function and promoting compliance.

Currently, the coverage of cash management in Indonesia is limited to the central government sector. Within the central government a notable gap is the lack of coverage of public service agencies (PSAs). These are entities with more operational independence than line ministries but which are largely financed by the Government. It would be more transparent and less risky to have their cash resources held in the TSA in the Bank of Indonesia.

The institutional framework for cash management in Indonesia, which was established in 2004 with the reorganization of the MOF, is stable and working well. The government set up separate Treasury and Debt Management departments and chose to anchor the cash management function in the Treasury Department in a separate Directorate for Cash Management. As in other countries that have chosen this institutional arrangement for cash management, the reason was that the Treasury has access to a network of field offices that are geographically well placed to assist spending units in the in-year updating of their cash flow plans. The field treasury offices are also directly responsible for ensuring that cash is made available by the central treasury to meet the daily expenditures of the spending units. Currently, a legacy system is being used by spending units to submit their cash flow plans to the Treasury.

Looking forward, an important challenge in the institutional arrangements for cash management is to coordinate the roles of DG Debt Management and DG Treasury if the Treasury moves to active cash management in money markets. The implementation of an IFMIS system (SPAN), should greatly improve the quality and timeliness of in-year cash flow updates as an input to the preparation of a government cash plan. A feeder system (called SAKTI) is being developed and will be used by the spending units to interface with SPAN which is currently being rolled out to all treasury offices. The functionalities of cash management in SPAN include: cash forecasting and daily funding; fund transfer; bank reconciliation; and formulation and submission of cash plans and updates. The deployment of the cash management module to the largest spending units is expected to improve the quality of cash plans received from these units.

## **Notes**

- <sup>1</sup> Government Cash Management, United Kingdom's National Audit Office, NAO HC 546, 16th October 2009
- <sup>2</sup> Cash Management Made Easy, 2002, Financial Management Service, US Department of Treasury.
- <sup>3</sup> Government Finance Statistics Manual 2001, issued by the IMF Statistics Department
- <sup>4</sup> For example in France
- <sup>5</sup> For example in India
- <sup>6</sup> This is the case in a number of African countries (MEFMI Public Debt Management Manual), and East European countries such as the Czech Republic and Slovenia.
- <sup>7</sup> Public Financial Management and its Emerging Architecture, IMF; John Gardner and Brian Olden, 2013.
- <sup>8</sup> Ian Lienert, 2009, Modernizing Cash Management, (Washington: IMF's Fiscal Affairs Department).
- <sup>9</sup> For example: Denmark.
- <sup>10</sup> UK NAO Report of 2011
- <sup>11</sup> Ian Lienert, 2009, Modernizing Cash Management, (Washington: IMF's Fiscal Affairs Department).
- <sup>12</sup> Reform of the Public Financial Management System in Indonesia, 2001
- <sup>13</sup> The Jakarta Post, Jakarta, September 18, 2004
- <sup>14</sup> Article IV Consultation Staff Report 2012 (Washington: International Monetary Fund)
- <sup>15</sup> The Government Regulation No. 23/2003
- <sup>16</sup> Law No.17 of 2003
- <sup>17</sup> Law No. 1/2004
- <sup>18</sup> Article 22 of the State Treasury Law
- <sup>19</sup> Article 23 of the State Treasury Law
- <sup>20</sup> "and/or banking services"
- <sup>21</sup> Government Regulation Number 39 of 2007 Regarding the Management of State/Regional Funds
- <sup>22</sup> Article #4 of the Government Regulation No. 39/2007
- <sup>23</sup> (SBN)
- <sup>24</sup> Article 32 Paragraph (1) Government Regulation Number 39 of 2007
- <sup>25</sup> Article 32 Paragraph (4) Government Regulation Number 39 of 2007
- <sup>26</sup> Finance Minister Regulation (PMK) 192 of 2009 on Cash Planning
- <sup>27</sup> Finance Minister Regulation (PMK) 03 of 2014 on The Placement of the State Cash at the commercial banks
- <sup>28</sup> Government Regulation (PP) Number 45 of 2013 on "The State Revenue and Expenditure Budget Implementing Guidelines"
- <sup>29</sup> A 2013 study under taken by MOF on Institutional Transformation recommended a vision to have a "lean and mean" combined unit performing "end to end" cash and debt management functions in 2019
- <sup>30</sup> The LTB Percontohan
- <sup>31</sup> Finance Minister Regulation No. 169/2012
- <sup>32</sup> In 2013 33 provinces and 491 districts /municipalities were to receive transfer allocations from the central government budget.
- <sup>33</sup> Law No. 33/2004

<sup>34</sup> The roles of the PFBs and their operating procedures are not uniform across ministries. The roles and processes described above are based on an interview with the head of the PFB of MOF.

<sup>35</sup> MONIKA: an application developed and used by the PFB of the Ministry of Finance

<sup>36</sup> Finance Minister regulation No. 192/2009

<sup>37</sup> Sistem Perbendaharaan dan Anggaran Negara

<sup>38</sup> A series of events to socialize the new cash forecasting regulation (PMK 192/2009) and its IT application in 2011 as part of the capacity building program for the spending units was partly funded by The World Bank Public Finance Management Multi Donor Trust Funds (PFM- MDTF) program.

<sup>39</sup> Article 8 of the Finance Minister regulation No. 192/2009 and article 17 DG Treasury Regulation No. 03/2010

<sup>40</sup> The PEFA was founded in December 2001 as a multi-donor partnership between the World Bank, the European Commission, and the UK's Department for International Development, the Swiss State Secretariat for Economic Affairs, the French Ministry of Foreign Affairs, and the Royal Norwegian Ministry of Foreign Affairs, and the International Monetary Fund. The PEFA Framework was created as a high level analytical instrument which consists of a set of 31 indicators and a supporting PFM Performance Report, providing an overview of the performance of a country's PFM system.



Agus D.W. Martowardojo  
Bank Indonesia Governor

Muhamad Chatib Basri  
Finance Minister

## Chapter 2

# Setting Up and Managing the TSA





## 2.1. INTRODUCTION

A preliminary and critical component of cash management is the Treasury Single Account (TSA). During the 1980s, a number of emerging economies did not give much importance to the time value of money. Approved annual budget allocations were disbursed to the bank accounts of budget users and the cash balances pertaining to budget allocations were held in these accounts for disbursement during the financial year. With the increased demand for accountability and transparency in the management of resources held by government, and the evolution of IT systems for IFMIS and electronic banking, it became necessary and feasible to implement a TSA to concentrate government cash resources and manage government payments. This chapter examines the pivotal role of the TSA in government banking, payment systems and cash management. International experiences are reviewed and the Indonesian reform in implementing a TSA is discussed in the context of emerging international practices.

## 2.2. TSA – CONCEPTS AND INTERNATIONAL PRACTICES

### 2.2.1. TSA Definition

Pattanayak and Fainboim<sup>1</sup> define a TSA as a unified structure of government bank accounts that gives a consolidated view of government cash resources. It is a bank account or a set of linked bank accounts through which the government transacts all its receipts and payments.

### 2.2.2. TSA Objectives and Characteristics

The primary objective of a TSA is to ensure effective aggregate control over government cash balances. The consolidation of cash resources through a TSA arrangement facilitates government cash management by minimizing borrowing. These cost savings derive from the interest that is saved from using cash surpluses in one area of government activity to cover cash shortages in another. If cash was not consolidated, the extra cash requirement would have to be financed by issuing debt. Thus, a TSA enables the Treasury to minimize idle cash balances in government bank accounts. The aggregate control of cash also facilitates monetary policy and budget management.

A TSA minimizes transaction costs during budget execution by expediting the remittance of government revenues (both tax and nontax) by collecting banks, and ensuring the efficient scheduling of the payment of government dues. It provides a mechanism for controlling cash outflows in accordance with aggregated cash plans and commitments and facilitates reconciliation between banking and accounting data. The consolidation of government cash in a TSA provides the opportunity to reduce transaction costs by effecting electronic payments directly to beneficiaries and automating bank reconciliation. Given that the TSA is usually held at the central bank, another objective is to secure government funds.

### **TSA Structure**

Theoretically, TSA architecture can be divided into three types, based on the structure of the bank accounts and the transaction processing model:

- *A fully centralized TSA*, wherein all government revenue and expenditure transactions go through a single account, which is usually at the central bank, with or without sub-accounts, such as in Armenia and Lithuania.
- *A decentralized TSA*, comprising several independent bank accounts operated by spending units for their transactions. These accounts are generally transitory zero-balance accounts opened at commercial banks. The balance is swept into the main TSA account at the end of each working day. Sweden and the United States are examples of countries with a decentralized TSA.
- *A distributed TSA*, comprising central bank or commercial bank accounts operated by local treasury branches for receipt and/or payment transactions of the spending units under their jurisdiction. These local treasury bank accounts are funded from the central Treasury either by the “top-up” of residual balances, or, in cases where the residual balances are “zero balanced” daily to the TSA, by transfer of daily cash requirements, as implemented in Ukraine.

In practice, TSA structures are usually hybrids of these three versions. In many countries, major payments such as transfers to lower levels of government and subsidies to state owned enterprises are made by the central Treasury through direct electronic payments from the TSA to the beneficiaries. Other payments

are made through the regional treasury bank accounts, either by electronic payments or through checks. Taking advantage of technological developments in some countries, all central government transactions are processed electronically through the central treasury without any intervention from local treasuries. In such cases, the local treasury branches are either closed or tasked with processing the transactions of local governments in their jurisdiction.

Imprest accounts, opened at the spending units with approved cash limits set by the Treasury for making small payments such as those related to travel or low value office supplies, are not always considered a part of the TSA system. Where they are separate, banking arrangements for such imprest accounts range from the “pooling” of daily residual balances for the purpose of receiving remuneration on idle government balances, to elimination of imprest accounts by the issuance of debit cards to the finance officers of the spending units (within limits prescribed by the Treasury) so as to obviate the need for holding unremunerated cash balances.

Pattanayak and Fainbom (2010) suggest that a TSA structure can contain ledger sub-accounts in a single banking institution (not necessarily a central bank), and can accommodate external zero-balance accounts in a number of commercial banks. However, these separate accounts should be integrated with a top account (called the TSA main account) usually held at the central bank for netting off their balances (usually at the end of each day) to get the consolidated cash position. Usually two or three main government accounts are held within the central bank ledgers. One main account (the “top” account) is set up to receive all the government cash inflows. A second account is generally operated by the central treasury for funding the zero balanced expenditure accounts held either by the budget agencies or by the treasury branches. This second account is funded daily from the “top” account. A third account is used as an “investment” account. This account is funded from the “top” account whenever the combined balances of the other two accounts exceed the operating balance targeted by the treasury and is used to invest the surplus balances in accordance with instructions issued by the Treasury.

Additionally, Mike Williams<sup>2</sup> suggests that the TSA structure in the central bank may include multiple sub-accounts, for example to maintain the distinct accounting identity or ledger of line ministries, agencies and tax departments.

Electronic “CORE<sup>3</sup> banking” facilities provide the opportunity for the Treasury to set and modify cash disbursement ceilings in the sub-accounts of spending units in accordance with their approved cash plans. For cash management purposes, positive and negative balances in these accounts are netted into the main TSA operational account—the top account in a pyramid structure. This distinction between ledger accounts and actual bank accounts is important—the ledger accounts do not hold cash but are used to monitor flows. A government spending unit’s legal authority to spend is not represented by actual cash. At any one time, the aggregate permissions to spend may greatly exceed the cash held in the top account. This is not a problem so long as cash is available when payments actually need to be made.

Maintenance of these sub-accounts in the central bank facilitates the monitoring of payments against aggregate budget allocations and enforces the accountability of spending entities by requiring them to keep their cash plans updated. In the case of revenues, it provides the opportunity to get online information on revenue receipts classified by major types of revenues. This information, coupled with the ability to reconcile revenue collection data electronically with the Treasury and tax departments, facilitates the timely transfer of the sub-national shares of collected revenues. Preliminary aggregated tax collection and budget execution reports, classified by major tax and expenditure categories, can be obtained from the ledger sub-accounts maintained in the central bank. These preliminary reports can be used by the Treasury, tax department and line ministries for managerial purposes. As will be seen from the description of some international practices with regard to TSA implementation below, Italy is one of the countries that maintain detailed sub-accounts for expenditures in the central bank’s general ledger.

However, the maintenance of detailed sub-accounts within the TSA general ledger in the central bank does impose additional transaction overheads on the central bank. It is the responsibility of the owners of the data (Treasury/ tax department) to ensure that the data resident in the central bank ledgers are properly classified and reconciled. Though this reconciliation is automated, any discrepancies noticed would have to be reconciled by the data owners with the central bank and correction of entries made in the detailed sub-accounts of the central bank. This would result in additional transaction costs for the central bank.

## TSA Coverage

The coverage of the TSA varies from country to country depending on the political and legal framework. The coverage of the TSA is determined by the PFM legal framework; central bank acts; state revenue agency acts; and decentralized fiscal responsibilities prescribed in national constitutions. The political and legal environment determines the extent to which the cash balances of the general government<sup>4</sup> (see chapter 1) sector are consolidated in the TSA. The cash balances of some agencies held outside the TSA may be held in designated accounts within the central bank.

In cases where practical or legal considerations make it necessary for general spending units to hold their cash balances in commercial banks outside the TSA structure, there should be requirements for providing the Treasury with periodic information on the cash flows and balances related to such accounts.

The Treasury should have a comprehensive view of all government cash resources and all government liabilities that can and may be legally charged to the government cash resources. As the Treasury has the responsibility to ensure the availability of cash resources to meet the emerging liabilities of the national government, it should have timely, relevant and accurate information on government cash balances held by agencies covered by the general government. This requirement should be considered while determining the coverage of the TSA. Mike Williams<sup>5</sup> points out that some central government funds are managed entirely separately from the budget and may have to be excluded from the TSA for policy, transparency or legal reasons. Such funds might include bond redemption funds or pension or other social security funds. However, it is still possible to lend surplus cash from these funds to government. Such lending should only be undertaken where it does not pose a risk to the fund's ability to meet its liabilities. The transactions involved must be transparent and objective, for example, based on a short-term market-related interest rate.

## TSA Processes

Options for accessing and operating the TSA mainly depend on institutional structures and transaction processing arrangements. The Treasury, as the chief financial agent of the government, should manage the government's cash (and

debt) positions to ensure that sufficient funds are available to meet financial obligations, idle cash is efficiently invested, and debt is optimally issued in accordance with the prevailing acts and fiscal targets.

In a TSA environment, the Treasury is responsible for an orderly flow of funds from revenue collection agencies and from the state budget to other spending units, acting as a bank for them, and ensuring fiscal discipline. Spending units are responsible for collecting taxes, fees and charges as authorized by various acts and regulations. The collections are remitted to the TSA through appropriate revenue concentration mechanisms. Spending units enter into expenditure commitments in accordance with their approved budget and associated procurement plans. In a TSA environment, they make payments for goods provided and services rendered, through the TSA held by the Treasury. The Treasury is responsible for ensuring that there are adequate cash balances in the TSA to cover the authorized liabilities of spending units. To be able to exercise this responsibility, the Treasury monitors the cash flows of spending units against their approved budget allocations and projected in-year cash flows. This approach balances control by the government agency over its own budget and underlying procurements, with control maintained by the Treasury over public funds.

In order to prepare financial reports and to reconcile payments made through the Treasury on behalf of spending units, the Treasury, in its general ledger, maintains individual spending unit budget allocations. In other words, individual spending unit cash balances earlier maintained in bank accounts are replaced by ledger accounts in the Treasury general ledger to identify available budget allocations during the year. Inter-agency transfers are accounted for within the Treasury general ledger, without affecting TSA operations. The Treasury should lay down procedures for reconciling the government balances in the books of the central bank with the balances recorded in its general ledger. In some countries, the spending units record their cash flows in a central general ledger “hosted” by the Treasury and issue pay orders directly on the central bank (see scenario 4 of chapter 3). In this arrangement, it is the responsibility of the spending units to reconcile their cash flow with the central bank. In other countries where spending units maintain their own stand-alone general ledgers (see scenario 1 of chapter 3), the reconciliation procedures developed by the Treasury should provide for reconciliation of their own general ledger sub-accounts with the corresponding ledger accounts maintained by the spending units.

### 2.2.3. TSA Banking Arrangements

In most countries, the TSA is kept in the central bank so as to ensure the security of government funds. The fiscal risk of government funds lying outside the central bank is mitigated by periodically sweeping surplus cash balances pertaining to these funds into the TSA. In cases where legal agreements (such as donor requirements) require government funds to be kept in commercial banks, public funds are secured through pledges of corresponding collateral by the respective commercial banks.

If 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, which are associated with government payments and receipts, retail banking operations can be delegated to a fiscal agent (normally an authorized commercial bank or government run post office). The Treasury transfers funds daily from the TSA in the central bank to the fiscal agent. The fiscal agent makes payments on behalf of the Treasury and returns any residual balances remaining at the end of the day to the TSA. Revenues collected by accredited fiscal agents on behalf of the government are remitted daily to the TSA.

The Treasury usually negotiates agreements with the central bank and commercial banks for providing banking services to the government. These agreements could be informal such as allowing commercial banks to either retain government funds for limited periods of time, thus enabling them to invest these funds in overnight money markets, or set them off against statutory liquidity requirements. Alternatively, the agreements may specifically provide for rates per transaction for processing government revenues and payments. International practices generally provide for the payment of transaction related banking fees. Bank fees can add up over time, particularly when multiple bank accounts are being maintained, but these fees can be reduced through consolidation of bank accounts while continuing to maintain separate ledger accounts in the books of the Treasury. International good practices also recommend periodic floating of tenders (say every 3-5 years) for securing banking services. This facilitates maximizing interest and minimizing fees. Banks continually refine their products and services, and periodic tendering for their services can encourage competition to identify the most cost-effective banking services.

There have been significant improvements in commercial banking systems over the last decade. Nowadays, most banks use CORE<sup>6</sup> banking applications to support their operations. Banks make these services available across multiple channels like ATMs, internet banking, and branch banks. Governments are increasing their use of ATMs and internet banking to collect government revenues. Debit cards issued by banks under the authority of the Treasury are also being used to make urgent, low-value payments for the purchase of goods and services by the spending units.

#### **2.2.4. Sequencing the Implementation of TSA**

The sequencing of the implementation of TSA varies considerably from country to country. It depends on the political ownership of the reform, the institutional structure of the government, the existing PFM legal and regulatory framework, the legal and administrative relationship between the MOF and the central bank, the available commercial banking facilities, the extent of fiscal decentralization, the capacity of MOF staff, donor willingness to use government systems, and the financial information processing capabilities of the Treasury.

Given a contemporary financial administration environment across the government, it is possible to enumerate certain basic steps to implement the TSA.

- i. The MOF should first develop a functional design for the operation of the TSA, including the roles of the central and commercial banks.
- ii. The Treasury should complete an inventory of all the bank accounts owned by spending units.
- iii. A schedule to consolidate these bank accounts into the TSA should be established and agreed with the owners of the bank accounts so as to ensure that there is no disruption in government activities as a result of the transfer of ownership.
- iv. The Treasury should tender for banking services, keeping in mind the large volumes of transactions associated with government activities and the need for timely and accurate information on government cash resources for cash management.
- v. The Treasury should review any special circumstances that prevent the integration of residual government-owned bank accounts into the TSA so as to find ways of bringing the information related to such bank accounts into the cash management exercise. In parallel, the Treasury should also



establish a modern financial information system to facilitate the collection and reconciliation of information on government cash flows and cash balances.

### **2.2.5. Contemporary International Practices in TSA Implementation – some Illustrative Examples**

Australia, India<sup>7</sup>, and Kyrgyz Republic are some countries implementing mixed TSA architectures that combine the three models discussed earlier in section 2.2.2. In large countries with decentralized federal governments such as India and Australia, each federal government maintains its own TSA. The federal TSAs could be held in branches of the central bank as in India or in commercial banks as in Australia.

The French TSA<sup>8</sup> covers national and regional (local) governments, municipalities and quasi-governmental bodies. It is managed by the agency of the French Treasury (Agence France Trésor). The government cash, which is required by 7,562 operating (transaction) accounts all over the country, are swept back into the TSA account (the state treasury account) at the Central Bank (Banque de France) in real time. Banque de France has a number of branches at the regional level, which are used to handle government transactions. There is no involvement of commercial banks.

In the United States, the TSA is managed by the US Treasury. It covers only the federal government. The Federal Reserve Bank (FRB), which has a role as the main government bank, maintains the Treasury's general account (TGA). Disbursements are managed through the intermediation of the FRB and are reflected in the TGA in real time, while tax revenue collections are made through a network of a thousand financial institutions. Under this TSA system, although each agency and bureau has accounting control and responsibility for the timing and use of its funds, they do not hold the funds in bank accounts outside the Treasury. An IFMIS is also available to support the implementation of TSA in the US.<sup>9</sup>

Balances in government revenue accounts held in commercial banks are usually swept daily into the TSA. Expenditure accounts, held by field treasury offices in commercial banks, are usually funded daily by the central treasury from the

TSA and unused balances are swept back into the TSA at the end of each day. In some countries like Ukraine, government revenues are deposited into the commercial bank accounts of field treasury offices and net balances remaining in those accounts, after paying for expenditures during the day, are swept to the TSA. In such cases, anticipated shortages of cash resulting from timing differences between inflows and outflows are funded through remittances made by the central Treasury from the TSA.

In some other countries such as India, expenditure accounts held by field treasury offices are virtual cash balances identified in terms of expenditure ceilings recorded in commercial bank accounts. Payments are made by the banks from their own resources, up to the ceiling limits, followed by a daily transfer of funds from the TSA to recoup the resources utilized by the commercial bank during the day. The banks are compensated for the short-term credit provided to government through a comprehensive transaction fee. Another variation of this structure is the implementation in Rwanda, where the virtual ceilings are dynamic to the extent that they are increased to reflect “own revenues” remitted by the non-tax revenue collecting ministries. This is intended to provide an incentive for ministries to collect their dues efficiently, although it is desirable to have some budgetary oversight of the expenditures.

Some of the developed countries found it expeditious to provide incentives to the budget agencies to maintain their cash balances in the central bank. For example, in Denmark,<sup>10</sup> public bodies that are independent of central government, for example, universities, schools and museums, must also open an account within the central banking structure at Danske Bank. Any state funding that these institutions receive is paid into this account. The bodies are permitted to move cash to a bank account outside the Danske Bank central pooling structure. However, the government pays independent bodies interest on cash balances to incentivize them to keep their money within the central banking structure. Interest is set at predefined rates for these bodies and is funded from the overall interest that is earned by the government account at the Danske Bank. In the UK, the notional cost of capital charge is applied to balances held at commercial banks but not to balances held at the Exchequer.

To summarize, the TSA concept is still evolving. The earlier versions of TSAs were managed by the central banks of those countries. When Treasuries were

established in these countries, the management of the TSA was transferred from the central bank to the Treasury under the Ministry of Finance. The Treasury became the hub for revenue collection and payment transactions. Many different TSA solutions have been implemented. In some countries where the central bank has a presence at the sub-national level, the preference is to operate through the regional branches of the central bank. However, in other countries, central banks are reluctant to enter the retail banking business as this is a diversion from their main responsibilities related to banking supervision and the management of monetary policy. In most countries, the central bank hosts the TSA, which is managed by the Treasury. At the same time, there are countries like Italy where the central bank manages the TSA on behalf of the Treasury.

With the evolution of electronic banking systems, vastly improved inter-bank connectivity, implementation of RTGS, and installation of IFMIS (ERP) systems in spending units, the Treasury can participate directly in the inter-bank settlement system. The central bank in most countries hosts such settlement systems, facilitating the direct participation of Treasuries, provided Treasury IFMIS solutions are secured for interfacing with the RTGS. It is quite possible that the Treasury in developing countries will in future host the TSA on behalf of the budget agencies. The arrangement would be similar to that introduced in Armenia in 2010, where a web-based operating system allows the budgetary institutions to manage their accounts on-line within the commitment/ expenditure limits set by the Treasury.

## **2.3. IMPLEMENTATION OF THE TSA IN INDONESIA**

### **2.3.1. Background**

Prior to the implementation of a TSA in 2009, the Indonesian government's banking arrangements comprised tens of thousands of government bank accounts operated by the DG Treasury headquarters and local offices, line ministries and agencies across the country. These accounts carried significant unremunerated balances. The treasury revenue recording and disbursement procedures also generated significant revenue and disbursement floats, which benefited the commercial banks at the expense of the government.

Prior to the formation of the TSA, a number of inefficiencies existed in Indonesia in the management of state expenditures and revenues, as described below:

- i. On the expenditure side, the inefficiencies included the existence of “idle funds” kept outside the central bank, which were not adequately remunerated. Specifically:
  - provision and funding in cash of expenditure ceilings in operational bank accounts (BO-I) for payments to suppliers of goods and services to spending units;
  - provision and funding in cash of expenditure ceilings in operational bank accounts (BO-II) for salary payments six days before salaries were due;
  - the existence of a reserve money mechanism in the Expenditure Treasurer account; and
  - the existence of sub-national governments’ transfer and pension payment procedures that provided for the transfer of funds to commercial banks to cover expenditures before payments were due.
- ii. On the revenue side, initially “floats” were permitted in government balances held by revenue collecting banks (bank/post persepsi)<sup>11</sup> as remittance procedures allowed collecting banks to transfer revenue collections to the TSA two or three times a week.

The State Treasury Law is the main legal basis for the implementation of TSA in Indonesia. The law authorizes the Minister of Finance to appoint banks and financial institutions to conduct government business, deposit state money and manage investments.<sup>12</sup> The Minister of Finance is also authorized to organize and operate a single account (the State General Cash Account) at the central bank. All state revenues and expenditures of the government are required to go through the state general cash account (RKUN).<sup>13</sup>

Detailed regulations issued to implement the provisions of the State Treasury Law included procedures for:

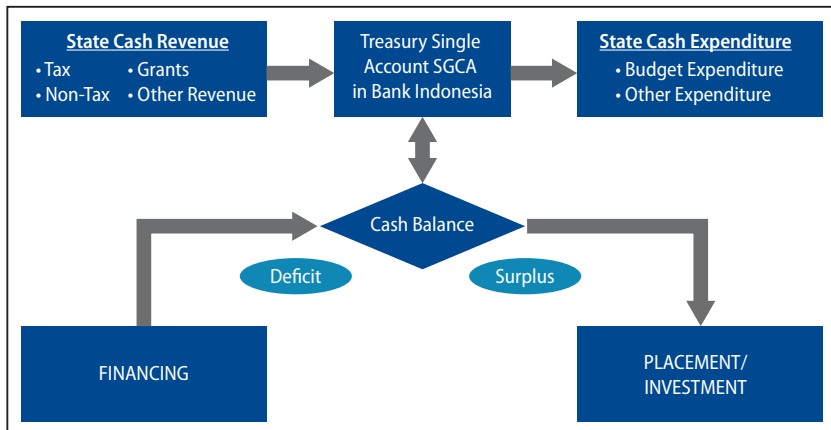
- depositing all state receipts in the TSA and making all state expenditures from the TSA;<sup>14</sup>
- implementing Zero-Balance Expenditure Bank Accounts at designated commercial banks of LTBs;<sup>15</sup>

- implementing Zero-Balance LTB Revenue Accounts in the implementation of the TSA;<sup>16</sup>
- implementing the Treasury Notional Pooling Account covering imprest accounts held in spending units;<sup>17</sup> and
- implementing the Treasury Notional Pooling Account for revenue accounts held in spending units.<sup>18</sup>

### 2.3.2. Objectives and Characteristics of the TSA in Indonesia

The government's effort to improve state cash management focused on the implementation of a TSA in accordance with international good practices. The figure below shows the links between cash management and the TSA.

**Figure 2.1 Linkages Between Cash Management and TSA**



The goals of TSA implementation in Indonesia are:

- controlling the cash balance and cash flow through legal provisions requiring all receipts and expenditures to pass through the TSA;
- consolidating government cash balances in the TSA on a daily basis by incorporating cash balances dispersed over numerous bank accounts used for defraying government operational costs;
- minimizing the cash float in government bank accounts outside the TSA to minimize risk and optimize returns on government cash resources; and
- augmenting accountability through transparency in the management of state cash receipts and expenditures.

2.3.3. TSA Banking Arrangements in Indonesia

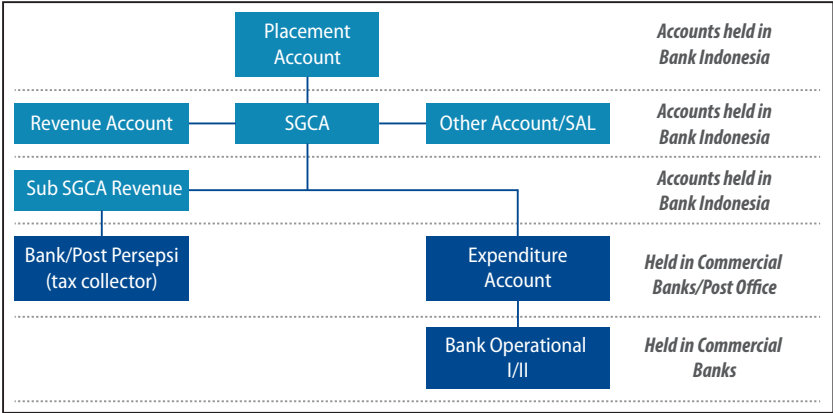
Prior to the implementation of the TSA, Indonesia’s government banking structure comprised: (i) accounts opened in the headquarters and regional branches of the central bank (Bank Indonesia – BI), operated by the Treasury headquarters and local offices; (ii) accounts held in commercial banks and controlled by regional treasury branches (RTBs); and (iii) accounts held in commercial banks and controlled by spending ministries, many of which were considered by the MOF to be “unknown/illegal” accounts.

With the improvements in electronic banking systems, the government bank accounts held in the BI and/or commercial banks have fallen in number and been centralized, i.e. it is no longer necessary to have bank accounts held by BI regional branches.

Government Accounts in BI following the Introduction of the TSA

The basic bank account structure in Indonesia is shown in the figure below:

Figure 2.2 Government Accounts in Indonesia



In general, the government bank accounts, which are categorized as TSA and managed by the Finance Minister as the State General Treasurer in BI, can be classified as follows:

- i. The State General Cash Account (SGCA/RKUN): used for fulfilling the government daily cash needs and maintained at a minimum of IDR 2 trillion for the Rupiah account and USD 1 million (or equivalent) for USD and/or other foreign currency accounts, and remunerated at 0.1% per annum.
- ii. Investment/Placement accounts: used for keeping the idle government cash and remunerated by BI at 65% of the BI rate for IDR accounts, 65% of the Fed Fund rate for USD accounts, and 65% of the reference rate of the home currency for other currencies.
- iii. Revenue accounts: used for retaining the receipts from revenues other than tax and non-tax. Most of these (129) mainly foreign currency denominated accounts pertain to loans/grants provided by the donors. The balance kept in these accounts is remunerated by BI at 65% of the BI rate for IDR accounts, 65% of the Fed Fund rate for USD accounts, and 65% of the reference rate of the home currency for other currencies. These are managed by one “special” LTB for loans and grants management located in Jakarta.
- iv. Sub-SGCA/RKUN revenue accounts: used for the temporary deposit of tax and non-tax revenues collected by the commercial banks/post offices as the Bank Persepsi, before they are pulled into the SGCA.
- v. Other government accounts kept in BI: these include contract oil production sharing accounts, accumulated surplus of cash from unrealized annual budget (SAL), natural resources agreement revenue accounts, reforestation funds, and entrusted funds. These “other” MOF accounts are categorized as TSA but different from the placement accounts in terms of the flexibility on the use of the cash. These accounts are “less liquid”<sup>19</sup> since their use is limited to the financing of predefined purposes and they can be spent by the Government only upon approval. However, the balances of these accounts are all remunerated by BI at 65% of the BI rate for IDR accounts or 65% of the Fed Fund rate and/or reference rate of the home currency for USD and other currencies, like the remuneration for the cash held in the placement accounts.

At end of 2012, BI held 169 Government accounts (the complete list can be seen in **Appendix 2**).

**Table 2.1 Government Account in Bank Indonesia**

Government Accounts in BI	2012	Note
SGCA/RKUN	4	IDR; JPY; USD; EURO
Placement	4	IDR; JPY; USD; EURO
Others (including loan/grant imprest account)	161	21 IDR; 12 JPY; 112 USD; 6 EUR; 9 AUD; 2 GBP.
<b>Total</b>	<b>169</b>	

## **Local Treasury Branch (KPPNs/LTBs) Accounts in Commercial Banks**

### *Before TSA Implementation*

Before the implementation of the TSA, accounts managed by LTBs, numbering in the thousands, constituted the bulk of treasury bank accounts. They were spread over the following generic types:

- i. Budget operation accounts known as BO-I, BO-II, BO-III. These were used for settling expenditure claims presented by the spending units. For BO-I, BO-II, and transfer of General Allocation Funds (DAU) for the regions, the DG Budget prescribed ceilings on overnight balances, based on the expected demand the following day. In practice, however, these ceilings were set at the start of the year based on some norms, and the local treasury offices typically interpreted the maximum ceiling as the minimum allowable balance. The ceilings for an LTb varied between IDR 1 million to IDR 58 million for BO transfer; and IDR 6 million to IDR 170 million for DAU transfer. BO-III was used to temporary deposit land and building sharing revenue funds that is belonged to the local governments.



- ii. Revenue mobilizing<sup>20</sup> accounts. These were opened in commercial banks, both in private and public banks, into which taxpayers remitted tax. Before the TSA was in place, these banks were allowed to retain the tax receipts for three days. Using the RTGS, they transmitted collections to MOF's account every Tuesday and Friday, and on the first day of each month. As the banks were allowed to retain amounts for three days, these accounts were not swept to zero and so generated a significant daily float. The float was permitted in commercial banks for three reasons:
- it was an informal compensation arrangement since the MOF did not remunerate commercial banks for government transaction services,
  - it provided time for reconciliation of transactions before the final transfer, and
  - not all branches of the collecting banks had access to electronic clearance facilities enabling daily clearance.

The twice a week clearance of revenue receipts through LTBs and regional BI offices to the central government required significant effort and additional transaction costs in terms of monitoring and reconciliation.

### *After TSA Implementation*

After the implementation of the TSA, each LTB is only allowed to open two spending accounts in an accredited commercial bank designated as the BO-I and BO-II accounts. The accreditation of commercial banks is carried out centrally by DG Treasury in accordance with the regulations for the procurement of goods/ services. The BO-I and BO-II accounts are zero balance accounts. BO-I which is used for payments related to the purchase of goods and services is zero balanced daily. The BO-II account, which is used for salary payments, is zero balanced during the period immediately after funds are transferred from the TSA till after the payment of monthly salaries is complete. The same procedures apply to spending accounts held in post offices. Essentially, the spending accounts held by each LTB are transitory accounts.

The following bank accounts are managed by the LTb:

**Table 2.2 Local Treasury (LTb) Accounts Held in the Selected Commercial Banks**

	Type of Account	# of Account	Balance	Remu- neration	Legal basis
<b>I.</b>	<b>Local Treasury (LTb) accounts held in the selected Commercial Banks</b>				
1	Bank Operational I	603 Bank Accounts	Zero	Zero	PMK 98/2007
2	Bank Operational II	570 Bank Accounts	Zero	Zero	PMK 98/2007
3	Bank Operational III (closed)*	-	-	-	-
4	Reverse payment (retur)	1,138 Bank Accounts	Balance	Zero	Per 33/PB/2012
5	Land/property tax persepsi (closed)*	-	-	-	-
6	Revenue collection accounts	3,782 Bank's branches Accounts	Zero	Zero	PMK 99/2006; Per 25/2013

\* The Bank Operational III and land/property tax persepsi are no longer necessary in view of the policy after the shift of the collection of land/property tax from the central government to local governments in 2013.

## Bank Accounts held by Line Ministries

Before the implementation of TSA, line ministries operated thousands of government accounts, both revenue and expenditure accounts, many of which were unreported and thus were not included in the government financial statements. The actual number of bank accounts being operated in 2002 is not known. These accounts were being used to bank own revenues generated by line ministries.

The State Treasury Law<sup>21</sup> authorizes ministers/institutional heads to carry out treasury duties related to the administration of the revenue and expenditure budget in their subordinate offices. In the context of performing these duties, they are empowered to open receiving and/or expenditure bank accounts in the name of the government with the approval of the Minister of Finance. Government regulations<sup>22</sup> also permit ministers/ institutional heads to open petty cash accounts<sup>23</sup> managed by spending unit treasurers, in commercial banks or at the central bank after obtaining the agreement of the Treasury.

Currently, there are 40,248 petty cash accounts held by the line ministries and their subordinate offices. A minimum balance is kept in these accounts for covering residual transactions pending at the end of the fiscal year and the rest is returned to the MOF at the end of the year.

## Local Government Bank Accounts

Budget transfers to local governments constitute one-third of the total budget, and these funds are held in local government accounts in commercial banks. The arrangements for managing local government bank accounts and the trend in the movement of their cash balances is shown in the box below:

### Box 2.1 Local Government Bank Accounts

In accordance with the State Treasury Law (Article 9 of Law Number 1 of 2004) the Heads of provincial/regional/city governments as regional General Treasurers carry out treasury duties related to financial management in the region. In pursuance of these duties, the Governor/mayor/head of districts may use commercial banks and/or central bank to deposit the regional government money generated from regional revenue and to pay regional expenditures. Financial regulations require that the opening of such accounts must be on the basis of an agreement with the bank which covers: (i) type of services to be provided; (ii) mechanism to withdraw the funds; (iii) transfer receipt to and expenditure from the regional TSA; (iv) remuneration for balances; (v) service fee; (vi) reporting obligation; and, (vii) sanctions and procedure to resolve disputes.

The Head of a Regional Finance Manager Work Unit (PPKD) is the proxy of the Heads of the Region to act as a Regional General Treasurer carries out the treasury duties related to financial management in the local governments. One of the main tasks of PPKD is to set up an implementing guideline on the regional revenue and expenditure cash management system. The other tasks of PPKD in the management of cash include: preparing cash budget; releasing payment order; monitoring the cash from revenue and expenditure kept in the commercial banks; obtaining money to finance budget; depositing the regional cash; placing and investing the cash; paying expenditure on the request of the spending units; managing debt and receivable of the local government. The PPKD in implementing its duty is responsible to the Head of Region (Governor/Mayor/Regent) through the Secretary of Region. Regional autonomy finance requires regional governments to be able to use the funds allocated to those regions in accordance with the targets of regional development, thereby making it capable of spurring on regional economic growth.

It is difficult to accurately determine the number of accounts held by all the local governments and their spending units since the existing regulations do not require those local governments to submit any report on either the number of account or balances held in those accounts, to the Ministry of Finance.

At the end of 2012; local governments have large cash balances (IDR 99.2 trillion). However, it should be noted that these large cash balances are held by a few local governments. Another feature to be noted is that most of the surplus cash balances of local governments are held in government owned regional development banks. There are 26 regional development banks (BPDs), each owned by one province or jointly by a number of provinces. The accumulation of large balances in some of the local government commercial bank accounts poses a challenge to the BI in managing monetary policy. Various options that could be considered to address this challenge include (i) providing incentives to local governments to participate in a central government cash investment program; (ii) assisting local governments to set up their own TSAs and getting them to place these in the BI; and (iii) convincing the local governments to open ledger accounts with the DG Treasury and consolidate their balances in the TSA (see example of France).

### 2.3.4. Sequencing and Steps Taken to Implement the TSA in Indonesia

The steps taken to implement the TSA are summarized in the box below:

#### **Box 2.2 Summary of Steps to Implement the TSA**

1. Consolidation of government cash balances into the single bank account (TSA) in the Bank of Indonesia, in which all state receipts must be deposited in and all state expenditures are paid out from this account (2009) and all government accounts opened by each line ministry as well as MOF must be consolidated and approved by Treasury (2007-2012).
2. Implementation of TSA for expenditure accounts through Zero-Balance Accounts in Operational Banks (BO-I and II) for payments made to suppliers so as to eliminate floats in government bank accounts held outside the TSA (2008).
3. Implementation of daily sweeping of revenue collection accounts in collecting banks/post offices and a requirement that all state receipts be swept to the TSA in Bank Indonesia on a daily basis (2010).
4. Non-cash consolidation and monitoring balances in imprest accounts held by spending units through the application of the Treasury Notional Pooling arrangement (2009).
5. Remunerations for surplus cash balances held in Bank Indonesia (2009).
6. Payment of service fee for government banking services provided to the commercial banks that collect the state revenue from tax and non-tax payers (2009).
7. Based on accurate cash forecasting, placement of idle funds into interest-bearing accounts at the Bank Indonesia/commercial banks or making short-term investments in secure and profitable monetary instruments (plan in 2014). This is further elaborated in chapter 4.

### **Consolidation of Government Cash Balances into the TSA**

As a first step in the implementation of the State Finance Law and the State Treasury Law, in 2007 the Minister of Finance<sup>24</sup> established a team for monitoring the government accounts (Tim Penertiban Rekening Pemerintah-TPRP). The team was made responsible for collecting and maintaining the data of all government accounts in each line ministry as well as for examining the status of each government account. Discussions were conducted so as to identify the ownership of the accounts, verify the objectives and legal basis of the accounts, and determine the flows and balances in the accounts. Based on the outcome of the discussions, decisions were taken as to whether to allow the accounts to be used permanently or temporarily, or to close the account and transfer the balance to the TSA.

Based on Supreme Audit Agency (BPK) inspections from 2004 to 2006, a total of 4,643 government accounts were found in all central line ministries/agencies with a consolidated balance amounting to IDR 32.35 trillion, which were not in the annual financial reports. Further, according to a census of government bank accounts by the Supreme Audit Agency, as of December 31, 2007, a total of 32,876 government accounts were being operated by spending units. A total of 26,553 of those accounts were allowed to be used permanently or temporarily. 2,086 of those accounts, with balances of IDR 7.27 trillion or 585 million USD, were closed by MOF.<sup>25</sup> Discussions on the retention of the remaining accounts could not be completed for several reasons; for instance the owner of the accounts could not be identified, required documents or information could not be obtained or their closure was under process at the time of the audit.

Progress in the consolidation of bank accounts held by spending units in commercial banks into the TSA over the last four years can be seen from the table below:

**Table 2.3 Total Number of Bank Accounts Approved by MOF**

	2008	2009	2010	2011	2012
Total number of accounts	39,477	40,084	41,390	46,586	40,248
1. Operational Accounts					
i. Approved and allowed to be continuously used		28,216	29,819	30,213	40,248
a. revenue		1,513	1,507	2,098	2,031
b. expenditure		19,771	19,754	21,811	24,744
c. other		6,914	8,558	6,304	13,473
ii. About to be approved by MOF		2,291	1,378	4,091	-
2. Accounts closed	3,930	6,877	7,499	9,275	-
3. Accounts still being reviewed	2,839	2,700	2,694	3,007	-

By the end of 2012, considerable progress had been made in closing a significant number of illegal or extra budgetary fund accounts. The MOF report showed that a total of 40,248 bank accounts maintained by spending units were allowed to be retained as operational accounts with a very minimum balance kept in

each account (mostly used by over 24,000 spending units for its daily operations such as depositing the non-tax revenue and conducting petty cash expenditure). Consequently, at the end of 2012, MOF decided to end the consolidation process and dissolve the TPRP team. It is consistent with the opinion of the Supreme Audit Agency (BPK) to consider that this issue of illegal or extra budgetary accounts that are not registered by MOF is no longer material considering that those unregistered accounts outside TSA (if any) have insignificant balances.

### **Implementing the TSA for Expenditure Accounts**

The TSA was first implemented for expenditure accounts as a pilot and then rolled out to cover all spending units. Implementation of the “expenditure TSA” through zero-balancing of the non-salary expenditure accounts (BO-I) held in commercial banks was carried out on a pilot basis for three treasury offices, based on a regulation issued by DG Treasury in 2005. This was then rolled out to 50 treasury offices and underpinned by a MOF decree of 2006. By 2008 the “expenditure TSA” was fully implemented with the establishment of Zero Balance bank accounts held by LTBs for making payments to the suppliers of spending units. Implementation of Zero Balance “expenditure TSA” for the salary accounts (BO-II) was not prioritized till 2009, as the balances in these accounts reduced to zero within 3 to 5 days upon completion of salary disbursements. Moreover, it was necessary to first issue regulations, requiring employees to open bank accounts for salary deposits. The “expenditure TSA” for salary payments has also been fully implemented with electronic payments being made immediately to employees through the BO-II bank accounts.

In order to ensure transparency and accountability in the implementation of the “expenditure TSA”, the MOF tendered for the selection of banks. The selection of Operational Banks, both Operational Bank-I for non-salary payments and Operational Bank-II for salary payments, was carried out in accordance with the provisions specified in the Presidential Regulation on the procurement of goods and services.

In addition to this, to enhance competition among commercial banks, the agreement with banks was limited to three years. To date, the tender for the selection of Operational Bank-I has been carried out three times: for 2006-2008; 2009-2011, and 2011-2013. In two earlier periods, Bank Rakyat Indonesia (BRI) was accredited to service 167 out of 178 non-salary disbursing bank accounts. In

the third bid held in 2010, more commercial banks participated and the three main accredited banks were Bank Mandiri (73 accounts), BRI Bank (28 accounts), and BNI Bank (64 accounts). This showed that the centralized tendering process fostered a degree of competition between banks for providing payment services to the government. Surprisingly, up to 2012, the selected commercial banks proposed a “negative” service fee (willing to pay instead of charging MOF a bank service fee). This is because the banks were looking to gain indirect benefits from getting the additional accounts of government clients (such as vendors/suppliers/contractors) who would open accounts with the banks to receive the cash from the government. From 2013, this arrangement was changed and rather than receiving remuneration from the commercial banks, MOF requested that banks contribute to the development of their IT systems, which will connect with MOF’s IFMIS.

### Implementing the TSA for Revenue Accounts

Government regulations mandated the implementation of a full “revenue TSA” by January 1, 2009.<sup>26</sup> However, the remittance of revenue collections to the TSA in BI by collecting banks on the following workday was undertaken in stages from 3 November 2008 to January 2010; and by early 2010, the same day sweeping of revenue collection accounts was fully implemented. Since then, 2,516 branches of 81 commercial banks and the post offices have been used as collecting agencies (Bank Persepsi) for revenue transactions.

The banking service fees paid by MOF to 81 commercial banks / post offices persepsi for managing revenue payment in the last four (4) years are shown in the table below (the current fee is IDR 5,000 per revenue transaction). Although the banking service fee was significant (a total of around USD 20 million a year in 2013), it is more cost efficient for MOF to pay the fee rather than to permit them to keep the revenue remittances (a total of around USD 106 billion in 2013) for 3 days to compensate for banking services:

**Table 2.4 Banking Services Fee for Revenue Collections**

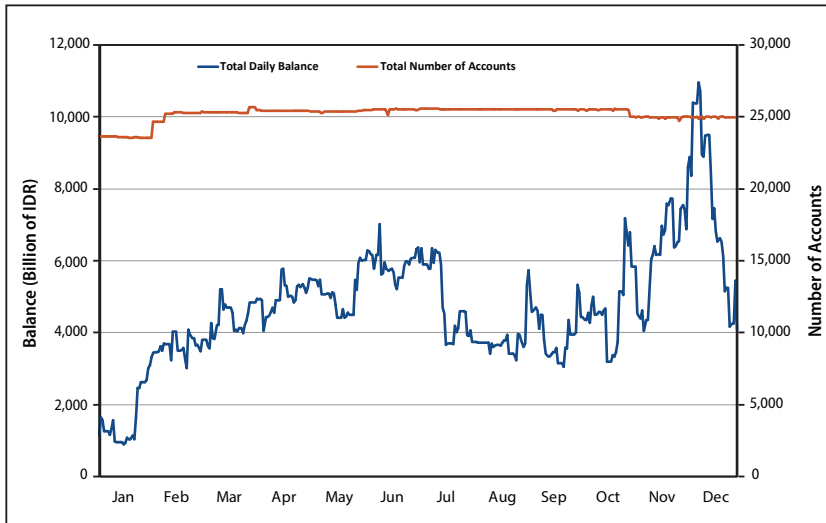
	2009	2010	2011	2012	2013
Paid fee by MOF to the commercial banks/post (In Million)	IDR 31,465.5 (USD 3.14)	IDR 102,072.1 (USD 10.2)	IDR 199,802.8 (USD 19.9)	IDR 199,934.8 (USD 19.9)	IDR 203,116.25 (USD 20)
Revenue collection (In Billion)	IDR 621,000 (USD 62.1)	IDR 710,300 (USD 71.0)	IDR 833,640 (USD 83.36)	IDR 978,360 (USD 97.84)	IDR 1,063,030 (USD 106.3)

## Implementing the Treasury Notional Pooling for Imprest Accounts held by Spending Units

The last step in consolidating the state bank balances was the implementation of the Treasury Notional Pooling (“virtually” sweeping) applied to revenue/ expenditure spending unit treasurer accounts in commercial banks.

The basic principle of payment of the state expenditure in Indonesia is, as much as possible, made directly from TSA to the beneficiaries’ account. Hence, the cash balance held in each spending unit’s imprest account shall be relatively small and used for holding the petty cash only. The average daily balance of all spending unit expenditure accounts is shown below:

**Figure 2.3 Average Daily Balance of all Spending Unit (Petty Cash) Accounts in 2013**



Implementation of the Treasury Notional Pooling accounts is underpinned by a set of government regulations and Minister of Finance decrees.<sup>27</sup> Before the MOF decided to apply the Treasury Notional Pooling for the spending units’ imprest accounts, the following three possible alternatives were evaluated:



**Table 2.5 Treasury Notional Pooling for Spending Units – Alternative Options**

Options	Benefit	Disadvantages
Daily Sweeping of the more than 24,000 spending unit accounts to TSA account in Bank Indonesia	Full Implementation of TSA Reducing the idle money in circulation	Time constraint BI did not want to do retail banking transactions (daily transfer and sweep cash from and to spending unit accounts)
Daily Sweeping of spending unit accounts to an account opened at the Head Quarter of a commercial bank	Time benefit Obtaining remuneration from the selected commercial bank	Cost: the bank would charge IDR 5,000 for each transfer from and to spending unit accounts (hence, +24,000 account times IDR 5,000 times number of working days in a year)  Zero balanced at branches' account but centralized in HQ account
Treasury Notional Pooling	Efficient in time  Cash is always available in Spending Unit's account ready to be used at any beginning of day  No transfer fee to be paid (no actual transfer of funds)  The end of day balance are mostly below IDR 2 billion per account which automatically fall under threshold of deposit insurance scheme  Obtaining remuneration from the selected commercial bank The bank can provide real time on line information on balance position of each Spending Unit's account at end of day	Pure zero balanced account is not implemented

Based on the above assessment, the TNP was chosen as the best option to manage the imprest accounts held by spending units. From the latest data, there are 29 different commercial banks (where the Spending Units have opened accounts) registered to join TNP program in which they are obligated to provide real time on line information and pay remuneration on the daily balance kept in the imprest accounts. The characteristics of the TNP are described in the box below:

### **Box 2.3 The Characteristics of the TNP**

Treasury Notional Pooling (TNP) for the Revenue/Expenditure Treasurer accounts is a balance consolidation management program involving every revenue/expenditure treasurer account in the commercial banks without doing any overbooking or cash transfer. The balances from all revenue & expenditure treasurer accounts are consolidated at the end of the day after the closing process.

Some of the Basic Principles of TNP Application in Indonesia are:

- a. The spending units of the line Ministries/agencies (K/L) ask the LTB for permission for a new/additional/closing account;
- b. The LTB adds the change to the accounts in the LTB account database and conveys this to the Directorate of State Cash Management;
- c. The Directorate of State Cash Management registers the spending unit's treasurer account to the head office of the commercial bank that manages the TNP, to be added to the TNP system;
- d. The balances of all treasurer accounts in commercial banks are consolidated at the end of each day by using the TNP system;
- e. The balances of treasurer accounts receive remuneration from the head office of the commercial banks and these funds are deposited to the RKUN at the start of each month;
- f. The implementation of TNP is done at each commercial bank's head office where the treasurer opened the account;
- g. The direct deposit interest income on treasurer accounts which are in the TNP are directly deposited by the head office of the TNP-executing bank to State General Cash Account 423253 (revenue from the implementation of Treasury Notional Pooling) to the BUN Budget Section (999);
- h. The spending unit's treasurer accounts that are not included in TNP still receive direct deposit interest income, which is deposited to the State General Cash Account to the Ministry/Institution Budget Section in question; and
- i. The amount of TNP remuneration is determined by an agreement between the commercial bank and the Directorate General of the Treasury as the Proxy of the BUN.

The balances of expenditure and revenue treasurer accounts are consolidated at the end of every day. The concept of "notional" pooling means that the cash is not actually pooled; rather, the balances of all treasurer accounts held at commercial banks are virtually consolidated and the information on the balances is used to determine the interest.

The interest of these balances will be given daily on the total of all consolidated balances. The rate of interest is based on the agreement between the government and the related bank, which is stated in the contract.

The Treasury Notional Pooling is expected to have the following benefits:

- A remuneration on the daily cash balances held in imprest accounts;
- Improved administration of the Expenditure and Revenue Treasurer Accounts resulting from daily information on the balances held in imprest accounts;
- Ease of calculation and monitoring of the non-tax revenue (PNBP) received from interest on Expenditure Treasurer Account balances;
- Avoidance of the daily transfer in and transfer out of Expenditure Treasurer Account balances through consolidation at the bank Head Office for reporting purposes; and
- No charge by banks for the application of TNP on the Expenditure Treasurer Accounts.

The revenue generated by the implementation of TNP is received by the government as non-tax revenue (PNBP). From 2009 to 2013, the government has received total revenue of around IDR 669 billion by implementing TNP. The following table shows the government revenue from implementing TNP per year since 2009.

**Table 2.6 Government Revenue from Implementing TNP 2009 – 2013**

Year	2009	2010	2011	2012	2013
Revenue (Million IDR)	51,470	119,677	193,856	176,929	126,903

Looking forward DG Treasury is considering options to reduce the aggregate balance held on these imprest accounts. One option is to issue debit cards to the finance officers of the spending units (within limits prescribed by the Treasury) to make urgent, low-value payments for the purchase of goods and services. This option would require a full analysis of the costs and benefits before it is introduced.

### **Bank Accounts Managed by the Ministry of Finance and/or Spending Units and Excluded from TSA (other non-TSA accounts)**

While the MOF has tried to consolidate all the state funds into the TSA or TNP, there are still many accounts that are known and continue to operate with permission from MOF, but on which TNP and TSA cannot be implemented. Those accounts are classified under the category of “other non-TSA” accounts.

The opening of these “other non-TSA” accounts must be approved by the Minister of Finance as regulated by financial decrees.<sup>28</sup> However, the spending unit of the ministry/agency has full responsibility and authority over the management of these accounts, including on the use of the interest generated from the balances.

Therefore, if those accounts are to be included in the TNP and TSA structure, then there must be prior approval from the spending unit of the ministry/agency. The features and characteristics of the accounts falling under this category are:

- Grant account: This is an account in a work unit of a ministry/agency that is used to hold domestic/foreign grants. Usually, the provision of this grant is embodied in an agreement between a grant provider and grantee.
- Cooperation/partnership/joint account: This is an account in a ministry/agency that is used to deposit funds pertaining to bilateral cooperation agreements between the government and other parties. A spending unit that receives the funds still has certain obligations towards the bilateral party.
- Transit Account: This account is used to temporarily hold other revenues in a ministry/agency.
- Specific Service Support Fund Account: This account is used to hold specific purpose funds in certain spending units in accordance with its main duties and functions.
- Collateral Account: This account is used to hold collateral funds against a matter that has not been decided or as a requirement in a work relationship.
- Escrow Account: This account is used to hold temporary trust funds pledged for payment to other parties.
- Public Services Agency (PSA) accounts: Accounts held by PSAs can be divided into 3 types, namely:
  1. PSA Operational Account: an account used to hold revenues as well as to pay all the expenses of PSA spending units.
  2. PSA Cash Management Account: an account used to hold idle cash in commercial banks related to PSA cash management. This is generally a demand deposit account in which the interest is deposited into a PSA operational account.
  3. PSA Management Fund Account: an account used to hold funds that cannot be held in a PSA operational account or cash management account, including revolving funds and funds that have not yet become the right of the PSA.

The 4,456 non-TSA accounts had a total balance at the end of 2012 of IDR 20 trillion, of which more than IDR 16.4 trillion was held in the PSA (BLU) account. This warrants consideration of a further expansion of the TSA coverage to include PSA accounts without affecting the autonomy of the PSA operations. The numbers of each type of “other non-TSA” accounts are:

**Table 2.7 Other Non TSA Accounts**

No	Type of Account	Number
1	Grant Account	28
2	Cooperation Account	90
3	Transit Account	3,036
4	Specific Services Support Fund Account	161
5	Collateral Account	99
6	Escrow Account	123
7	PSA accounts	290
8	Other Accounts	703
<b>TOTAL</b>		<b>4,456</b>

### 2.3.5. Remuneration of Cash Balances in Bank Indonesia

Before the agreed MOU between the MoF and BI on the TSA was in place, the government did not receive any remuneration from the cash kept in BI. Then, the MoF and BI agreed that remuneration on government deposits at BI would be a “win-win” situation for both parties, even if the rate were less than the market rate. From the MoF’s viewpoint, BI will provide full security at zero risk and any remuneration paid by BI would add to state revenues. From BI’s perspective, the retention of government money in BI would reduce the cost of monetary policy operations to sterilize the liquidity resulting from government cash balances being held in commercial banks. If the government placed its surplus cash in fully remunerated deposits in commercial banks, BI would have to sterilize it. Another factor to be considered is that, although the payment of interest or remuneration by the central bank will provide additional income to the government, it will also reduce the profits of the central bank, eventually leading to a reduction in the dividend that the central bank can pay the government.

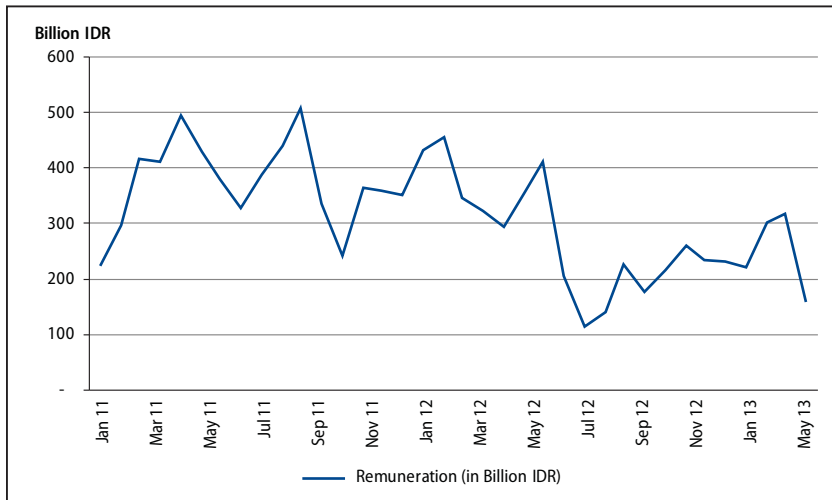
In 2007, the Governor of BI and the Minister of Finance reached an “in-principle” agreement that the government deposits should be remunerated at a rate less than the market rate provided this was consistent with prevailing law. However, the discussion on the remuneration rates were prolonged until finally in August 2008, the BI Governor and Minister of Finance agreed to the specific remuneration rates for government deposits in placement accounts opened at BI, which would receive funds from the State General Cash Account (SGCA/RKUN) once the agreed minimum balances were exceeded. The MOU between the Finance Minister and the Governor of Bank Indonesia formalizing this agreement on remuneration was signed at the end of January 2009.<sup>29</sup> The full content of the MOU can be seen in Appendix 3.

The rates of remuneration for different types of government accounts held in BI are shown below:

**Table 2.8 Rates of TSA Remuneration**

Type of account	Currency	Balance	Remuneration
a. SGCA (RKUN) used as a current account for daily transactions	Rupiah	Minimum IDR 2 Trillion	0.1% p.a
	USD	Equivalent to US\$1 million	0.1% p.a
	YEN		0.1% p.a
	EURO		0.1% p.a
b. Placement/Investment Account used as a deposit account to place the idle cash to be invested	Rupiah	No limit	65% x BI rate
	USD	No limit	65% x Fed Funds rate
	YEN	No limit	65% x BOJ cash rate
	EURO	No limit	65% x ECB refinance rate

The figure below show the trend of remuneration paid by the BI since January 2011.

**Figure 2.4 Remuneration for TSA Held in Bank Indonesia**

The table below shows the total annual remuneration paid by BI from 2011 to 2013.

**Table 2.9 Total Remuneration Paid by BI in 2011 - 2013**

In Rupiah	2011	2012	2013
SGCA (RKUN)	2,515,529,137	3,014,747,014	3,276,540,811
Placement	1,972,374,511,655	2,061,153,198,126	1,616,387,708,707
Other accounts	2,691,796,457,699	2,092,703,337,761	990,830,669,950
Total	4,666,712,430,668	4,156,871,254,901	2,610,494,919,468

### 2.3.6. Quantifying the Benefits from TSA Implementation

In order to make an assessment of the quantifiable benefits of implementing the TSA two approaches have been used. The first is a quantification of the direct financial flows to DG Treasury as a result of the implementation of the TSA, and the move to remunerate government cash balances held at BI. This is an objective measure as the flows are relatively easily identified. However it has some weaknesses as it mixes the TSA reform and the potentially separate decision to remunerate the balances held at BI. It also fails to capture either any costs to BI of the payment of interest (which ultimately are a cost to the Government through a lower profit / dividend) or any gains to the Government through a reduced borrowing program.

The second approach makes a broader fiscal assessment of the gains from the TSA reform by attempting to quantify the benefit to the Government as “idle balances” were moved from the commercial banking sector into the TSA. This assessment is less precise as many of the components need to be estimated, but it is conceptually a more robust approach to the quantification of benefits of the reform.

#### *i. First Approach: Direct Financial Gains from TSA Reform*

Available data show that the implementation of TSA and the decision to remunerate BI balances at 65% of the BI rate, has generated a relatively significant amount of income for the government, with around IDR 2-4 trillion (US\$ 200-400 million) being collected every year, most of which is generated from the balance of cash kept in BI. The direct financial benefit of TSA in Indonesia is summarized in the table below:



**Table 2.10 Direct Benefit to the Treasury of TSA and BI Remuneration**

Type of transactions	Amount collected/ spent in 2012 (IDR)	Amount collected/ spent in 2013 (IDR)	Notes
(a) Remuneration on cash balance in the Bank Indonesia kept in SGCA/ RKUN; Placement; and other accounts	4,156,871,254,901	2,610,494,919,468	The benefit for the Government of having the remuneration paid by Bank Indonesia on all the state cash balance kept in BI.
(b) Revenue Daily Sweep: Banking service fee paid by MOF to the 81 Bank/post Persepsi for collecting tax revenue and daily remit into the TSA	(199,934,810,000)	(203,116,245,000)	The cost for the Government of having the Paid fee for processing +42 million tax payment transactions at IDR 5,000 cost per transaction
(c) Zero balance account in Bank Operational I/ II to manage the government expenditure paid to its vendor/contractors/ supplier	84,071,000,000	0	The benefit for the Government of having the commercial banks willing to pay ranged from IDR 1,000 to IDR 50,000 from each payment order (SP2D) processed by those banks.
(d) Treasury Notional (virtual) Pooling to consolidate all balance maintained by +24,000 spending units	176,929,000,000	126,903,791,564	The benefit for the Government of having the consolidated spending unit's account Remunerated at current deposit rate on the aggregate daily balance account of around IDR 5.3 trillion.
<b>Total Direct Benefit received from the implementation of TSA</b>	<b>4,217,936,444,901</b>	<b>2,534,282,466,032</b>	

*ii. Second Approach: Quantifiable Fiscal Benefit of TSA Reform*

Table 2.11 below presents the findings of an assessment of the broader fiscal benefits of implementing the TSA. The conclusion is that a saving of IDR 3 trillion (USD 300 million) would have been made had the TSA reform been in place in 2007 – the last year of the pre-TSA environment. This is approximately 4 percent of the central government financing costs that year.

The assessment is based on three paths through which Government idle balances in the commercial banks in 2007 were eliminated. These are through (i) having revenue receipts which were immediately swept to the TSA at the end of the day rather than held by the commercial bank, (ii) having the balances of local treasury offices (RTBs/LTBs) held in zero balance accounts, and (iii) closing many of the bank accounts of spending units and ensuring that any remaining accounts are covered by the notional pooling system. It is assumed that any reduction in idle balances provides a saving to the government either through a reduction in borrowing from the market, or a reduction in BI sterilization activity as higher balances are held by the Government in BI. In both cases the benefit accrues at the BI interest rate in 2007, which was 8 percent, while estimates have been made for offsetting fee payments, or lost interest using a range of assumptions. For this assessment no distinction is made for “idle balances” previously held at state banks. It should also be mentioned that while the approach assumes that a gain to BI is a gain to the Government generally, BI has never paid a dividend to the Government and the benefit is therefore reflected in an increased ownership interest for the Government as the BI balance sheet expands.

**Table 2.11 Fiscal Benefit of Implementing TSA**

Benefit from TSA reform	Quantification of the Gain IDR billion	Notes
(i) Revenue Daily Sweep:	IDR 57.5 billion	(i) Assumed that all (IDR 416,925 billion) revenue collections in 2007 were held by commercial banks for an average of two days. The BI interest rate in 2007 was 8% as the cost should be paid if BI had to sterilize the idle balance in market.
(a) Reduction in idle balances in commercial banks through daily sweep to TSA.	IDR 416,925 billion/360 days = IDR 1,158 billion of average daily revenue x 2 days float x 8% BI rate = IDR 185.3 billion	(ii) Assumed that the banking service fee for 22,551,307 revenue collection transactions in 2007 would have been the same as in 2013 at IDR 5,000 per transaction.
(b) Estimate of banking service fee payable to commercial banks for the service.	22,551,307 transactions x IDR 5,000 fee per transaction = (IDR 127.8 billion)	
(ii) RTB/LTB zero balanced accounts:	IDR 1,044.9 billion	DG Treasury estimates that the daily average aggregate balance of regional treasury offices in 2007 was IDR 13.66 trillion and that would have been sterilized by BI at interest of 8%. This is the reported interest revenue in 2007.
(a) Using Zero Balance accounts to consolidate the balances of regional treasury offices.	IDR 13.66 trillion daily balance x 8% = IDR 1,092.8 billion	
(b) Lost interest from consolidation of regional treasury balances.	(IDR 47.9 billion)	
(iii) Notional Pooling	IDR 1,920 billion	DG Treasury report that there were spending unit balances of IDR 36.76 trillion in commercial banks in 2007. Of these balances IDR 22.5 trillion were subsequently returned to BI once the accounts were closed. Assumed that remaining balances of daily average IDR 6 trillion were covered by the TNP with an interest rate of 2% - which is the average rate on current accounts in 2007.
(a) Closure of spending unit bank accounts in commercial banks and transfer of balances to BI.	IDR 22.5 trillion x 8% = IDR 1,800 billion	
(b) Treasury Notional (virtual) Pooling to consolidate all balance maintained by +24,000 spending units	IDR 6 trillion x 2% = IDR 120 billion	
Total	IDR 3,022.4 billion	

Other than the quantifiable benefits, some “non-quantifiable and indirect” benefits have emanated from implementation of the TSA. These include:

i. Better Coordination between Cash and Debt Management

Improved coordination between DG Treasury and DG Debt Management leads to greater efficiency in debt issuance, redemption programs, and use of cash. Having a consolidated balance in the TSA helps DG Debt Management and DG Treasury to decide on the borrowing strategy, cash plan and placement. This can also support efficient cash management by altering the profile of debt redemptions (i.e. through buy-backs or swapping securities of different maturity structures). While DG Debt Management used to set a schedule for bonds issuance in a particular year, the issuance of bonds was usually seen as a “front loading” policy, since DG Debt Management based the schedule around securing its own financing needs at the beginning of year without consultation with DG Treasury on their cash needs. This imposed unnecessary carrying costs resulting from the increase in the idle cash under management at the beginning of the fiscal year.

ii. Reduction in Corruption

The elimination of thousands of government bank accounts through the consolidation of balances in the TSA has eliminated the potential for corruption resulting from the authority to manage large cash balances in commercial bank accounts. Since the TSA has been in place, the LTBs and spending units have had much less discretion than before, because of the direct disbursements and minimal balance kept in their account. Furthermore, it is not possible for a public agency or unit to open an unauthorized bank account. Also, all public employees including teachers receive their salaries through direct transfer into their bank accounts.

## 2.4. CONCLUSIONS

The hybrid TSA structure chosen by Indonesia is based on practical considerations and generic international practices. The “top” account of the TSA is established in the central bank—Bank Indonesia. The geographic spread of the country and the limited number of BI branches required the conversion of previous payment

accounts held by local treasury branches into zero balance accounts in commercial bank branches for making payments across the country. More than 2,500 zero balance accounts were also set up in commercial banks to facilitate revenue deposits and to implement electronic transfer of revenue remittances into the TSA.

The implementation of the “notional pooling” account enables the government to get a return on the idle cash balances in imprest accounts. Government spending units often require quick access to cash for making small value but urgent payments. Most developing countries provide this facility for spending units by allowing them to keep limited cash in imprest accounts and in some cases zero balancing the petty cash accounts on a daily basis. Indonesia has permitted spending units to hold petty cash accounts in commercial accounts and at the same time ensured that the residual balances in these accounts are virtually consolidated through a daily “notional pooling”. Agreements with commercial banks provide for interest payments on the amounts held in these accounts as identified by the “notional pooling”.

In Indonesia, following good international practice, banking services provided by the central bank and commercial banks are formalized through bilateral agreements. The MOU with the BI also has provisions for remunerating cash balances held in an investment account with the BI. Commercial banks are chosen through a transparent process and the agreements explicitly provide for fees for services rendered. In Indonesia, up to the end of 2012 the arrangement on the expenditure side was that the commercial banks are paying the government a commission for each transaction. This is because the banks evaluated that they have “knock-on” benefits from the fact that government suppliers and government employees open accounts with them to receive payments. From 2013, this arrangement was changed and rather than receiving remuneration payment from the commercial banks, MOF requested that the banks contribute to the development of the IT system, which will connect with MOF’s IFMIS.

The sequencing of the implementation of the TSA has been very much in line with international practices. The preparatory phase involved institutional reforms and setting up the TSA architecture. Government bank accounts were surveyed and most of them have been gradually brought into the TSA regime. The consolidation was done in phases, with the expenditure accounts being brought in first followed by the revenue accounts and finally the imprest accounts.

An assessment of the direct financial benefit to the Treasury of the consolidation of government cash balances and the introduction of remuneration at 65% of the BI rate showed gains of approximately IDR 2-4 trillion (US\$200-400 million) per annum, mostly generated from the balance of cash kept in BI. This is a partial assessment without taking into account a possible reduction of the dividend payment from BI to MOF or potential gains where the consolidated cash allows the government to reduce its borrowing program. Another approach is through a fuller assessment of the economic benefits of eliminating the idle balances in commercial bank accounts through the establishment of the TSA found gains in 2007 of IDR 3 trillion (USD 300 million). The benefit arises as the consolidation of cash allows either a reduction in government borrowing or a BI sterilization activity. For this calculation a consolidated view is taken of the BI and Treasury position. These financial benefits are in addition to the qualitative benefits associated with the introduction of the TSA (i.e., reduced opportunities for corruption, better security for government cash, better coordination between cash and debt management, etc.).

## Notes

<sup>1</sup> Pattanayak, Sailendra, and Israel. Fainboim, 2010, Treasury Single Account: Concept, Design and Implementation Issues, IMF Working Paper WP/10/143.

<sup>2</sup> Williams, Mike, 2009, Government Cash Management: International Practice, Oxford Policy Management Working Paper 2009-01.

<sup>3</sup> “Centralized Online Real-time Environment”: This basically means that the bank’s branches process their transactions through a centrally maintained database. The deposits made are reflected immediately on the central database.

<sup>4</sup> As defined in the GFSM 2001

<sup>5</sup> Williams, Mike, 2009, Government Cash Management: International Practice, Oxford Policy Management Working Paper 2009-01.

<sup>6</sup> “Centralized Online Real-time Environment”: This basically means that the bank’s branches process their transactions through a centrally maintained database. The deposits made are reflected immediately on the central database.

<sup>7</sup> India practices a TSA arrangement. At the central government the TSA was implemented in 1977 and thereafter it was implemented in the state (federal) governments. The central and state governments hold their TSAs in the Reserve Bank of India. No government cash balances are held in commercial banks. Revenue accounts held in commercial banks are cleared daily to the respective TSAs. In the case of expenditures, the accredited banks make payments out of their own cash resources up to the extent of available ceilings set by the treasuries, and are compensated at the end of each day from the respective TSAs. The government pays an agreed transaction fee for this arrangement.

<sup>8</sup> Source: Pattanayak and Fainboim (2010)

<sup>9</sup> Refer to row 4 of the table in appendix 1 of the IMF Working Paper on TSA: Concept, Design, and Implementation Issues.

<sup>10</sup> Government Cash Management Part One National Audit Office paragraph 1.41 Danish Government.

<sup>11</sup> Bank/Post Persepsi: a commercial bank/post appointed by the Minister of Finance to receive Non- Import State Receipt deposits, which consist of tax receipts, domestic customs and non-tax state revenues.

<sup>12</sup> Article 7

<sup>13</sup> Article 12 paragraph 2: “All state revenues and spending shall be performed through the State General Cash Account.”;

<sup>14</sup> Government Regulation No 39/2007 on State/Regional Cash Management; Article 14 (2): “All state revenues shall be deposited to the State General Cash Account and all state spending shall be disbursed from the State General Cash Account.”

<sup>15</sup> Regulation of the Minister of Finance No.98/PMK.05/2007 regarding the Implementation of Zero Balance Spending Accounts in Commercial Banks’ Counterparties in the Framework of TSA Implementation

<sup>16</sup> PMK No. 116/2009 regarding Trial Implementation of Zero Balance LTB Revenue Accounts in the Implementation of TSA.

<sup>17</sup> Regulation of the Minister of Finance No. 61/PMK.05/2009 regarding the Application of Treasury Notional Pooling in the Spending Treasurer Account

<sup>18</sup> Regulation of the Minister of Finance No. 126/PMK.05/2009 regarding the Application of Treasury Notional Pooling in the Revenue Treasurer Account

<sup>19</sup> There are four types of cash liquidity in the TSA accounts. They are categorized on the basis of flexibility in the use of the cash from the directorate cash management (DCM) perspective. They are: (i) Very Liquid accounts, consisting of SGCA and placement accounts; (ii) Liquid accounts, consisting of the cash in transit awaiting to be transferred back to SGCA/placement accounts, e.g. cash in revenue account in persepsi banks/post office before being pulled into SGCA; (iii) Less Liquid accounts, consisting of SAL, Oil and Gas, imprest accounts, etc; and (iv) Illiquid accounts or cash with limited use, consisting of PSA/BLU accounts, escrow accounts for USDA grant, civil service pension funds, petty cash of spending units, forest rehabilitation accounts, etc.

<sup>20</sup> Known as RK Gabungan

<sup>21</sup> Article 10 of Law Number 1 of 2004

<sup>22</sup> Article 20 of Government Regulation No. 39 of 2007

<sup>23</sup> UP (uang persediaan)

<sup>24</sup> Regulation of the Minister of Finance (PMK) No. 58/PMK.05/2007 Regarding the Issuance of Government Accounts at State Ministries/agencies is a PMK which regulates the ordering of accounts in the environment of State Ministries/agencies/Offices/Work Units. For implementation guidelines, Regulation of the Director General of the Treasury Number 35/PB/2007 Regarding Following Up on the Ordering of Government Bank Accounts at State Ministries/agencies/Offices/Work Units has been published.

<sup>25</sup> Data from central government financial statements (LKPP) 2007

<sup>26</sup> Law No. 1 of 2004 regarding State Treasury and by Government Regulation No. 39 of 2007 regarding State/Regional Cash Management, and by Joint Decree of the Minister of Finance and Governor of the Bank of Indonesia dated 31 January 2009 regarding Coordination of State Cash Management.

<sup>27</sup> Article 25 of Government Regulation No. 39 of 2007 Regarding the Management of State/Regional Funds, Regulation of the Minister of Finance No. 61/PMK.05/2009 Regarding the Application of Treasury Notional Pooling for Treasury Expenditure Accounts, and Regulation of the Minister of Finance No. 126/PMK.05/2009 Regarding the Application of Treasury Notional Pooling for Treasury Receivables Accounts.

<sup>28</sup> PMK No. 57/PMK.05/2007 as amended by PMK No. 05/PMK.05.2010 and Regulation of the Director General of Treasury No. 35/PB/2007

<sup>29</sup> Memorandum of Understanding between MOF and BI: Joint Decree of the Minister of Finance and the Governor of the Bank of Indonesia Number 17/KMK.05/2009 and Number 11/3/KEP. GBI/2009 dated 30 January 2009 regarding Coordination of State Cash Management.





## Chapter 3

### Cash Planning and Budget Execution

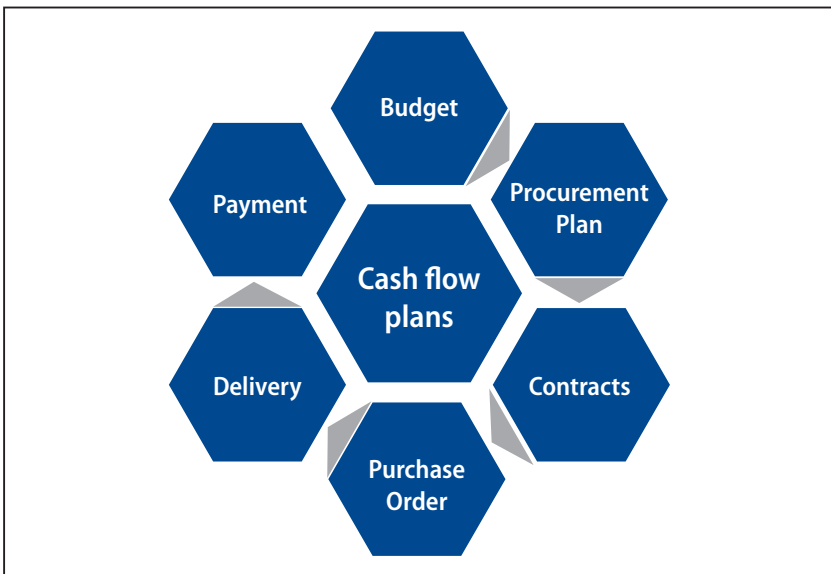


### 3.1. INTRODUCTION

As detailed in Chapter 1, the Public Financial Management (PFM) regulatory framework of a country sets out the environment for cash management, one of the main purposes of which is to finance the activities undertaken by the government during a fiscal year. It establishes the roles, responsibilities, systems and procedures for: (i) linking annual cash flow plans to the revenue mobilization and procurement plans; (ii) committing budget allocations when entering into contracts, or at the time of issuing purchase orders; (iii) recording payables and receivables; (iv) making payments or collecting receivables; (v) reconciling cash flows recorded in the Treasury, with bank statements and the original transactions recorded in the spending units; and (vi) accounting and reporting outcomes. If the budget is not well prepared, external conditions are unstable, control over in-year commitments is inadequate, the billing/ invoicing procedures are not transparent, or if the collection/ payment systems are complex and user-unfriendly, significant adjustments may have to be made to cash flow plans during the execution of the budget.

This chapter analyses the interaction between cash planning and each of the in-year stages in the budget execution cycle depicted in the figure below:

**Figure 3.1 Budget Execution Cycle**



## 3.2. CASH PLANNING AND BUDGET EXECUTION – THE GENERIC ISSUES

### 3.2.1. Cash Planning and the Annual Budget

#### Cash Planning and the Credibility of the Annual Budget

The credibility of the annual budget and the timing of its approval are fundamental to in-year cash management. Budget allocations need to be sufficient to fund the policy outcomes that budget users are expected to deliver during the year. Only when the Ministry of Finance (MOF) and the responsible spending ministry agree that the budget allocation is appropriate for its purpose can a meaningful cash flow plan be formulated and implemented. The PFM legal framework usually provides for a budget calendar allowing for adequate time to discuss and approve annual budgets well before the commencement of the fiscal year. It also provides for interim funding measures in case of unforeseen delays in the timely approval of the annual budget.

The reasons for in-year divergence between budget allocations and cash flow plans should be analyzed and understood before action can be initiated to mitigate such divergence. The cash flow dynamics related to the implementation of government activities have to be understood not only by the cash managers in the Ministry of Finance but also by the financial managers in the executing agencies. The effect of in-year changes to cash flow dynamics is often not trivial, particularly when they are linked to commodity prices or exchange rate variations. Methods used for forecasting annual budget requirements can be applied equally to analyze and understand in-year variations between expected cash flows and actual outcomes. The analysis should bring out any differences between cash plans and outturns for each ministry, policy area, or program resulting from in-year changes in: (i) macroeconomic determinants, such as GDP growth, inflation, or unemployment; (ii) operational parameters specific to the particular ministry, program, or policy area; and (iii) accounting changes, such as changes in the accounting treatment of particular transactions within ministries or reclassification of a particular budget line from one ministry to another.

The credibility of budget execution could be undermined by inappropriate budget classifications. Budget classifications should be consistent across spending units and for past data. GFSM2001<sup>1</sup> provides a standard and well documented framework for classifying stocks and flows related to budgetary transactions. Most countries are moving towards adopting budget classifications consistent

with the classifications prescribed in GFSM2001 as part of a budget classification that also identifies the program and administrative classification. It should be ensured that (i) budget appropriations are classified under the appropriate revenue and expenditure categories instead of undefined groups such as “not classified elsewhere”; and (ii) residual data pertaining to earlier classifications are migrated to the new classifications so as to maintain the history of past trends.

Contingency budget provisions used during the year should be subsequently vired (reallocated) to the appropriate budget classifications to ensure meaningful analysis of expenditure trends. The frequent use of contingency provisions for meeting expenditures during the year could also undermine the quality of cash flow plans. Contingency provisions are usually meant for meeting unforeseen expenditures such as those related to natural disasters. However, some countries establish contingency provisions in budgets for dealing with uncertainties in inflows resulting from donor pledges or excessive shortfalls in revenues. The PEFA Field Guide suggests that accepted “good practice” for the use of contingency provisions requires that these amounts be vired to those votes (budgetary heads) against which the unforeseen expenditure is recorded (in other words, that expenditure is not charged directly to the contingency vote).

The quality of forecasts used in the preparation of the budget and to guide budget implementation should be assured through quality assurance processes that may involve independent reviews. In most countries, fiscal forecasts are based on a single, central scenario with limited exploration of the implications of alternative assumptions. There is a natural tendency in such cases to underestimate the cash outflows of new spending programs and to overestimate the inflows from tax increases. Independent fiscal councils are being established in a growing number of countries to help guard against over-optimistic economic and budgetary estimates. An important task of the auditing function of fiscal councils is to review government forecasts. Some fiscal councils are mandated to provide independent forecasts for use by government. Given this mandate, independent fiscal councils can play a useful role in removing biases and providing quality assurance of government fiscal forecasts. However, a recent IMF publication<sup>2</sup> cautions that “their (fiscal councils) benefits should not be oversold, especially for developing countries in which the fiscal policy reform agenda is long and institutional capacity is limited. Moreover, along with many other good fiscal policy practices and innovations, the decision to create a fiscal council, and its role should a council be set up, has to be appropriate to country circumstances.”

## **Cash Planning and in-year Changes in Budget Allocations**

Cash planning should take into account the greater flexibility provided to line managers in a Performance Based Budgeting (PBB) environment, to plan the deployment of their resources. In a number of countries (such as Botswana, Tanzania, and Indonesia) the budget allocations and cash ceilings are set at a very detailed level of budget classification. In a PBB environment, budgets are appropriated for programs and activities instead of for line items of expenditures. Managers have the flexibility to decide on the optimal use of resources to facilitate the achievement of performance targets. With this flexibility comes the added responsibility of managing in-year budget allocations in an efficient and transparent manner. The responsibility for adjusting unit cash plans to meet changes remains with the line managers, while the Treasury continues to be responsible for ensuring the overall availability of cash to meet the projections made by the line managers. In cases where cash ceilings are required to deal with in-year cash constraints, it is preferable to set the ceilings at an aggregate level, e.g., for the spending unit as a whole rather than by detailed line items of the budget - while recognizing that ensuring that future budgets can be financed is the only sustainable response.

## **Cash Planning and Budget Carry-Overs**

Budget carry-overs are exceptions to the general concept of annuality of budget appropriations and are usually closely regulated. Disproportionate end -year expenditure is a common feature of budget execution in most developing countries. These are largely related to delays in implementing capital projects due to complexities in procurement processes or delays in preparatory activities such as land acquisition. Delays could also result from impediments to budget disbursements such as delays in approving the budget or delays in transferring budget disbursement authority to the spending units. The resulting rush of expenditure towards the last quarter of the year to use the annual budget often leads to wasteful use of budget funds. Allowing end-year carry-overs is one way of preventing poor quality expenditures resulting from the rush to use the budget before the end of the fiscal year, as this provides limited flexibility to use the budget in the following year.

The planning of cash flows to defray expenditures related to budget carry-overs is one of the challenges in cash management. The possibility of using carry-over balances, in addition to the current year's appropriation, introduces uncertainty in the expenditure outturn, which needs to be considered when monitoring compliance with the expenditure ceiling. If a large stock of accumulated carry-overs is translated into expenditure in any one year, this poses a challenge for cash management as the amounts to be carried forward are usually not known till after the final quarter of the prior year is complete.<sup>3</sup> A comprehensive picture of the actual cash flows related to budget carry-overs is therefore not available until well after the start of the fiscal year. It is therefore essential that procedures are put in place to ensure that the cash flow implications are quickly incorporated into the cash flow plans.

## Summary

The quality of in-year cash plans is dependent on the credibility of the annual budget appropriations. While preparing cash flow plans the following aspects of budget appropriations should be considered:

- The timing of budget approvals and any impediments to the conveyance of budget authority.
- Reasons for in-year divergence between budget allocations and cash flow plans.
- Appropriateness and consistency of the budget classification of revenues and expenditures.
- Shifting of the contingency budget provisions used during the year to the appropriate budget classifications.
- Quality assurance through independent reviews of forecasts used in the preparation of the budget.
- Comprehensive inclusion of budget carry-overs in cash flow plans.
- In cases where cash ceilings are required to deal with in-year cash constraints, it is preferable to set the ceilings at an aggregate level, e.g., for the spending unit as a whole rather than by detailed line items of the budget.

### 3.2.2. Cash Flow Plans

#### Introduction

Cash management defines those activities undertaken by the government cash manager to ensure that financing is in place to meet the government's spending obligations and that identified cash surpluses are put to the most efficient use consistent with the defined risk parameters.<sup>4</sup> Cash planning is the process by which a government forecasts its cash availability and cash needs for a future time span—often the fiscal year, and in more detail over shorter periods. Its objective is to understand how the procurement and activity plans of the government are linked to the expected trends in aggregated liquid financial resources over the chosen time horizon, or, put simply, the overall expected balance in its bank account.

Annual cash flow plans are disaggregated by months, weeks and even days to facilitate efficient cash planning. Liabilities arise when goods or services are delivered in accordance with contractual terms. These liabilities are reflected and prioritized for payment in cash flow plans. In some countries, funds (commitment ceilings, authority to spend or transfers of cash) are released by the ministry of finance in stages within the budget year (monthly or quarterly). In others, the passing of the annual budget law grants the full authority to spend at the beginning of the year, but the ministry of finance (or other central agency) may in practice impose delays on ministries in incurring new commitments (and making related payments), when cash flow problems arise.

Annual cash flow plans formulated at the beginning of the fiscal year based on the approved budgets are at best indicative. These are invariably modified and refined during the course of execution of the annual budget. The first part of this chapter describes the dependencies between cash flow plans and the different stages in the annual budget execution cycle. Following the thread of discussion in Chapter 1, this chapter addresses cash planning both from the top-down perspective within the MOF and from the bottom-up perspective of the budget execution agencies. As changes and modifications to the annual cash flow plans are inevitable, it becomes important to ensure that both the MOF and the budget executing agencies are “on the same page” while making and executing in-year updates to cash plans. The changes could result from inefficiencies emerging during the budget execution cycle, or due to in-year volatility in the basic macro assumptions. It should be



noted that it is not good practice to frequently update for macro developments. The in-year practice should be to monitor developments against the projected flows and periodically update cash plans if required, but not more frequently than quarterly as otherwise this may result in losing sight of the trends.

## **Planning for Revenue Flows**

The International Handbook of Public Financial Management<sup>5</sup> reiterates that the short-term forecasting of revenue collections within a financial year is a basic input into treasury cash management.

The amount of revenue that can be collected is mainly determined by policy settings, economic fluctuations and tax administration capacity. Major fluctuations in in-year revenues could arise in economies that are dependent on revenues from minerals or other commodities vulnerable to world prices. It is difficult to modify tax legislation or to accelerate tax collection to mitigate an unexpected fall in in-year revenues. On the other hand, it is equally challenging to formulate development projects in time to absorb unexpected in-year revenue surpluses.

Explicit rules and regulations for revenue forecasting underpinned by well-defined responsibilities are essential for ensuring robust in-year cash flow plans. An IMF Working Paper<sup>6</sup> on revenue forecasting in 34 low-income countries indicates that “most of the 34 countries sampled score low on various aspects characterizing the quality of the revenue forecasting process. Forecasting responsibilities are often not well defined and there are few formal rules and regulations governing the forecast. Revenue forecasts, for the most part, are produced late in the budget process, and estimation techniques are rudimentary. The production of forecasts usually involves multiple executive agencies outside the ministry of finance, setting high coordination requirements. As a result, the existence of multiple competing forecasts is quite common. Public accountability, in terms of access to forecast data or through participation of nongovernmental agencies in the forecasting process, is limited.” These challenges encountered while developing medium- term and annual revenue forecasts have adverse impacts on the quality of in-year revenue projections.

Some good practices for projecting government revenues recommended in the OECD reference book<sup>7</sup> on PFM are described in Box 3.1.

**Box 3.1 Good Practices in Revenue Forecasting**

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.

Systemic biases in revenue flows should be analyzed and considered while formulating cash flow plans. In some countries, the incentives given for improving the efficiency of revenue collection could result in a deliberate underestimation of revenue flows. An example is the bonuses given to tax collectors for exceeding the revenue collection targets, which encourage tax authorities to project lower levels of revenue inflows. Biases in forecast can be mitigated through using a conservative approach to revenue forecasts, or through improving the quality of the forecasts to counter the biases. International best practice<sup>8</sup> suggests that, given the inevitability of biases and the serious fiscal and macroeconomic implications of revenue shortfalls, erring on the side of caution is understandable.

Different practices followed in budgeting for non-tax revenues will affect the way in which forward cash plans are made. Some countries budget for non-tax revenues in gross terms in the sense that the budget provides separately for the revenues and expenditures of the service delivering agency. In other countries, the revenues are netted against the expenditures in the budget. For purposes of cash

planning in the service delivery units, non-tax revenue flows and the expenditure flows should be projected separately. It should also be ensured that whenever service delivery units are permitted to retain non-tax revenue collections in their own bank accounts, the cash planners in the MOF have timely access to the cash flows and balances in those accounts.

A high level coordinating body should be made responsible for reviewing and approving in-year revenue projections. In a complex government environment, the responsibility for projecting in-year revenue flows usually rests with a number of stakeholders. It then becomes the responsibility of a high level coordinating body such as a liquidity committee, usually headed by the Minister of Finance or the Permanent Secretary of Finance, to moderate the different positions and establish an agreed projection, which taken together with the expenditure projection, determines the borrowing or investment positions of the government. The liquidity committee also provides advice on the steps to mitigate deviations from the revenue inflows projected in the annual cash plans. The role of the liquidity committee is further discussed in Chapter 4 “Financing the Budget”.

### *Planning Tax Revenues*

A review of the tax revenue profile provides a good basis for analyzing and updating in-year cash flow plans. The review brings out the significance of different components of tax revenues, the specific characteristics of the type of taxes and the likely risks associated with the actual collection of planned revenues. The potential tax revenue is dependent on a number of factors, such as how broad the tax base is, what the tax rates are and the extent to which businesses comply with the tax. For example:

- VAT is largely dependent upon economic variables such as growth in the economy and more specifically the final consumption of goods or services. Estimating the value of goods and services purchased by final end users automatically captures the tax base under VAT.
- Excise taxes are typically charged on selective consumption items and structured in coordination with other broad-based taxes on consumption of goods and services such as VAT. The complexity in the projection of excise taxes is also related to whether the imposition of the tax is as a specific unit tax or as ad valorem rates.

Past trends in conjunction with current revenue collection data can help establish likely month-to-month inflows of tax revenue. During the fiscal year the government continues to collect tax revenues and data from either advance installment payments or actual tax payments. The data should be used, in conjunction with a comparison of this year's actual monthly tax collections up to the month of assessment with the corresponding months of the previous year, for refining and updating projections of cash inflows during the year.

### *Planning Non-Tax Revenues*

Revenue forecasts include forecasts of non-tax revenues prepared by the Treasury in close coordination with the agencies responsible for the management and collection of these revenues. Non-tax revenue comprises social contributions, grants, property income, sales of goods and services, fines, penalties, forfeits, and settlements arising from judicial processes. Past patterns can help establish likely month-to-month inflows of non-tax revenues. These should be adjusted for any economic and regulatory changes and emerging trends.

Royalties and dividends related to mineral sources are impacted more than other non-tax revenues by the global economic environment. In an uncertain economic situation, and due to the highly elastic nature of these revenues, they are somewhat unpredictable. The best projection of these flows can be made by the industry itself, both on a short-term and long-term basis. Cash planners in the Treasury should, therefore, set up mechanisms for frequent exchange of information with the responsible spending units to be able to anticipate in-year variations in mineral revenues.

### *Summary*

The quality of in-year cash plans for revenues is dependent on the quality of the annual budget appropriations. While preparing cash flow plans the following aspects should be considered:

- Short-term forecasting of revenue collections within a financial year is a basic input into treasury cash management. This is required so that accurate financing decisions can be taken to ensure cash is available for the planned budget disbursement over the financial year.

- Explicit rules and regulations for revenue forecasting underpinned by well-defined responsibilities are essential for ensuring robust in-year cash flow plans. Past trends in conjunction with current revenue collection data can help establish likely month-to-month inflows of tax revenue.
- Systemic biases in revenue flows should be analyzed and considered while formulating cash flow plans.
- A high level coordinating body should be made responsible for reviewing and approving in-year revenue projections.
- A disaggregated projection of tax revenues by major tax categories improves the quality of in-year projections of revenue inflows.
- There is a need to draw a distinction,<sup>9</sup> for forecasting purposes, between revenues assessed and collected through voluntary compliance versus those collected through administrative actions.
- Monitoring certain aspects of the macro fiscal budget assumptions and reviewing in-year cash flows accordingly, particularly revenues that are dependent on internationally traded commodities, will improve the quality of the in-year cash projections.

## Planning for Expenditure Flows

As mentioned in Chapter 1 the objective of cash flow planning is to determine how much cash is available, when will it become available and for how long will it be available. The in-year planning of revenue flows, described in the previous section, helps in determining how much cash is available and when it will become available. In-year planning for expenditure flows determines how long the cash will be available before it is required to meet government obligations in the most efficient way. Planning of expenditure flows is needed to determine the financing implications of in-year differences between cash outflows and cash inflows.

The accuracy of cash flow projections is to some extent dependent on the nature of the cash spending and the period of the forecast. A U.K. NAO report on cash management<sup>10</sup> made a series of observations on the variability of cash flow projections of different agencies in the government of UK (Box 3.2).

### Box 3.2 UK NAO report on cash management

In 2007-08, for example, the Department for Culture, Media and Sport had relatively even month to month expenditure, and grants to its sponsored bodies represented 98 per cent of its expenditure, which may partly explain why it achieved the highest forecast accuracy. By contrast, the Department for Environment, Food and Rural Affairs' expenditure fluctuated considerably, and only 25 per cent of its expenditure was on grants, with the rest being a combination of administrative expenditure as well as bill payments and receipts on the part of its Executive Agencies. This complexity may explain why it was one of the least accurate forecasters.

Another factor that seems to influence the accuracy of forecasting is the month of the year.

In particular, departments consistently produce less accurate forecasts for March (which is the last month of the fiscal year of the United Kingdom). Between 2005-06 and 2008-09

March was the only month in which the forecast error was always greater than £1 billion. This might be partly due to expenditure being highest in March. Between 2005-06 and 2008-09 the 14 departments in our survey collectively spent between £5 billion and £8 billion, or 17 per cent and 24 per cent, respectively, above the monthly average in March.

Some issues to be considered while projecting in-year cash flows for expenditures include:

- When personnel management and payroll is performed by separate agencies it is important to validate forward cash plans by ensuring that there is minimum delay between a personnel change and corresponding payroll change.
- The scheduling and costing of capital projects should be periodically reviewed by spending units while formulating in-year cash flow updates.

### 3.2.3. Cash Management and Commitments

Commitment management gives the Treasury the ability to schedule cash outflows to match government obligations. Many countries are now adopting commitment management processes within a cash based accounting regime. Commitment management procedures require the spending units to register expenditure contracts or purchase orders with the Treasury. The registration obligates the budget allocations available against the appropriate budgetary classification and ensures that the obligated amount is not available for other purchases. The registration also provides the ability to record the underlying disbursement schedules for contractual payments. Whenever the Treasury receives payment requests, these are checked against the amounts earlier obligated for the budget classification before a payment order is issued. The commitment process facilitates the planning and

monitoring of cash flows resulting from spending commitments made during the contracting stage in the expenditure cycle. This helps the Treasury to manage cash more efficiently as it provides additional information on how long the cash will remain in the TSA before it is required to meet government obligations.

The Box below shows the relationship between different types of commitments and the timing of cash required to meet the liabilities arising from the commitments:

**Box 3.3 Commitment and Cash Requirements for Payments<sup>11</sup>**

Salaries, wages, and allowances. The need to pay salaries, wages, and allowances arises from an implicit or formal agreement between the employer and an employee, according to conditions laid down in various acts and regulations. At any point in time, the ministry of finance (MoF) (and each line ministry accountant) should know, with a fair degree of accuracy, what the salary bill will be for the foreseeable future. Because of the stability, predictability, and regularity of these types of payment, the cash flow is often deemed to occur monthly at the same time as the line ministry's monthly commitment (e.g., from a payroll management system).

Other recurrent costs. This category contains a variety of items, some items where expenditures might be expected to occur simultaneously with commitment, and others where actual expenditures take place after the placing of a requisition or order. However, likely expenditures on most of the items are predictable, including post and telephone services, water, electricity and sanitation charges, printing and stationery, etc. The key is to examine each line item and determine the amount and its pattern of payment.

Grants/transfers. Commitments to pay grants and transfers will be known based on the program developed at the beginning of the year, influenced by law, regulation, and/or policy.

Financing. The profile of debt services and loan receipts and repayments should be readily identifiable from the debt database or corresponding loan agreements.

Capital projects. This category is probably the most difficult to forecast in terms of both commitments and the associated cash payments. However, most projects are the result of contracts placed, so payment details should (broadly) be known when the contract is signed. The commitment can be for a long period of time (probably more than one year) and expenditure flows tend to be "lumpy." Delays can occur in construction and delivery, so updated forecasts on the progress of work and requirement of funds are needed regularly for these projects.

Updates to in-year cash flow plans should incorporate delays in the finalization of contracts for the purchase of goods or services. Registering and monitoring commitments, either at the time of contracting or at the time of issuing purchase orders, provides the basis for updating cash flows to reflect changes in disbursement profiles or delivery dates. Most countries use IFMIS, which provides facilities for blocking budgets at the commitment stage and recording the schedule of cash

outflows related to the commitments. In some countries, which control in-year cash ceilings, commitments can be registered in IFMIS only if the total amount of the commitments is within the cash ceiling for the period, even if the underlying payment schedule of the commitment extends over several cash ceiling cycles.

In such cases, the cash flow forecasts should incorporate the contractual cash outflows for the entire year and not just for the cash ceiling cycle.

Financial managers in spending units should review commitment information while updating cash flow projections. Spending units are authorized to enter into commitments for making expenditures. Financial procedures prescribed for spending units should require them to manage commitments by updating the information as new developments occur. Wherever spending units use IFMIS, end-of-period closing routines of the system provide for reports on “hanging” commitments—commitments which remain unused even after the dates registered for delivery of the contracted goods or service. Financial managers should use these exception reports to review the reasons for delays in contractual deliveries and to reschedule cash flows. If the contractual deliveries are no longer feasible within the financial year, then timely action should be taken to reallocate the budget through appropriate virement.

### *Summary*

Commitment management can provide the Treasury with better information to schedule cash outflows provided that the information is kept up to date. Some of the common practices related to commitment management are:

- Cash flows related to personnel emoluments are deemed to occur monthly on the dates prescribed in payroll regulations.
- In the case of other recurrent costs, depending on the nature of the expense, cash flows might be expected to occur simultaneously with commitment, or at a specified time after the placing of a requisition or order.
- Commitments to pay grants and transfers will be known based on the program developed at the beginning of the year, influenced by law, regulation, and/or policy.
- Cash flows for capital projects should be specified when the contract is signed but need to be regularly examined.
- IFMIS systems should be configured to implement commitment management procedures.



- Financial managers in spending units should use exception reports on outstanding commitments to update cash plans and, if appropriate, to reallocate budgets.

### 3.2.4. Cash Management and Invoicing

Cash collections can be improved and revenue inflows smoothened over the year with more frequent and timely billings. For example, semi-annual billing for water user fees can be accelerated to quarterly, to provide a quicker and steadier stream of income.

At the payment stage of the budget execution cycle, cash management should take into account some widely used commercial practices for the efficient timing of disbursements. Some of these are:

- Take full advantage of creditor payment terms. If a payment is due in 30 days, don't pay it in 15 days.
- Use electronic funds transfer to make payments on the last day they are due.
- Carefully consider vendors' offers of discounts for earlier payments. These can amount to expensive loans to suppliers, or they may provide a chance to reduce overall costs.

The Treasury's centralized payment systems supported by IFMIS enable it to time government cash outflows at the disbursement stage of the payment cycle. Payable modules of IFMIS are usually configured to validate payments with reference to the original purchase order, the goods or services actually delivered, and the amount of actual payment made. In the absence of IFMIS systems, this validation is done manually by requiring storekeepers and contracting officers to sign off on invoices before they are processed for payment. During the course of this validation, it should be possible to identify any payment arrears as long as the invoices received from suppliers are registered. However, in an environment of cash constraints it is not unusual for finance officers in spending units to delay the processing of invoices pertaining to non-prioritized expenditures and expenditures not committed in the system. An example is that of expenditures pertaining to the usage of utilities such as electricity and water. Such delays generate payment arrears and add to the domestic liabilities of the government. Cash flow projections should explicitly indicate such arrears with proposals to liquidate the outstanding payables.

### *Summary*

Billing and invoicing procedures should be improved so as to ensure that government cash balances are predictable and returns on such balances are optimized. Some of the issues to be considered are:

- Cash collections can be improved and revenue inflows smoothened over the year with more frequent and timely billings.
- Payments should be timed to take full advantage of creditor payment terms.
- Centralized treasury payment procedures should facilitate electronic payments to beneficiaries on the last day that payment terms permit.
- Cash flow projections should explicitly indicate any payment arrears with proposals to liquidate the outstanding payables.

### **3.2.5. Arrangements for Revenue Collection and Payment**

This section discusses the way in which revenues are collected and payments are made through the banking system. It is closely related to the discussion in Chapter 2 of the structure of the government banking arrangements.

#### **Banking Arrangements for Revenue Collection**

An important goal of good cash management is to minimize the time required to process revenue deposits and payments between spending units and between the government and the banking system. Revenue concentration mechanisms should ensure that funds deposited as government revenues are remitted into the TSA immediately and any residual inconsistencies related to the classification of the revenue and identity of the revenue depositor resolved subsequently through a reconciliation process between the Treasury, the collecting bank and the revenue billing agency. In countries where internet facilities and commercial banking presence in the regions are limited, treasury branches play an important role in the transmittal of revenues deposited in cash or by check. Usually the remittance from local treasury branches to the TSA is electronic and made periodically or when the collections reach a prescribed threshold.

In some countries, central banks have operational offices in the regions. Commercial banks with their widespread network of branches operating on CORE banking

systems are increasingly being used as collection points for government revenues. The OECD recommends<sup>12</sup> that when revenues are collected by commercial banks, arrangements must be defined to foster competition and ensure the prompt transfer of collected revenues to government accounts. They suggest that a system of bank remuneration through float, which consists of authorizing the banks to keep the revenues collected for a few days, is inefficient. This is reiterated in a 1984 report of the Auditor General of Canada, which indicates that “financial institutions take an average of 2.3 calendar days to deliver government revenues collected through them to the government account in the Bank of Canada. However, when questioned by them, Canadian banks stated that they can give same day service. Based on this information, the report asked the government to take advantage of this same day service offered to other financial institution customers. It was estimated that the failure to receive same day service cost the government about \$18 million in lost interest each year.” This example from Canada indicates the gains that could be achieved by accelerating cash inflows into the TSA even by a single day.

One of the challenges in using commercial bank branches as collection points is the need to ensure the quality of revenue data entered at these points. With the increased sophistication of IT capacity, networks and application software, it is quite common for banks to host additional “front-end” services for revenue transactions such as online transaction validation and automated ledger posting in the depositor’s account with the billing agency. The collecting banks are often provided with read-only access to the data bases of the billing agencies so as to facilitate real time confirmation of the revenue depositor’s ledger identification number and tax classification. The on-line confirmation of the revenue depositor’s identity and revenue classification obviates the need for post-transaction reconciliation of data. In some countries, the commercial banks provide a straight- through facility for posting validated revenue transactions into the tax payer’s ledger account maintained by the tax authorities.

While availing of such additional services from commercial banks, it becomes necessary to clearly define the roles and responsibilities of the billing agency and those of the bank through a Performance Level Agreement (PLA). The PLA should clearly specify the fees to be paid to the banks, the access to be provided to the billing data, the services to be rendered, and the periodicity of the remittance of revenue collections into the government TSA. Stringent rules to ensure prompt transfers should be established. Moreover, bank remuneration through fees is more transparent and promotes competitive bidding.

Banking Arrangements for Payments

Centralized payment systems managed by the Treasury help reduce transaction costs and promote efficient cash management. As mentioned earlier in this chapter, the implementation of a TSA enables the Treasury to make direct electronic payments to government suppliers as close to due dates as possible. Centralized payment systems also provide the opportunity to make a single payment to a supplier providing common services to a number of spending units. An example is payments made to a utility company providing electricity or water to a number of spending units in the same city. A number of payment requests emanating from the spending units could be consolidated by the Treasury into one payment order for transferring funds to the bank account of the utility company. There are a number of possible options for configuring electronic payments through the banking system. Some of them are discussed in the paragraphs below.

Electronic banking facilities provide for direct electronic transfers through Real Time Gross Settlement System or through Electronic Fund Transfers. The main difference between the two systems is shown in the table below:

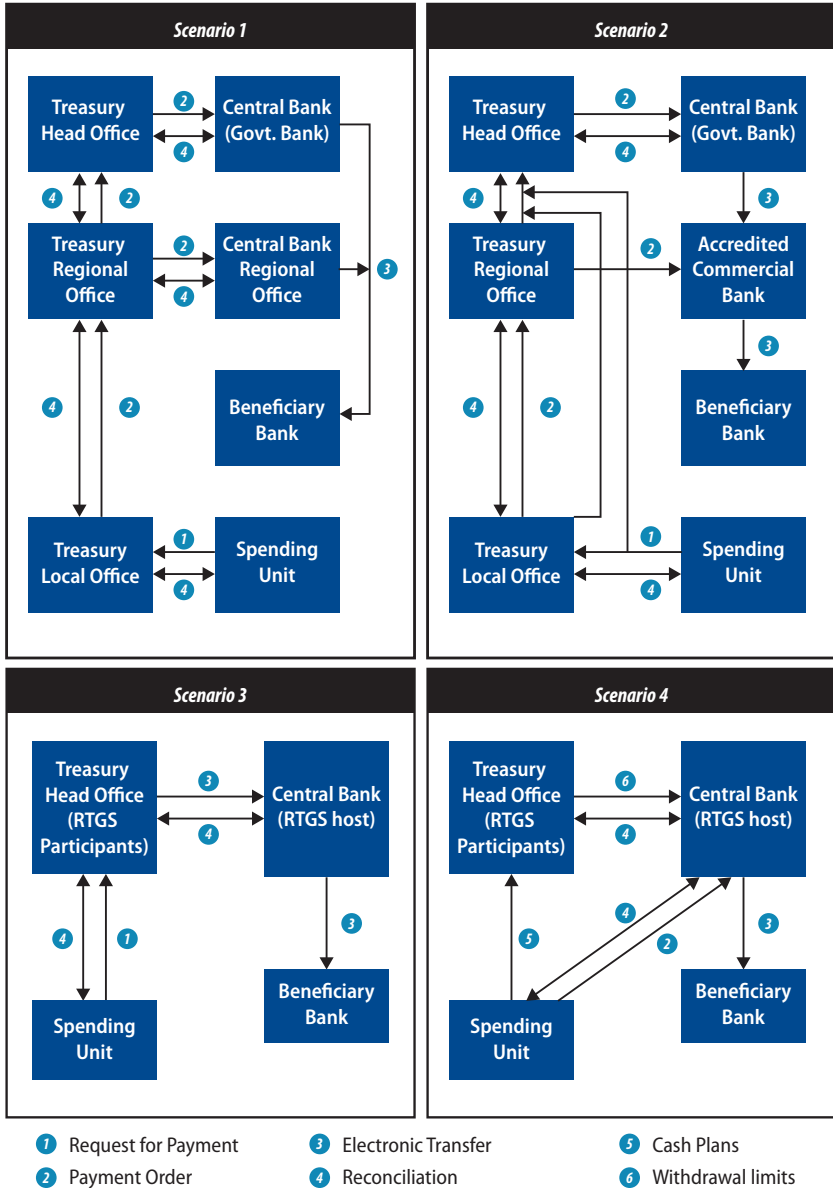
Table 3.1 Difference between RTGS and EFT

	RTGS	EFT
Definition	Transactions are processed and settled in real time and on gross level	Transactions are processed and settled in batches, typically at the end of the day.
Money Transfer System	Swifter	Comparatively slow
Transactions	Focus on high value transactions	Usually any transaction
Inter-bank Payment	Participating banks pay only the net difference of debit and credit	Each transaction is generally settled individually
Amount	Minimum is fixed at a certain amount; No maximum limit	No minimum or maximum stipulation of amount.

With the advent of CORE banking systems most transactions are now settled between banks through the RTGS and recorded in individual bank accounts of each branch bank in the centralized general ledger maintained by the headquarter of that branch bank. In other words, transactions are now increasingly being processed seamlessly at the gross and the individual level without delay irrespective of the value of the transaction.

Typically, payments through the TSA are structured in four basic ways, as depicted in the four scenarios below:

**Figure 3.2 Banking Arrangements for Payments**



**Scenario 1.** The TSA is held in the central bank and managed by the central bank. Treasury payment services are managed through a central Treasury Head Office and sub-treasury offices servicing regional and local governments. Payment orders are issued by the Treasury offices at each level of government to the corresponding levels of central bank branches. Wherever electronic transfer facilities are not available, the Treasury branches issue checks, which are presented for payment to the respective central bank branches by the beneficiaries. The payments made by the branches of the central bank are reconciled with the payment orders (or checks) issued by the respective treasury branches. The role of regional treasuries varies depending on the extent of fiscal decentralization prevailing in the country. In some countries where the fiscal operation is centralized, regional treasuries provide payment services to the regional administrative units of central government ministries. In some countries with a partly decentralized fiscal environment, sub-national governments continue to be serviced by regional treasury branches with the difference that the regional treasuries execute payments on behalf of the sub-national governments. In countries with a fully decentralized fiscal environment, regional governments often have independent treasury systems and TSAs.

**Scenario 2.** Again the TSA is held by the central bank and managed by the central bank. However, the central bank does not have regional offices, and so the retail banking services for treasury payments are provided through accredited commercial banks. There are variations of this arrangement depending on the IT environment obtaining in the accredited commercial banks. As mentioned in Chapter 2, most banks have now standardized their IT environment to the CORE banking environment. The Treasury operational environment has also moved from a stand-alone environment to a distributed data processing environment. In countries where both the Treasury and the banking systems have been modernized, it is convenient for the sub-national treasury branches to route their payment orders electronically to the central Treasury office for onward transmission to the central bank or onward transmission to the head offices of commercial banks. Another variation is related to the service level agreements with commercial banks for availing of banking services. In many countries, the Treasury transfers funds daily from the TSA to government accounts held in commercial banks for making payments. Residual balances are swept back into the TSA at the end of each day. In some countries, the commercial banks pay out of their own resources and claim reimbursement from the TSA (central bank) at the end of the day.

**Scenario 3.** This scenario relates to countries where the Treasury is a direct participant in the RTGS clearing facility. In such cases, the central bank's role is limited to hosting the TSA rather than managing it. The Treasury draws down from the TSA directly and makes electronic transfers to the commercial bank accounts of beneficiaries through the RTGS.

**Scenario 4.** In the fourth scenario, the “hosting” arrangements with the central bank may extend to permitting the Treasury to maintain expenditure ceilings in sub-accounts of the TSA. In such cases, line ministries are given direct access to draw down from their sub-accounts in the TSA and make payments directly to their beneficiaries. This arrangement requires a robust cash management arrangement within the Treasury so that the ceilings set in TSA sub-accounts are updated to synchronize with the in-year cash flow plans.

### *Summary*

By speeding remittance of government revenues into the TSA through appropriate revenue concentration mechanisms, the government ensures the timely availability of cash to meet its obligations and can use any surplus cash to maximize returns through appropriate investments. The following issues should be considered while making arrangements for revenue collection and remittance:

- Funds deposited as government revenues should be remitted into the TSA immediately and any residual data inconsistencies resolved subsequently.
- Selection of commercial banks for providing revenue collection and transmission services should be done through an open tender process to foster competition.
- The quality of revenue data entered at source by collecting banks should be assured by ex-ante validation.
- Performance Level Agreements for banking services should clearly specify the fees to be paid to the banks, the services to be rendered, and the nature of access to the revenue authority's billing data.
- Centralized payment systems managed by the Treasury should be configured so as to reduce transaction costs and promote efficient cash management.

### 3.3. CASH PLANNING AND BUDGET EXECUTION IN INDONESIA

#### 3.3.1. Cash Planning and the Annual Budget in Indonesia:

In Indonesia, the prescribed budget process provides sufficient time for budget discussions and approval for the budget to be appropriated well before the commencement of the financial year. The main stages in the annual budget process are shown in the box below.

##### **Box 3.4 Annual Budgeting Process in Indonesia**

The budget process starts in February by establishing the resources available for the next financial year. Once the Fiscal Policy Office of the Ministry of Finance has established the maximum level of expenditure consistent with the government's deficit target, the Directorate-General Budget (DGB) distributes the available resources into those required for funding on-going activities (non-discretionary) and those available for discretionary programs. This distinction focuses the budget discussion with the parliament on evaluating the performance of the new initiatives rather than on the on-going recurrent activities.

- For the non-discretionary on-going activities, the DGB uses the current year's budget and applies pre-determined norms (e.g. standard cost) and indexes to arrive at a figure for the next year's budget. This process also highlights the rigid nature of the budget.
- Once the Ministry of Finance has established the ceiling for resources available for new (discretionary) programs, the State Planning Agency (NDPA/BAPPENAS) takes the lead, in co-operation with the Ministry of Finance, for establishing priorities for programs. For the central spending units, the exercise is essentially top-down, although spending ministries do of course give input through preliminary contact with NDPA. NDPA also conducts a series of national fora with regional governments, de-concentrated units of government ministries and various civil society organizations before finalizing the government-wide work plan.
- This process culminates in a March cabinet meeting to discuss the draft annual government-wide work plan (RKP) and to approve its broad outlines. Following the March meeting, BAPPENAS and the Ministry of Finance issue a joint budget circular to spending ministries. Based on the development priority and the "indicative budget ceilings", each ministry prepares its work plan, broken down by programs and expenditure types.
- The final government-wide work plan is issued by the President following a cabinet meeting in May. By law, it must be issued no later than mid-May to be submitted to the Parliament together with fiscal policy and macroeconomic framework.
- From mid-May to mid-June discussions are held by the Ministry of Finance with the Parliament Budget Committee on fiscal policy and overall ceilings. At the same time, discussions are held by spending ministries and agencies with their respective Parliament sectoral commissions on detailed allocations.
- The government submits the budget proposal to Parliament in Mid-August
- From mid-August to late October, the Government, the Parliament Budget Committee and the sectoral commissions review the budget proposal.
- The Parliament approves the annual budget law for the next fiscal year by 31st October.



The budget formulation process is quite well structured and provides for the approval of the budget by Parliament as early as two months before the start of the fiscal year. This gives enough time for the spending ministries to prepare the detailed budget allotment documents for each of their budget users.<sup>13</sup> This is the last stage of the budget formulation process and is quite unique to Indonesia.

However, there are still impediments in the budget execution process that delay cash disbursement.

One impediment is that the budget is approved by Parliament at a very detailed level, limiting the flexibility to move budget allocations. Following the final approval of the budget by Parliament, the Directorate-General Budget (DGB) prepares disbursement warrants that are issued to more than 24,000 budget users. Each warrant is very detailed, providing breakdowns by organization, function, sub-function, activities, and two levels of economic classification of expenditure. Each breakdown must be respected, and reallocations (virements) are very difficult, even within spending units. The use of carry-overs is possible for certain transactions, but in practice is not done to any significant extent.

A further impediment is that Parliament's review sometimes goes beyond the end of October deadline, even if the budget has been formally approved. Individual sectoral commissions in Parliament can place a "hold"<sup>14</sup> on disbursements from the approved budget until their concerns<sup>15</sup> have been addressed by the spending ministries. These "holds" could be at the level of a very detailed line-item of the budget or even at aggregate levels. They cannot be removed unless the discussions (negotiations) between each ministry and its sectoral commission in Parliament have been completed. As a result of this practice, budgets are sometimes not executed until several months into the next fiscal year. For example, at the beginning of FY 2013 about 41 per cent of line ministries' total budget was on "hold" and could not be executed from the start of the fiscal year. This is one of the reasons for the delays in capital expenditure, with only 28% of the ceiling being disbursed by the end of July 2013. According to an analysis made by the MOF, IDR 32 trillion of line ministries' budgets (5 per cent of the total) was still on hold in July 2013.<sup>16</sup>

### 3.3.2. Planning for Revenue Flows in Indonesia

#### The Revenue Profile

Government revenues during the period 2008–2012 showed a steady increase. In this period, in nominal terms, the revenues earned by the Government rose 8.1 per cent per annum on average, i.e. from IDR 981.6 trillion in 2008 to IDR 1,338.1 trillion in 2012. The revenue consisted of (i) domestic revenues (99.7 per cent on average), and (ii) grants (0.3 per cent on average).

An assessment of Indonesia's revenue profile brings out certain characteristics relevant for in-year cash flow planning:

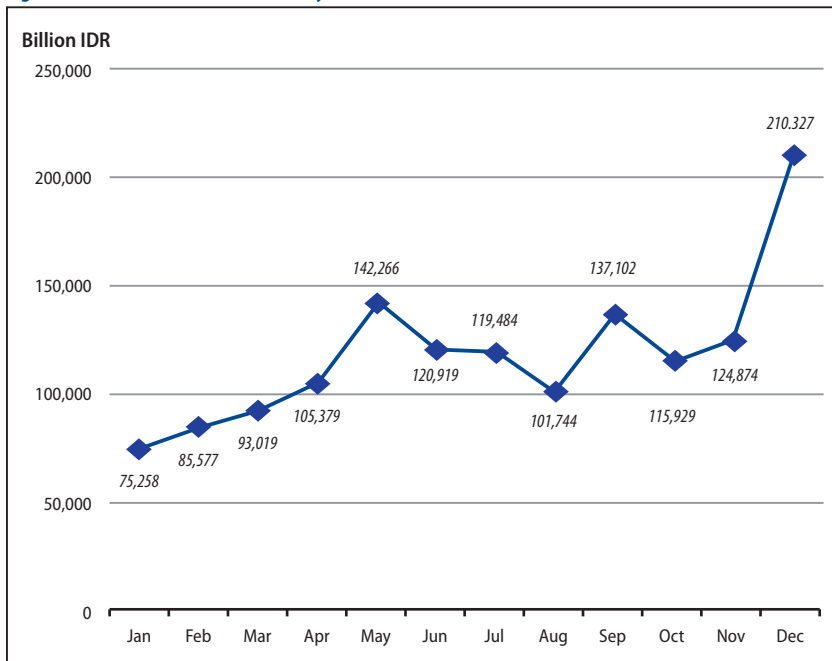
- Revenues are largely dependent on international commodity prices, notably those of tobacco, crude palm oil, and oil and natural gas. The risk arising from volatility in international commodity prices that would create significant deviation between the cash plan and realization needs to be monitored closely during in-year cash management.
- MOF agrees with collecting ministries on the amount of non-tax revenue that is permitted for their own use. This procedure provides some degree of stability in the in-year revenue flows of non-tax revenues related to fees and charges for services rendered, since the ability to retain part of non-tax revenue is considered as an incentive to motivate the line ministries to collect more non-tax revenue.
- Regulations at present allow PSAs to keep their revenues in commercial bank accounts and use them to finance their own expenditures. PSA revenues are therefore not available for purposes of central government cash management.
- Cash inflow from grants is now insignificant, reducing the risks related to the timing of cash inflows from donor funds.

#### Revenue Flow Planning

Revenue flows in Indonesia are seasonal, since there are significant fluctuations in revenue flows during the year, with the usual peaks in April (the deadline for closing the corporate tax payment obligations four months after the end of the fiscal year) and December (the combination of an increase in economic transactions and

the payment of bonuses/dividends/rewards by corporates to other parties at the end of the fiscal year). Revenue forecasts are also heavily dependent on volatile international oil and gas prices. Roughly one quarter of state revenue is derived from oil and gas through tax (VAT and income) and non-tax sources (production sharing and royalties). As is the case in many countries rich in natural resources, actual revenue outturns are highly vulnerable to volatile international commodity prices.

**Figure 3.3 Revenue Flows in January - December 2013**



Planning revenue flows for the next fiscal year typically starts in February and is the responsibility of the Ministry of Finance, namely the Fiscal Policy Office (FPO). In implementing its responsibility, the FPO is required to work together with various Directorate Generals within the MOF.<sup>17</sup> The roles and functions of those Directorate Generals and the FPO during the planning of revenues are shown in the box below:

**Box 3.5 Planning of Revenues in Indonesia****(i) Planning Tax Revenues:**

- FPO prepares and recommends the estimated revenue target as the basis for formulating the draft annual budget;
- DG Tax and DG Customs and Excise provide inputs and their assessment of the feasibility of achieving the projected tax and customs/excise revenue forecasts, to FPO;
- Once the estimated annual revenue target is agreed, these targets are conveyed to DG Budget who uses the information for preparing the Financial Note and the Budget Bill.
- During the year, DG Tax and DG Customs and Excise set the monthly revenue target by regions and types of revenues.
- FPO also monitors target realization.

**(ii) Planning Non Tax State Revenues (PNBP):**

- FPO prepares and formulates the policies on non-tax revenue (PNBP), based on data and information from the Directorate of Non Tax State Revenues of DG Budget, and policy recommendations on Non Tax State Revenues from the line ministries - such as the Ministry for Energy and Mineral Resources (for oil and gas) and the Ministry for SOEs for SOE revenues
- Directorate of Non Tax State Revenues then recommends the estimated revenue target;
- DG Budget also monitors Non Tax State Revenues outcomes.

The budget documentation makes explicit the key economic assumptions and provides sensitivity analysis for some of them, such as the effects of different oil prices. The committee proposes a range – albeit a narrow one – rather than fixed values for each macro-fiscal variable: economic growth, foreign exchange, interest rate, inflation, oil price and crude oil production.

Fixing the exact values of the macro-fiscal variables within the range proposed by the FPO is subject to negotiation between the government and Parliament. This approach promotes ownership of the forecasts through consensus. The downside is the fact that forecasts of inflows, such as the tax revenue targets put in the annual budget law, are largely based on a political consensus rather than on the basis of transparent underlying macroeconomic models, and tend to be overestimated. This disconnection between the underlying macro-fiscal assumptions and the targets included in the approved budget makes it difficult to explain the deviations that may arise between the budget and realization.

The table below shows the deviation between the revenue target and actual outturns for the tax managed by DG Tax:

**Table 3.2 The Deviation between the Target and Actual Outturns for the Tax Managed by DG Tax**

In trillion IDR	revenue target (State Budget)	Realization	Deviation
FY 2009	647.85	544.53	-16% below target
FY 2010	658.24	628.22	-4.5% below target
FY 2011	764.48	742.75	-2.8% below target
FY 2012	914.20	835.83	-8.6% below target
FY 2013 (unaudited)	921.99	832.52	-9.6% below target

Over-estimation of revenues is not desirable as it can lead to a budget which is not fully funded and thus not credible. However, in Indonesia this deviation has been offset by underspends on expenditures. It should also be noted that the main reason for the large deviation (lower realization than budgeted revenue) in revenue outturn in 2009 was the introduction of a fiscal stimulus package during that year to combat the impact of the global financial crisis. Indonesia's stimulus package was unusual at that time in terms of the large share allocated to tax cuts—around IDR 61 trillion was allocated to income and corporate tax cuts.

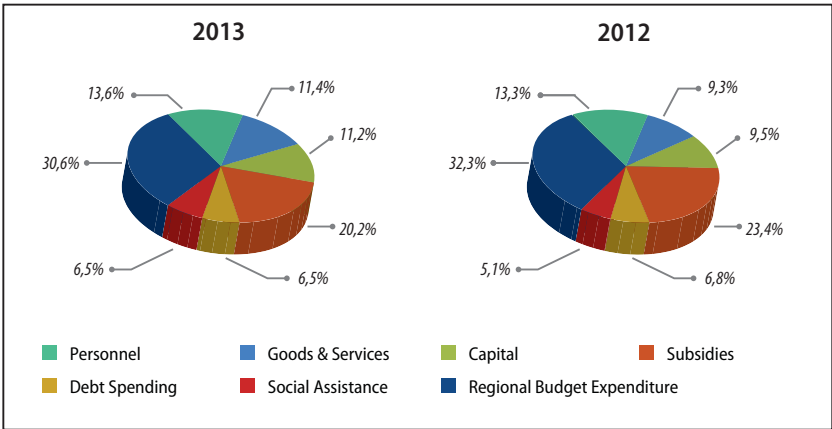
Non-availability of accurate data on non-tax revenue (NTR) realization is an impediment to in-year cash flow projections. A WB study indicates that, given the absence of a comprehensive license registry and lack of data on non-compliance with royalty payments, DGB does not have accurate data to evaluate NTR forecasts, and to provide oversight of NTR realization. This hampers MOF's ability to develop revenue projections and assess fiscal risks. Significant focus and energy of the NTR directorate of DG Budget is spent on recording and reconciling NTR payments with DG Treasury and sub-national governments to ensure correct revenue sharing. Currently, no systematic use is made of other coal producer data collected by the government (customs, VAT, tax, production data) to evaluate NTR payment calculations by companies.

3.3.3. Planning for Expenditure Flows in Indonesia

The Expenditure Profile in Indonesia

It can be seen from the figure below that around one-third of the government budget in Indonesia was spent by the central government’s line ministries for their own operations (personnel, goods and services, and capital expenditures). The remaining two-thirds were spent on regional budget (transfer) expenditures, subsidies, social assistance, and debt repayments.

Figure 3.4 Profile of Government Expenditure in Indonesia



The methodology for estimating cash outflows by different categories of economic classification is summarized below:

Compensation to Employees (Personnel Expenditures)

Estimates of cash outflows pertaining to compensation to employees are adjusted during the year for inflation. The projections provide for the practice of disbursing one month additional salary every year and for the increase in personnel expenditures resulting from the on-going bureaucratic reform program.

The management of salary administration for government employees was transferred<sup>18</sup> to the line ministries to increase their accountability and responsibility in managing their own salary expenses. The personnel costs are, therefore, now computed, verified and recorded against the budget allocation

of the line ministries. With the regular reconciliation of personnel records and controls in the automated payroll system<sup>19</sup> for central government, it is possible to more systematically identify government employees, eliminate ghost workers, and thereby improve the accuracy of payroll data.

Each spending unit is required to appoint<sup>20</sup> a Salary Expenditure Treasurer<sup>21</sup> who is responsible for maintaining employee data, issuing employment letters, and preparing the payroll (gross salary amount and deductions).

DG Treasury has also distributed an IT application<sup>22</sup> to spending units to enable them to manage their employee expenditure data. This application facilitates the preparation of cash flow forecasts pertaining to compensation to employees.

### *Goods and Services Expenditures*

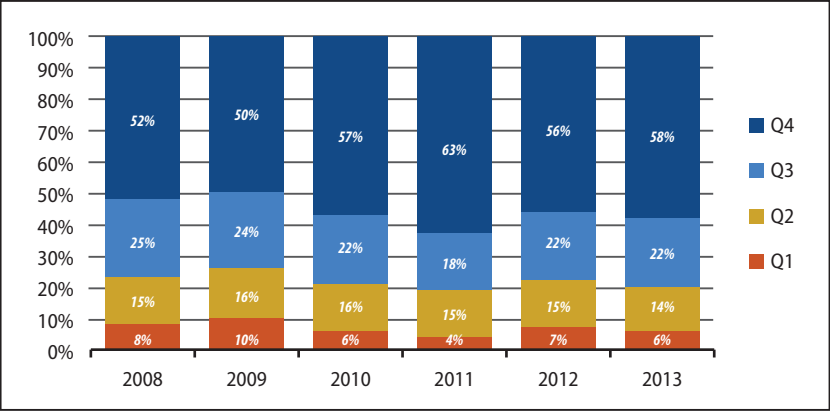
The costs of operating goods (e.g. office operation costs; office inventory; food; uniforms; and honoraria) are more predictable and easier to estimate and standardize. The non-operating goods budget (e.g., materials, utilities, consultant services and maintenance costs) is estimated for each spending unit on a case to case basis.

The main challenge in estimating cash outflows on goods and services is the introduction of new policies that affect the budget allocation for goods and services such as across-the-board cuts applied during the fiscal year. The experience in FY 2013 has shown that implementation of the Presidential Decree<sup>23</sup> on budget efficiency delayed budget execution, since each of the more than 24,000 spending units were required to adjust their budget allotments to accommodate this general budget cut, mainly affecting the budget allocation for goods and services. These potentially adverse impacts of in-year changes to budget allocations, on budget execution, should be anticipated by allowing enough time during the budget execution cycle for making adjustments for on-going commitments.

### *Capital Expenditures*

The slow pace of absorption of the capital budget in the last 5 years highlights on-going challenges with budget execution. Less than 90 per cent of the revised capital expenditure budget was disbursed and more than 50 per cent of total disbursements occurred in the last quarter (see figure below).

Figure 3.5 Disbursement of Capital Expenditure Budget by Quarter



Low absorptive capacity coupled with skewed spending patterns towards the end of the fiscal year on the capital expenditure budget raise particular concerns, as these could hinder the achievement of development targets and affect the quality of the infrastructure being built. This slow and low disbursement performance has been consistent over recent years and needs to be taken into account in cash planning so that cash balances are not accumulated and left idle.

A team has been established by the President to monitor budget disbursements for capital projects<sup>24</sup> and assigned to evaluate the spending performance of the line ministries' capital budget. The team's work will include monitoring the spending performance not only of the central government ministries but also the sub-national governments. The team is also expected to coordinate and harmonize policies and regulations that affect the execution of the budget. The Government has also improved its policy on procurement by issuing a new Presidential Regulation<sup>25</sup> to accelerate the procurement process for the infrastructure development projects. For cash management purposes, attention needs to be given to whether these efforts cause a change in the patterns of capital expenditure during the year.

Subsidies

The projection of cash outflows for subsidies is determined on the basis of the formula agreed between the Government and Parliament. It is the responsibility of the Government to pay and/or transfer the money to the beneficiaries on a timely basis in accordance with the established parameters. The main challenge with estimating cash outflows on subsidies is the substantial deviation between



the budget and realization with regard to the fuel subsidy allocation. This mainly arises due to unrealistic estimations of fuel consumption. Consequently, for the last few years the budget outcome on subsidies is always higher than the budget. This is reflected in the table below:

**Table 3.3 Central Government Expenditure Budget and Subsidy Realization (in Billion IDR)**

Year	Total Disbursement (excluding Transfer)	Revised Budget	% overall disbursement to budget	Subsidy expenditure Excess of the budget
2011	878,300	908,243	97%	124%
2012	1,001,300	1,069,534	94%	141%
2013	1,126,000	1,197,000	94%	102%

Given the historically unreliable forecast of the fuel subsidy in the budget, monitoring this expenditure within the year is a high priority for cash management. It will be important to identify any likely deviation from the budget at the earliest opportunity so that plans can be adjusted accordingly.

### *Social Assistance*

Provisions for expenditures related to social assistance are made through the budgets of the relevant line ministries. There is no specific formula to calculate the amount and to set the schedule of payment. It is therefore important that information is collected from the responsible line ministries on the plans for disbursement and that these are regularly updated.

### *Regional Budget (Transfer) Expenditures*

In Indonesia, transfer from the central to the regional governments is done through budget allocations made under the Balanced Fund, the Special Autonomy Fund and the Adjustment Funds scheme. The Balanced Fund consists of: (i) the Revenue Sharing Fund<sup>26</sup> as a means of reducing the fiscal imbalance between the central government and regional governments; (ii) the General Allocation Fund<sup>27</sup> as a means of reducing inter-regional disparities; and (iii) the Specific Allocation Fund<sup>28</sup> as a means of assisting poorer regions. Details of the types of transfer funds can be seen in appendix 6.

Fund transfers to the regional governments over the last few years have been around one-third of the annual state budget, with the minimum required amount to be allocated through the General Allocation Fund being at least 26% of net domestic revenue, as established in the annual budget.<sup>29</sup>

It should be noted that projecting oil prices and oil production has been especially difficult in recent times. Indonesia is generally viewed as having forecasted these variables very conservatively in the past. There are also incentives to do so. Under Indonesia's revenue-sharing arrangements with regional governments, the amount is based on the assumed oil prices contained in the budget. If the actual revenue is higher, there is no need to share the additional revenue. If the actual revenue is lower, the government cannot get any money back from the regional governments. In some years, the oil price was underestimated by over 100% compared with the real market price. More recently, the oil prices assumed in the budget have been more realistic but still underestimated by just over 10%.

### *Implications of the Expenditure Profile for Cash Management*

The above description of Indonesia's expenditure profile brings out certain characteristics relevant for in-year cash flow planning:

- The responsibility for monitoring and accounting for personnel emoluments has been transferred to the line ministries, while the Government Employee Administration Agency (GEAA) retains the responsibility for monitoring changes resulting from new appointments or in-year changes in entitlements. This division of responsibilities requires timely exchange of information between the line ministries and the GEAA to ensure timely payments to employees and to prevent in-year accumulation of arrears in personnel payments.
- Estimating cash flows for goods and services is a challenge when new policies are introduced that affect the budget allocation for goods and services, such as across-the-board cuts applied during the fiscal year.
- The slow pace of absorption of the capital budget in the last 5 years highlights on-going challenges with budget execution. The government has recently issued regulations to accelerate the procurement process for infrastructure development projects and established a team to monitor the in-year disbursement of capital budget allocations. For cash management, attention will need to be paid to whether these effect a change in the pattern of disbursement through the year.

- The main challenge with estimating cash outflows on subsidies is the huge deviation between the budget and realization with regard to the fuel subsidy allocation. This arises from the unrealistic estimation of the expenditure on fuel consumption as a result of the inability to get timely approval from Parliament for increases in fuel prices.

## **Planning of Expenditure Flows in Indonesia**

### *Institutional Arrangements*

The roles and functions of the various Directorate Generals within the MOF, the NDPA (BAPPENAS), FPO, and line ministries during the planning of expenditures are described below.

#### *Fiscal Policy Office (FPO), Ministry of Finance*

Unlike the dominant role that the FPO has in setting the economic assumptions for the preparation of state revenues for the annual budget, the FPO plays a limited role in in-year cash outflow projections.<sup>30</sup> The responsibility of FPO for state spending is limited to collecting information on central government spending policies, which it then provides as an input to DG Budget, which in turn establishes the overall budget policy and amount of central government spending in the budget.

#### *Directorate General of Budget, Ministry of Finance*

DG Budget has the important role of establishing the overall amount of central government spending in the budget and of monitoring budget realization.

After the budget is approved by Parliament, DG Budget issues budget disbursement warrants for each spending unit (more than 24,000 in number). As mentioned in section 3.3.1, each warrant is very detailed, providing breakdowns by organization, function, sub-function, activities, and two levels of economic classification of expenditure. Referring to the disbursement warrants prepared by DG Budget, the spending ministries prepare detailed proposals for budget allotments to each of their subordinate spending units, which are ratified by DGB. There is a specific page in the budget allotment document (page #3 of DIPA) that lists the initial spending unit's projections on its cash flows during the year. Budget execution can commence only after the budget allotments have been ratified by

DGB and communicated through DG Treasury to the spending units and their servicing Treasury branches. The ratification and management of DIPAs was previously with DG Treasury but, since 2012, the Finance Minister has transferred this responsibility from DG Treasury to DG Budget.<sup>31</sup> The responsibility was transferred so as to implement a “single” budget office that undertakes the full cycle of the budget process from formulation and appropriation to allotment and virement.

The State Finance Law requires that the DIPA be issued by end-December of the previous year, which is generally adhered to, and it was even issued earlier for FY

2013 (by December 20) following the integration of budget submission data with the detailed budget allotments proposed by the line ministries (as a result of the additional responsibilities given to DG Budget mentioned in the previous paragraph). With regard to in-year cash flow projections, under the new dispensation, DGB has the responsibility to coordinate with DG Treasury (DCM) and ensure that the cash flow profiles and the underlying spending unit work plans are updated regularly by the spending unit at the beginning of each month for onward communication to the servicing treasury branches (RTBs and LTBs).

#### MenPAN and RB<sup>32</sup> for Personnel Expenditures

The Government Employee Administration Agency (GEAA)<sup>33</sup> under MenPAN and RB endorses the appointment, recruitment, promotion, demotion, and retirement of staff at line ministries and all local governments, and maintains central personnel records. The role of MenPAN and RB in approving additions or reductions in the number of civil servants and in setting their emoluments is important for cash management, given that more than 50 per cent of central and local government budget allocations are used for personnel expenditures. While the monthly cash outflow for personnel expenditures is projected by the spending units, the accuracy and speediness of the updated data on personnel from the MenPAN and RB is important to improve the quality of the cash forecasting.

#### Line Ministries

The Planning and Finance Bureau (PFB)<sup>34</sup> within each spending ministry plays the main role in harmonizing the budget with the procurement plan and the cash disbursement plan. In the early stages of the budget preparation process, the PFB conducts a “learning by doing” workshop for the major subordinate

spending units,<sup>35</sup> to train their staff in preparing budget submissions and the annual cash plans. This is followed up by assistance from the administrative office or secretary Directorate General of each Echelon I during the preparation phase. The budget documents and the annual cash plans submitted by the spending units are then reviewed by a team from the PFB, the procurement services unit, the e-procurement unit, and the IT unit. One of the checks performed during the review is to ensure that the annual procurement plans are consistent with the cash disbursement plan. After the budget appropriations are approved by parliament in October, the annual cash disbursement plan is finalized by November.

During the fiscal year the PFB conducts monthly expenditure reviews with the major spending units and their respective DGs to compare the actual procurements realized with the disbursements and timeliness of the procurement packages included in the budget documentation. The review is used as the basis to update each spending unit's cash flow plan. Any deviation from the previous cash realization performance and its original plan will be analyzed to improve the quality of the next updated cash plan. The reviews become more frequent before the finalization of the supplementary budget and the preparation of the annual budget. Two months before the date for the presentation of the supplementary budget, the PFB discusses with the spending unit which procurements are unlikely to be implemented and looks for a possible reallocation of the budget to other priority areas. The PFB in the MOF uses a budget disbursement tool<sup>36</sup> to monitor revenue, expenditure, and procurement progress.

Ministries have attempted to introduce efficient management of budget disbursement as one of the criteria in the performance evaluation of government staff. However, it is not easy to attribute responsibilities for inefficiencies in managing disbursement due to the existence of impediments at different levels of government. Moreover, the performance indicators for programs included in performance budgets are not always consistent with the indicators included in the employee performance evaluation indicators.

### Cash Flow Projection Processes

Currently, there are three kinds of cash-flow projections: (i) the (bottom- up) annual 'rough' cash-flow estimation made in the annual budget allotment documents<sup>37</sup> prepared by spending units; (ii) the (top-down) monthly cash-flow prediction (Cash Planning Information Network—CPIN—report) developed by an inter-directorate committee in the MOF; and (iii) a daily cash withdrawal plan

report developed on the basis of cash requested by Treasury branches to settle the payments requested by spending units for the following day. The three types are explained in the box below.

**Box 3.6 Types of cash flow projections in Indonesia**

- **Annually:** Spending units roughly estimate their annual disbursement (on a monthly basis) and send it to DG Treasury (Directorate of Budget Execution). This estimate is basically a formality which provides rough figures as opposed to a disbursement plan which the spending units are committed to (the rough figures at the beginning of the fiscal year are normally derived from dividing the annual budget equally into twelve month periods presented in the spending unit's budget allotment document which shall then be regularly updated throughout the year).
- **Monthly:** The CPIN holds periodic discussions to prepare a monthly cash forecasting report for the Ministry of Finance. The committee uses historical data of revenues and expenditures, as well as recent updated cash plan data (daily/weekly/monthly) from the spending units and assumptions of key macroeconomic and monetary indicators.
- **Daily:** Twice a day (morning and afternoon), all local treasury branches prepare an estimation of cash needed to settle potential payments on that particular day (morning) or the next day (afternoon), based on requests for payments received from the spending units

The updated bottom-up cash outflow projections from each spending unit are regularly made for one budget year, broken down into outflows for each month, week, and day. Every month, each spending unit is required to submit the updated cash plan, in which for the immediate two months ahead, these projections are broken down by weeks, while for the immediate week ahead, the projections are broken down by days. DG Treasury utilizes three mechanisms to develop the forward cash plans:

- Analysis of historical time series spending patterns;
- Statistical models to forecast the future estimated spending in addition to the updated data obtained directly from spending units through the regular monthly submission of their cash plan; and
- Meetings of the CPIN – a regular meeting of working-level officials of the MOF and some line ministries for the purpose of maintaining oversight of spending units with large expenditure budget allocations.

Despite the promulgation of regulations and administrative measures to impose discipline on the spending units to update their cash flow projections during the

year, a review of the implementation of this regulation by the Directorate of Cash Management of DG Treasury concluded that compliance rates and the accuracy of the bottom-up forecasts were very low, with less than 50 per cent of the spending units regularly submitting their updated cash projections and many of those were of poor quality in terms of accuracy. This may be attributed to a combination of the onerous requirements of the new procedures for updating the cash plan and the lack of sanctions imposed on noncompliance.

The low quality of cash forecasts and lack of compliance in the submission of regular cash plan updates from the spending units does not lessen the importance of this bottom-up information process. The spending units as budget owners should decide, through the “bottom-up” process, when and how much cash they will actually withdraw during the year. While DG Treasury uses time series models to estimate (daily/ weekly/monthly) cash flow projections for each currency, the model might not be effective unless underpinned by timely and accurate data to factor in unexpected and irregular cash withdrawals. A further benefit of the bottom up projections is to help identify the reasons for variations in the plan.

To improve the quality of the forecasts Treasury is proposing to give more attention to the plans of the larger spending units. An analysis of the transaction volumes and amounts pertaining to spending units based on the budget allotment for FY 2013 is shown in the table below.

**Table 3.4 Distributions of Budget Allotment in 2013**

Budget Allotment Range (IDR)	Number of Spending Unit (SU)	% number of SU to total	Total budget allotment (in Billions of IDR)	% of SU budget to the total Budget allotment
< 1 billion	4,573	18.69%	2,182.57	0.13%
1-5 billion	10,092	41.24%	25,184.75	1.55%
5 - 10 billion	3,633	14.85%	25,538.38	1.57%
<b>Sub-Total</b>	<b>18,298</b>	<b>74.77%</b>	<b>52,905.70</b>	<b>3.25%</b>
10 - 15 billion	1,474	6.02%	18,000.69	1.11%
15 - 20 billion	968	3.96%	16,713.33	1.03%
20 - 30 billion	1,066	4.36%	26,071.56	1.60%
30 - 50 billion	935	3.82%	35,886.85	2.21%
<b>Sub-Total</b>	<b>4,443</b>	<b>18.16%</b>	<b>96,672.44</b>	<b>5.95%</b>

Budget Allotment Range (IDR)	Number of Spending Unit (SU)	% number of SU to total	Total budget allotment (in Billions of IDR)	% of SU budget to the total Budget allotment
50 - 100 billion	829	3.39%	57,705.26	3.55%
100 - 1 trillion	818	3.34%	205,860.91	12.66%
1 - 5 trillion	68	0.28%	134,398.71	8.27%
<b>Sub-Total</b>	<b>1,715</b>	<b>7.01%</b>	<b>397,964.89</b>	<b>24.48%</b>
5 - 10 trillion	5	0.02%	31,824.58	1.96%
10 - 100 trillion	7	0.03%	315,423.70	19.40%
>100 trillion	3	0.01%	730,823.23	44.96%
<b>Sub-Total</b>	<b>15</b>	<b>0.06%</b>	<b>1,078,071.51</b>	<b>66.32%</b>
<b>Total</b>	<b>24,471</b>	<b>100.00%</b>	<b>1,625,614.53</b>	<b>100.00%</b>

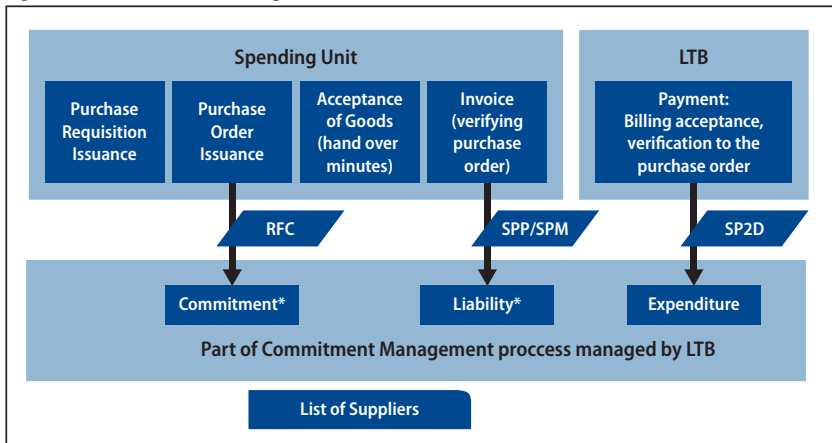
It can be seen from the table above that 75% (18,298 out of 24,471) of the spending units have a budget allotment of less than IDR 10 billion each, and yet have received only 3.25% out of the total budget allotment for the country. Based on these findings, the Directorate of Cash Management is planning to apply a simpler procedure by using the “80/20” rule, in which only the few spending units with large expenditure budget allocations will be required to submit their regular updated cash flow projections. An incentive scheme is to be considered rather than applying a sanction to defer disbursement, as that would cause delays in budget execution.

The current cash flow projection suffers from inaccuracies due to significant unexpected flows related to both revenues and expenditures. These stem from uncertainty regarding the size and timing for which funds are drawn down from the TSA sometime before final payment is due. The DG Treasury is planning to improve the accuracy of cash flow projections from the spending units/ line ministries through the incentive and sanction mechanism (see chapter 1). This should be supplemented by a more active follow-up by Treasury on major variances in line with the plan to reinforce to the spending units the importance of accurate projections.

3.3.4. Commitments in Indonesia

Once SPAN and SAKTI are implemented, commitment management will be used as the basis for controlling budget allocations and as an input for forward cash planning. The proposed data flows pertaining to the recording of commitments through SPAN are shown in the figure below:



**Figure 3.6 Commitment Management Process in Indonesia**

\* : RFC (Request for Commitment) is submitted by SU to LTB to record commitments

\*\* : Liability is based on the valid invoices according to the issuance of SPP or SPM

As can be seen from the figure above, commitments will be registered with the LTBs by the spending units at the time they issue purchase orders. The approval of the commitment by the LTB will result in the generation of a commitment approval number. This number will be used to match and approve subsequent payment requests made by the spending units for purchases related to the particular commitment. With the completion of the roll-out of SPAN and SAKTI, commitment control will be applied across all central government spending units. This will significantly enhance the timeliness and accuracy of forward cash plans.

Indonesia follows a cash based budgeting system with a strict annual authority to spend given to the budget users, which establishes a ceiling on their authority to commit expenditures. Normally, any in-year payment arrears or delays in settlement of government liabilities should be eliminated by the end of the fiscal year unless there are delays in submitting claims for payment beyond the end of a fiscal year.

As mentioned earlier in this section, there are certain procedural inefficiencies which have resulted in delays in the actual availability of budget allocations for budget execution from the commencement of the new fiscal year (e.g. line items in budget allocations being blocked due to incomplete documentation and delays due to the annual reappointment of spending unit officials). While the budget cannot be expended from the beginning of the year, the spending units continue to avail of some basic services (such as utilities, fuel consumption, etc.)

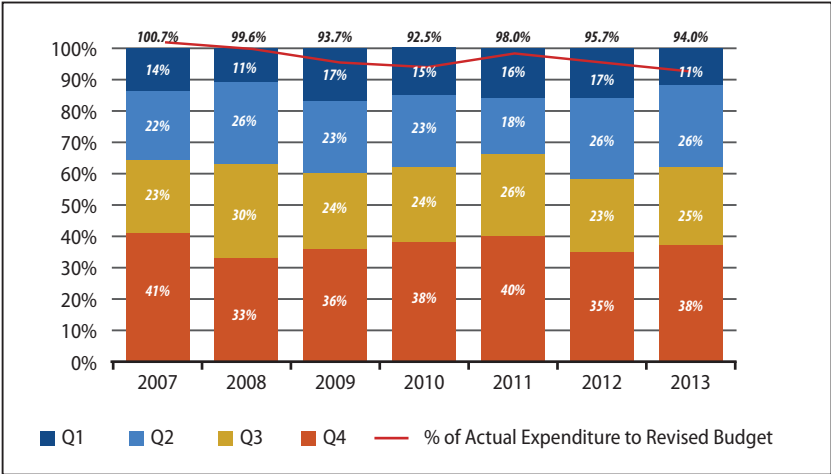
during this period. On-going capital works also continue to create liabilities for which payments cannot be made until the budget allocations are available for disbursement. These on-going activities create interim cash outflow arrears, which should be factored into the cash outflow plans for the latter part of the fiscal year. The commitment management process provides a mechanism for estimating these cash flow delays and for including them in subsequent disbursement projections.

### 3.3.5. Invoicing in Indonesia

#### Smoothing in-year Expenditure Flows

As can be seen from the figure below, for the last six years the expenditures during the last quarter of the fiscal year have been proportionately much higher than in the first quarter.

Figure 3.7 Disbursement of Total Expenditure Budget by Quarter

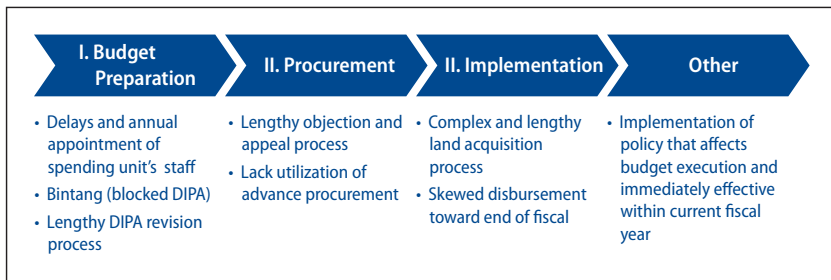


Interestingly, delays and complexities during budget allocation appear to be the most critical factors constraining smooth budget execution, more so than constraints related to procurement and payment processes. The performance of budget execution also depends on (i) the nature of the project, such as project duration (single or multi-year), source of funds, and project characteristics (operation and maintenance, or construction), and (ii) influences from both internal factors within the spending units or the respective line ministry and external factors such as other line ministries, lower-level governments, parliament, and other institutions.

There are also instances when increased transaction costs deter suppliers from presenting periodic invoices for work-in-progress upon completion of interim stages of construction or maintenance projects. They prefer to submit one consolidated invoice towards the end of the fiscal year. While these delays in payments cannot be classified as arrears due to the fact that invoices have not been presented, it is necessary to keep track of delayed invoices in order to factor the potential cash outflows into the cash flow plans.

A number of critical issues at each step of budget execution in Indonesia have been identified as causing delays in the submission of invoices and thus slowing in-year disbursement. These issues are presented in Figure 3.8.<sup>38</sup>

**Figure 3.8 Critical Issues within Each Step of Budget Execution in Indonesia**



## Optimizing the Timing of Disbursements

As discussed earlier one objective of cash management is to pursue the efficient timing of cash disbursements. There are two ideas being discussed on the timing of cash payments in Indonesia:

- Fully utilizing the possibility to settle the payment of invoices up to a maximum of thirty (30) calendar days after the invoice supported by proof of delivery is received.<sup>39</sup> This can be done provided there are no other clauses in the agreement with contractors which may attract penalties. This flexibility to settle the payment in a maximum of 30 calendar days is often confused with the current service standard for the treasury local offices (LTBs) to issue a disbursement order (SP2D) after receiving the request for payment, which is currently one (1) hour. While this standard could be retained for purposes of judging the performance of the LTB staff, it may be possible to empower the head of the LTB to prioritize payments to take advantage of the 30-day float allowed for by government regulations for making payment to suppliers.

Alternatively, the disbursement order could be released with instructions to make the cash transfer within the maximum time allowable.

- Staggering transfers to the regions. As required under the decentralization laws, the budget allocation for regional transfers is more than 30% of total state spending, confirming the effort to strengthen regional autonomy. For the purpose of optimizing the timing of disbursement, the Directorate General of Fiscal Balance (DGFB) recommended a change in the strategy for intergovernmental transfers from a regular monthly disbursement of a fixed amount to a staggered disbursement based on the actual sub-national cash surpluses accumulated by them in their bank accounts. This would postpone a large amount of fund transfers to the end of the year, but would not change the total amount to be transferred in a year since the total amount is set in the law as the right of the sub-national government.

### **3.3.6. Revenue Collection in Indonesia**

The main responsibility for managing the assessment and collection of revenues lies with DG Tax, which has around 32,000 staff deployed in 363 offices (including the Head Office, regional offices, 4 Large Tax Payer Offices, 28 Medium Tax Payer Offices and 299 Small Tax Payer Offices). This section describes the arrangements made by the Treasury for the in-year concentration and management of government revenue deposits.

At present, revenue is collected in several ways:

1. Revenue is collected by the branches of accredited collecting banks.<sup>40</sup> Individual and corporate tax payers deposit tax in a collecting bank branch or post office. The headquarters of the collecting banks consolidate daily tax collections and transfer them to the state treasury account in the BI. This includes the revenues from various taxes, customs and excises.
2. Some taxes, revenue sharing, profits and dividends are deposited directly by SOEs in the state treasury account at the BI. This includes the revenues from revenue sharing (from oil, gas and natural resources), profits and dividends from SOEs, and repayments of government loans.

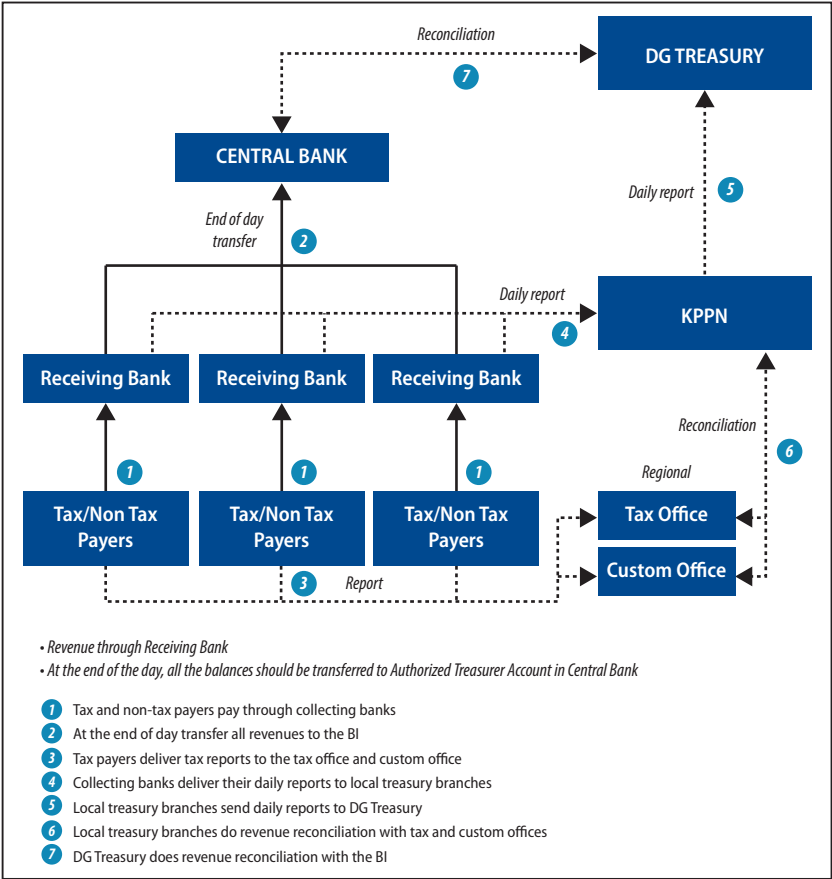
3. For cash inflows from grants/loans, the DG Treasury operates special accounts<sup>41</sup> at the BI for better coordination between international donors/lenders and the beneficiaries (ministries, state institutions or sub-national governments).

The government has enacted laws<sup>42</sup> and issued regulations prescribing time schedules for depositing advance taxes so as to smooth out revenue inflows during the year. The State Finance Law and the State Treasury Law provide for the daily sweeping of government revenues into the TSA. The agreement between the DG Treasury and revenue collecting banks provides for the payment of fees for banking services received; obligates the banks to transfer revenue collections to the TSA within one day; and requires banks to provide appropriate information technology to support the smooth collection of state receipts. It provides for penalties in the event of delayed remittances to the TSA; delayed opening of receipt counters; and for charging the depositors any fee for government collection services. Taxes withheld by spending units from payments made to employees and suppliers are recorded as government revenues through the e-pay point facility without the physical transfer of funds.

The collecting bank network in Indonesia extends to more than 2,300 branches of 81 commercial banks and post offices located in all the regions of the country. The collecting branch provides revenue collection data to the respective local treasury branch, which inputs this data into a database. The collecting branch also reports the collection data to its respective headquarters, which consolidates collection data from all other branches nation-wide. The data from the headquarters of collecting branches, combined with the withholding tax data from payments made by local treasury branches, are sent to the IT department of DG Treasury to be consolidated as total government collections. A reconciliation and consolidation of all government collections/deposits is then conducted by both DG Treasury and the local treasury branches.

The transaction flow diagram below shows the banking arrangements for revenue collections.

Figure 3.9 TSA for Revenue Processes



The System for Managing Revenue Collections MPN  
(Modul Penerimaan Negara)

Over the last two decades, Indonesia has experimented with different systems of revenue collection and concentration. Systems have evolved to keep pace with the evolution of banking and payment systems. The MPN system has emerged as the core system for the collection and transmittal of government revenue deposits from collecting banks. State revenues handled through the MPN system significantly increased from 2008 to 2013, as can be seen from the table below, which gives an indication of the amounts and volumes of revenue transactions involved.<sup>43</sup>

**Table 3.5 State Revenue Handled through the MPN (*Modul Penerimaan Negara*)**

	2008	2009	2010	2011	2012	2013
Value of transactions (Trillion IDR)	622.68	621.03	710.30	833.64	978.36	1,063.03
Volume of Transactions	32,798,584	36,669,720	39,170,928	40,615,039	42,645,791	44,019,933

The concept of MPN was initially established in an effort to create an integrated state revenue receipt system by using a single database, where previously the state revenue was managed by different Directorate Generals (DG Tax; DG Customs and DG Budget) within the Ministry of Finance through stand-alone systems. MPN was envisaged as a system that would connect the tax and non-tax obligations set by DG Tax, DG Customs and DG Budget to be paid in cash by the tax/non-tax payers at the appointed banks/post offices as the collection points, for eventual deposit in the TSAs managed by DG Treasury.

During the earlier implementation of MPN<sup>44</sup> from 2008 to 2011, the quality of tax data entering into the system at the collection points was not adequately controlled and reconciled. As a result, substantial numbers of revenue transactions could not be posted in the ledger accounts of the tax payers even though the collections were transmitted to the TSA. Consequently, up until 2010 the Supreme Audit Agency<sup>45</sup> issued a disclaimer in its audit report related to the inaccuracy of data capture and the inadequate reconciliation of state revenue transactions processed through MPN (G-1).

To resolve this issue, DG Treasury set up a special unit (Project Management Office-PMO) to review the discrepancies between the revenue flows entering the TSA and the taxes recorded in the tax payer ledgers with the Tax Department. The unit worked closely with the commercial banks to examine the source data related to discrepant transactions and to identify and correct missing or erroneous tax payer data. Simultaneously, the Treasury also implemented a series of measures to deal with the systemic issues that had adversely affected the quality of revenue collection data, including:

- The Finance Minister assigned DG Treasury as the settlement authority and the key owner of the MPN system.
- DG Tax, DG Customs and Excise, and DG Budget as the administrators of the tax, customs and excise, and non-tax revenues respectively, became the billing authorities of the state revenue services and the co-owners of the MPN system.
- The MOF Central Computer Services Department<sup>46</sup> provided support for IT Systems and Infrastructures.
- A dedicated unit was assigned to be responsible for:
  - Improving the overall MPN system (business process, IT system, infrastructure, and legal basis);
  - Evaluating the benefit of Information and Communication Technology to support the automation of MPN;
  - Preparing the legal frameworks to support MPN; and
  - Conducting the monitoring, evaluation, and quality assurance of the system.

As a result of this effort to clean up the tax collection data, the discrepant entries were almost fully reconciled. This has been confirmed by the Supreme Audit Agency in their audit of FY2011 and 2012 with an unqualified opinion.

The PEFA indicator for the effectiveness in collection of tax payments in Indonesia reflects an improvement (between the first assessment in 2007 and the recent one in 2011) in the quality of tax collection data (see Table 3.6). With the improvement of the tax remittance system and better governance and accountability implemented by DG Treasury, the discrepancy between the tax revenue data reported by the commercial banks,<sup>47</sup> and the data recorded at BI has decreased significantly. In 2006, the Supreme Audit Agency (BPK) reported that tax revenues as determined by DG Tax were higher than those reported by the Treasury by IDR 1.9 trillion (approximately 0.5% of aggregate revenues) and considered this discrepancy a cause for recording a disclaimer. By the end of 2010, this discrepancy declined to about IDR 236.4 billion (approximately 0.04% of the aggregate tax revenues) and now it is fully reconciled so that in the audited financial statement of 2012, BPK reported that the tax revenue data recorded in MPN is clean with an unqualified opinion.



**Table 3.6 PEFA Scores for Indicator on Effectiveness in Tax Collections**

Indicator	Score 2007	Score 2011	Performance Change
<b>PI-15. Effectiveness in collection of tax payments. (M1)</b>	<b>D+</b>	<b>C+</b>	
(i) Collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year (average of the last two fiscal year)	<b>C</b>	<b>C</b>	The proportion of outstanding tax arrears to the total non-oil and gas tax revenue declined from 7.5% in 2006 and 8.3% in 2008 to 6.7% in 2010. The average tax collection ratio for tax arrears for the last 2 years is 52%, down from 66% in 2006 (source: DG Tax)
(ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administration.	<b>A</b>	<b>A</b>	Taxpayer pay their taxes directly into Treasury bank accounts or at commercial banks that are authorized by Treasury to receive such funds, and which then remit these to Treasury, on a daily basis.
(iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records, and receipts by the Treasury.	<b>D</b>	<b>C</b>	Reconciliation of tax payments is done centrally at the Treasury on a daily basis and reported bi-annually. Payments are not automatically updated in the taxpayer accounts. Differences in the revenue collections between the treasury and DG Tax are identified. Old arrears data is maintained manually, and it is not linked to the taxpayer accounts or reported to the Treasury.

### **The New Revenue Collection System (MPN G-2)**

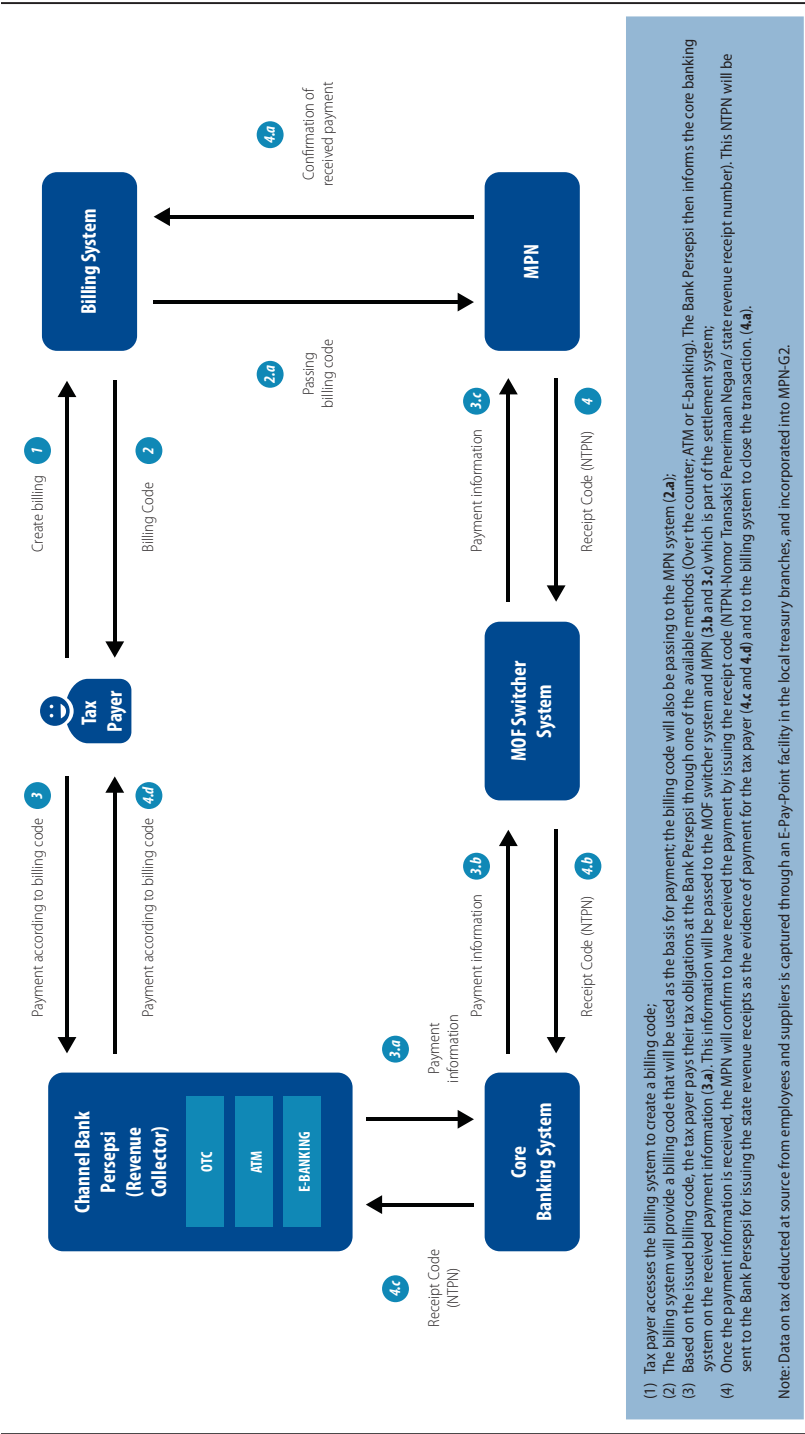
For the purpose of easy, safe, fast, accurate and efficient state revenue (tax and non-tax) administration and in order to produce timely and comprehensive revenue collection reports, in 2011 MOF developed the second generation of MPN (MPN G-2), which was developed and implemented through four closely related strategies, namely:

- i. Integration of the state revenue receipt system using a centrally-administered single database;
- ii. Optimum utilization of information technology; i.e., MPN to be integrated or interfaced with the SPAN and tax system;
- iii. Improvement of human resource capacity in every operational unit along with e-literacy programs on the benefits and use of the system for tax payers and other revenue depositors; and
- iv. Formulation of clear and firm regulations for the smooth administration, management, and implementation of the state revenue cash depository system.

The billing system is a new feature of MPN G-2. The tax payer is issued a billing code by the system before the revenue payment can be deposited into the bank/post office persepsi account. It is intended to minimize the data discrepancies between the collected cash and the tax invoices; hence, it will reduce the time for reconciliation. The MPN G-2 and the associated billing system have been implemented on a pilot basis across the country. By the end of 2013, piloting of MPN G-2 has been completed at eight revenue collecting banks<sup>48</sup> and the switching system development was jointly done with Bank BRI. To date, tax payers from all over Java have been able to pay their taxes using the MPN G-2. Full roll-out is planned for 2014.

The flow of revenue payment through the MPN G-2 is shown in the flow chart below:

Figure 3.10 Flow of Revenue Payment through the MPN G-2



(1) Tax payer accesses the billing system to create a billing code;  
(2) The billing system will provide a billing code that will be used as the basis for payment; the billing code will also be passing to the MPN system (2.a);  
(3) Based on the issued billing code, the tax payer pays their tax obligations at the Bank Persepsi through one of the available methods (Over the counter, ATM or E-banking). The Bank Persepsi then informs the core banking system on the received payment information (3.a). This information will be passed to the MOF switcher system and MPN (3.b and 3.c) which is part of the settlement system;  
(4) Once the payment information is received, the MPN will confirm to have received the payment by issuing the receipt code (NTPN-Nomor Transaksi Penerimaan Negara/ state revenue receipt number). This NTPN will be sent to the Bank Persepsi for issuing the state revenue receipts as the evidence of payment for the tax payer (4.a and 4.d) and to the billing system to close the transaction. (4.a).

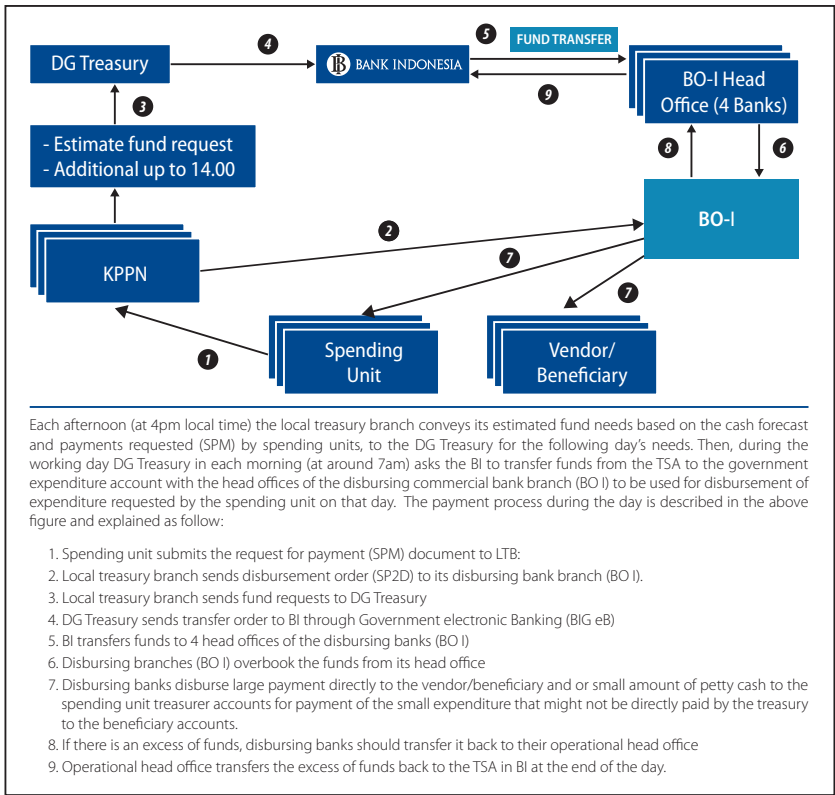
### 3.3.7. Payments in Indonesia

Indonesia applies a combination of both centralized TSA procedures for large payments and decentralized TSA procedures for small payments. The basic principle of payment of the state expenditure in Indonesia is, as much as possible, made directly from TSA to the beneficiaries’ account. While most of the large payments are directly made by Treasury through the local treasury branches to the bank account of the government’s vendors or beneficiaries, the MOF additionally permits each of the spending units to have imprest accounts to manage petty cash.<sup>49</sup>

#### Payments Made Through the TSA

The figure below brings out the process flows related to payments made by the Treasury through the TSA.

Figure 3.11 Payment Made through the TSA



The current process flows for payments facilitate the actual transfer of cash for payments at the time when payments are due. Cash is transferred out of the TSA in BI to the bank accounts of the local treasury branches by DG Treasury on the basis of the payment requests approved by the treasury branches for the following day. Residual balances remaining in the bank accounts of the local treasury branches at the end of each day are returned to the TSA in BI. Payments from the bank accounts of the local treasury branches to the beneficiaries are made electronically either through the RTGS when the transaction involves different banks or through intra-bank transfers whenever funds are transferred between branches of the same bank.

The reconciliation of payment transactions is fully automated ensuring the quality of the data on cash flows. Transactions between DG Treasury and the BI for cash flows out of the TSA and refunds into the TSA related to the funding of expenditure accounts of local treasury branches are reconciled automatically through an IT application provided by the BI. Payment orders issued by the local treasury branches on their own banks are automatically reconciled with the daily bank statements issued their banks through a legacy software provided by DG Treasury to the LTBs.

### **Payments Made Through the Imprest Accounts**

Decentralized payments for urgent small value transactions are made from the imprest accounts held by spending units of the line ministry in accredited commercial banks approved by the MOF. The Treasury monitors the imprest accounts by: (i) setting the cash limits, without controlling individual transactions; (ii) consolidating the daily balances in a Notional Pooling Account for purposes of determining the daily cash balances held in these bank accounts without zero balancing them; and (iii) negotiating for a better remuneration of the idle balances held in the imprest accounts with the commercial bank. The banking arrangements for imprest accounts held by the spending units are explained in Chapter 2.

### 3.4. CONCLUSIONS

This chapter focuses on how cash plans are dependent on the quality of processes at different stages of the expenditure and revenue cycle, bringing out the importance of the credibility of the annual budget, and procedures for identifying the timing of cash flows during the year. It then discusses the mechanisms for consolidating revenues and executing expenditures. Although there are procedures in place to support cash planning in Indonesia, the current quality of cash plans is poor. DG Treasury has decided on a number of strategies to improve the quality of the cash projections coming from spending units. Making progress in this area will be critical to the adoption of a more active approach to cash management. In contrast, good progress has been made on mechanisms for consolidating revenues and executing expenditures.

The starting point for the cash plans are the budget projections. In Indonesia, the budget process provides for the approval of the budget by the end of October for the financial year starting in January, although parliamentary review may continue after appropriation. Line ministries have sufficient time to finalize their annual cash flow plans for submission to the Treasury well before the start of the fiscal year in January. However, parliament's review sometimes goes beyond the end of October, which needs to be taken into account in preparing annual cash plans.

One weakness in the current budget process that affects cash planning is the lack of a mechanism for the quality assurance of forecasts used in the budget. The actual revenues collected over the last four years have been consistently below the target, while the budget outcome on subsidies is significantly higher than the budget. A cash shortage has only been avoided because of under spending in some other expenditure categories – especially capital. The credibility of the budget could be improved if independent reviews were commissioned by the government through think tanks (or possibly by establishing an independent fiscal council). The improved quality of forecasts would provide a sounder base for in-year cash planning, particularly with reference to the volatility of mineral revenues.

For in-year cash plans, the procedures provide for the preparation of quarterly, monthly and daily cash flow projections. However, despite measures taken to impose discipline on the spending units to update their cash flow projections during the year, a review of the implementation by DG Treasury concluded that the quality of the bottom-up cash plans was poor. This could be attributed, in part,

to the onerous requirements of the new reporting procedures for in-year updates to the cash plans. Based on these findings, the Directorate of Cash Management is planning to apply a simpler procedure by using the “80/20” rule, in which only spending units with a large expenditure budget allocation will be required to submit their regular updated cash flow projections. Capacity building to improve the ability of cash planners in spending units is also underway and is currently scheduled to cover most of the major spending units. These efforts should be supplemented by a more active follow-up on major variances in line with the plan by Treasury to reinforce to spending units the importance of accurate projections.

Alongside measures to improve the quality of cash plans from spending units, the coordination needs to be addressed. An option would be to interface the Human Resources Planning system operated in GEAA with SPAN. Meanwhile, the Treasury should consider setting up a task force to meet once a quarter and review outstanding personnel payment issues with GEAA and the relevant line ministries. The MOF should also consider ways in which more reliable data can be gathered on the in-year cash flows related to natural resources. Between the Treasury, line ministries and GEAA for synchronizing payroll data also With the implementation of IFMIS (SPAN), SAKTI, and MPN-G2, the IT environment for budget execution will be in line with international practices as mentioned in chapter 1. The data entry and data validation of cash flow plans will be done at source by the spending units using the application software SAKTI. Thereafter, the data will be piped to the SPAN database through a portal. Further consolidation and processing of cash flows will be done through the cash management module of SPAN. The module will generate forward cash flow forecasts and automatically update them with respect to the actual expenditure data already available in the central database. These bottom up projections will be an input to the Treasury cash planning process. The implementation of MPN G2, which is just being launched, will ensure the ex-ante reconciliation of all revenue collections and their straight-through posting in the tax ledgers maintained by the revenue collecting authorities.

## Notes

- <sup>1</sup> IMF Government Financial Statistics Manual 2001
- <sup>2</sup> Public Financial Management and Its Emerging Architecture, International Monetary Fund, 2013.
- <sup>3</sup> Carry-over of Budget Authority Public Financial Management, Technical Guidance Note, Ian Lienert and Gösta Ljungman, January 2009.
- <sup>4</sup> Emerging PFM Architecture
- <sup>5</sup> Graham Glenday in “The International Handbook of Public Financial Management”
- <sup>6</sup> Kyobe, Annette and Stephan Danninger, 2005, Revenue Forecasting—How is it done? Results from a Survey of Low-Income Countries, IMF Working Paper 05/24.
- <sup>7</sup> Managing Public Expenditures, A Reference Book for Transition Countries, OECD 2001
- <sup>8</sup> Public Financial Management and Its Emerging Architecture
- <sup>9</sup> Graham Glenday : The International Handbook of Public Financial Management
- <sup>10</sup> Government Cash Management, United Kingdom’s National Audit Office, NAO HC 546, 16th October 2009
- <sup>11</sup> IMF PFM Technical Guidance Note No. 4 of July 2006
- <sup>12</sup> Managing Public Expenditures- A Reference Book for Transition Countries, Edited by Richard Allen and Daniel Tommasi, 2001
- <sup>13</sup> Blöndal, Jón R., Ian Hawkesworth and Hyun-Deok Choi, 2009, Budgeting in Indonesia, OECD Jurnal on Budgeting, Vol 2009/2
- <sup>14</sup> The amounts on “hold” are marked in the final budget appropriation document by “\*” or “bintang”.
- <sup>15</sup> Usually these concerns relate to incomplete or inaccurate supporting documents included with the budget submissions.
- <sup>16</sup> An OECD review of the budget process in Indonesia carried out in 2007 also mentions that “The result (of the “hold” on the annual budget) has sometimes been that – even with the two-month period to finalize the details – budget disbursement has not been authorized until several months into the next fiscal year. In 2007, for example, about 45% of total expenditures were delayed up to the end of 1<sup>st</sup> semester.”
- <sup>17</sup> Finance Minister Regulation (PMK) No. 44/2007 on synergized responsibilities and business processes in fiscal policy and draft annual budget law preparation
- <sup>18</sup> Finance Ministry regulation No. 133/2008
- <sup>19</sup> GPP Spending Unit
- <sup>20</sup> Treasury regulation No. 37/2009
- <sup>21</sup> Bendaharawan Gaji
- <sup>22</sup> GPP Spending Unit
- <sup>23</sup> Perpres #7/2013
- <sup>24</sup> TEPPA: Tim Evaluasi Percepatan Dan Pengawasan Anggaran (Evaluation and Supervisory Team for Budget Absorption), chaired by the Head of UKP4 (the President’s Unit for Development Control and Monitoring), and jointly co-chaired by the head of BPKP and Deputy Finance Minister
- <sup>25</sup> No. 54/2010 and No. 70/2012
- <sup>26</sup> DBH = Dana Bagi Hasil
- <sup>27</sup> DAU = Dana Alokasi Umum



<sup>28</sup> DAK = Dana Alokasi Khusus

<sup>29</sup> Article 27 (1) of Law No. 33/ 2004 on Fiscal Balance between the Central and the Regional Governments

<sup>30</sup> Minister of Finance Regulation (PMK) No.44 Year 2007 on Synergized Responsibilities and Business Process in Fiscal Policy and Draft Annual Budget Law Preparation

<sup>31</sup> KMK 293/2012

<sup>32</sup> MenPAN and RB: State Ministry for State Apparatus Empowerment and Bureaucratic Reform

<sup>33</sup> Badan Kepegawaian Negara or BKN

<sup>34</sup> The role of the PFBs and their operating procedures are not uniform across ministries. The roles and processes described above are based on an interview with the head of the PFB of MOF.

<sup>35</sup> In the case of the MOF, those with appropriations of IDR 1 billion or more

<sup>36</sup> MONIKA

<sup>37</sup> Page III of DIPA ('halaman 3 dari DIPA')

<sup>38</sup> DIPA tracking study, World Bank and MOF, 2011

<sup>39</sup> Article 75 (1) of the PP 45/2013

<sup>40</sup> (Bank Persepsi or BP)

<sup>41</sup> Imprest Account or "Rekening Khusus"

<sup>42</sup> Law # 16/ 2009 on general policies on tax and Finance Minister Regulations No. 80/2010 and 187/2007

<sup>43</sup> However, there is still a limitation in the MPN system in that the foreign currency (tax, customs, non-tax) revenue can only be made in USD at one collecting bank (Bank BNI).

<sup>44</sup> MPN Generation 1

<sup>45</sup> BPK

<sup>46</sup> PUSINTEK

<sup>47</sup> Through MPN, daily Cash Position Report (aggregate transfers) submitted by the commercial banks.

<sup>48</sup> BNI, BRI, BCA, BJB, Bank Permata, Rabobank, Citibank, dan CIMB Niaga

<sup>49</sup> Uang Persediaan-UP





# Chapter 4

## Financing the Budget



## 4.1. INTRODUCTION

While the reforms described in earlier chapters set the stage for efficient cash management, this chapter looks at the way cash management needs to be coordinated with budget deficit financing and the investment of surplus cash balances.

Improved coordination between planning, budgeting, cash management, debt management and monetary policy is crucial for optimizing the short-term financial borrowing and investment of the government. International good practice in this regard and the Indonesian practice are discussed in this chapter.

The planning of cash flows related to debt and debt servicing is critical to ensure the credibility of governments among investors, donors and rating agencies. Defaults in debt servicing could have serious implications for future external and domestic financing in terms of both the availability of financing sources and the increased costs of financing. This chapter discusses international experiences in planning and managing cash flows related to debt and describes the practical solutions adopted by Indonesia.

Options for the investment of surplus cash balances and some international practices are discussed. The challenges faced by Indonesia in investing their surplus cash balances are examined in the context of international experiences.

The last part of this chapter concludes with a summary of the strengths of the Indonesian practices related to budget financing and suggests some improvements.

## 4.2. FINANCING THE BUDGET – INTERNATIONAL EXPERIENCES

### 4.2.1. Objectives of Cash and Debt Management

As mentioned in chapter 1, the key objective of cash management is to have the right amount of money in the right place and at the right time to meet obligations in the most effective way. The main objective of debt management, on the other hand, is to ensure that the government's budget deficit financing needs and its

debt servicing obligations are met at the lowest possible cost over the medium to long term, consistent with a prudent degree of risk (IMF and World Bank, April 2014). Cash management has a short-term focus limited to the fiscal year, whereas debt management has a medium- to long- term horizon.

Once the medium-term fiscal framework and the debt sustainability dynamic has been analyzed<sup>1</sup> and confirmed, the government can select its requisite medium-term budget framework. This will lay out the budget balance—deficits and/or surpluses—over the coming three or four years. Given this framework, the debt managers will devise an optimal medium-term debt management strategy. This strategy should comprise the currency breakdown and instruments to be used for financing the budget, with a view to optimizing the associated cost-risk trade-off in conjunction with the existing public debt portfolio. For example, it may appear to be efficient to make all necessary borrowings externally where interest rates are lower, but the extra currency risk must be taken into account in order to justify such a rebalancing of the debt portfolio.

Whilst the strategy for the subsequent two or three years may only be based on the aggregate portfolio parameters, the coming fiscal year strategy should give a fully detailed Annual Borrowing Plan (ABP). This should specify the exact instruments to be issued in the particular markets and the currencies. Where possible, it should provide expected issuance dates and amounts. Clearly, the medium-term debt strategy and the ABP will also take account of debt servicing requirements such as redemptions; liability management operations such as buy-backs; and loan amortization. Efficient debt market development procedures also affect the borrowing plan and these can entail the need for large benchmark bond issues; a smooth issuance calendar throughout the year – particularly for the domestic market; and the possible need to pre-fund future maturities. These plans are a vital input to cash planning for the fiscal year since they can cause tension between debt management and cash management policies – for example, pre-funding can create additional cash surpluses at a time when plans predict an excess of cash.

Effective government cash management should ensure that budget execution can take place efficiently within the fiscal year. It assumes that government ministries and agencies have the best understanding of their services and how to provide them and that they use this knowledge when procuring goods and services. If this procurement conforms to budget commitment rules, payment should be

effected as and when necessary. Expenditure arrears (entailing delayed payment of valid invoices) and cash rationing (entailing spending units being forced to delay procurement until cash is available) can and should be avoided through good cash management.

While coordination between cash and debt management is necessary and discussed further below, it is important that they are not considered as having the same function. While the debt manager focuses on financing the budget deficit and managing the public debt portfolio, the cash manager should only be concerned with short-term in-year variations of the overall government cash position. This will ensure that payments can be made and that any temporary cash surpluses are handled efficiently. The cash manager operates on the premise that its operations are a zero-sum game. That is: if the budget is credible and the debt manager has financed any planned deficit through the year, the cash balance at year-end is the same as at the start of the year. Supplementary budgets within the year are handled in the same manner.

In many cases, budgets are not planned credibly and realistic supplementary budgets are not produced during the year when the original budget and its planned financing become unbalanced. In such cases, the cash and debt management roles become confused. The cash manager may be expected to provide deficit financing additional to that sourced by the debt manager. This blurring of respective roles and objectives should be avoided if possible through formal in-year budget planning revisions which explicitly provide the debt manager with projections of the required extra deficit financing. This will allow such funding to be consistent with the medium-term debt strategy—which the cash manager could not ensure.

#### **4.2.2. Coordination between Cash Management, Debt Management, and the Central Bank**

Close coordination between the cash and debt managers is necessary on two levels. Firstly, as described in the previous chapter, the cash manager must produce accurate cash flow plans for the fiscal year. Major factors in any government cash flow are inflows from borrowing and aid, and outflows related to the cost of debt servicing. Secondly, active cash management operations required to meet its principal goals of ensuring budget execution payments and managing cash surpluses will have an impact on debt markets. Both of these levels affect the

operation of monetary policy and domestic financial markets, and thereby also place an obligation on the cash manager and the central bank to coordinate transactions and information flows.

A Liquidity Management Committee can play a crucial role in coordinating cash management with the budget, debt management and monetary policy. Its functions include (i) monitoring the macro-fiscal, macro-economic and monetary situation and taking corrective actions in a timely manner; (ii) ensuring coordination and sharing of information between the key stakeholders; (iii) facilitating policy decisions on government debt and short-term investments; and (iv) conducting oversight of the timely and orderly financing of the budget. Usually, the Liquidity Committee is chaired by the Minister of Finance or the Permanent Secretary of Finance and comprises (i) the Ministry of Finance represented by the Accountant General, the Budget Director, and the Head of the Macro-fiscal Department; (ii) the tax and customs revenue stream represented by the Director General of the Tax Department; (iii) any major non-tax revenue streams represented by the relevant parent ministries; (iv) the Central Bank represented at an appropriate level; and (v) major spending ministries represented by their Permanent Secretaries.

At the operational level, there is a need to coordinate debt and cash management with monetary policy objectives and the budget and planning functions. This is to ensure that there is appropriate sharing of information on the government's liquidity flows between debt managers and fiscal and monetary policy authorities and a common position of the government in dealing with financial markets.<sup>2</sup>

### **4.2.3. Planning Cash Flows for Financing the Budget**

#### **Ways of Financing the Budget**

Budgets are financed through domestic and external borrowing. Domestic debt includes direct loans and market securities in the domestic currency. External debt includes loans from, and securities issued to, foreign governments, multilateral institutions and other investors, denominated in foreign currency.

Loan disbursement methods are direct, reimbursement, or replenishment. Direct disbursements involve the release of funds by the creditor directly to the beneficiary. Reimbursable disbursements relate to agreements which require the government



to undertake expenditure from its own resources before reimbursement. Replenishment disbursements are made on an installment basis by creditors through project accounts opened by the Treasury either in commercial banks or in the central bank in accordance with the loan agreement.

Cash outflows related to debt transactions include repayment of principal, interest payments, and payment of commitment fees and other charges (such as penalty, management fees, and legal fees). Interest terms, available from the loan agreements registered in the Debt Management Office (DMO), include interest rates, applicable day convention, and interest period. Cash outflows for interest payments will vary depending on the type of interest payments, which could be annuity (or interest included in the principal); fixed interest rate; variable interest rates (including inflation-indexed); or penal rates of interest.

Cash inflows and outflows are also affected by other loan cycle events such as cancellation of undisbursed loans, face value adjustments, restructuring, and debt swaps. The effect on cash flows would depend on the option chosen to implement the loan cycle event. For instance, cash outflows would depend on whether debt swaps resulted in debt forgiveness, on the accumulation of arrears, and on the staggering of the payment of arrears or penalty accumulation and payment.

The DMO is the main provider of information on cash flows related to debt. Information registered from loan agreements includes cash flow parameters such as the date of activation of the loan, the grace period of the loan, applicable currency, date when principal payments begin, dates and amounts of principal payments, dates and amounts of interest payments, date when principal payments end, and date when the interest payments end.

Owing to the importance of ensuring that debt servicing payments are made correctly and on time, a DMO will record all debt obligations in a database specifically designed for this purpose. The software is installed in the ministry of finance and/ or central bank and will provide the functions listed in the box below.

**Box 4.1    Functionality of DRMS 2000+ and DMFAS 6**

- Record bids on government securities auctions, as well as notes and bonds on a single price or multi-price basis
- Maintain an inventory of all external and domestic instruments including: public debt and grants; short-term and private sector debt; restructuring agreements including rescheduling.
- Record all information concerning loans, grants and debt securities including their possible relationship to projects and to different national budget accounts
- Record other relevant debt related information such as exchange rates, interest rates, and macro-economic data.
- Forecast debt-service payments, both by instrument and in aggregate terms with future disbursements.
- Record actual transactions of debt service and disbursements on a transaction-by-transaction basis.
- Identify loans in arrears and calculate penalty payments.
- Monitor loan and grant utilization and disbursements.
- Monitor government lending including on-lending.

The information recorded from loan agreements might include the types of credit,<sup>3</sup> types of creditor,<sup>4</sup> payment dates, payment amounts, and currency of payment. Information on domestic debt includes outstanding government securities; loans from local banks, arrears (pension payments, pending bills), and guarantees.

The debt database will be a vital source of debt servicing information for the cash manager. Cash flow models will need regular access to this database to ensure that cash requirements are updated as necessary. The cash manager must also maintain a direct relationship with the debt manager in order to be able to include in the cash flow model all information relating to planned debt issuance—both domestic and external. Although the ABP will contain details about planned issuance, these plans are strongly affected by market and investor conditions and can change quickly. Such changes must be incorporated in the cash flow plans whenever they occur.

## **Managing Cash Flows Related to Budget Financing**

Debt-related cash flows are often very large and have an undue influence on the smoothing operations of active cash management operations. Following the production of a cash flow model that describes the projected level of cash resources available to the government over the current budget execution year, the cash manager will use active cash management operations to smooth anticipated

fluctuations in the TSA. An optimal cash buffer level in the TSA should be determined from the expected volatility in cash flow projections and errors in forecasts. Projected periods of cash shortage will be handled by short-term borrowing, usually using T-bills. Periods of anticipated cash surpluses will entail placing short-term deposits using the central bank, commercial banks, or the repo market. If forecasts are accurate and the T-bill market is deep and liquid, this buffer level can be very low<sup>5</sup> and, therefore, less costly.

Coordination between the cash and debt managers can assist in smoothing the TSA balance, thereby making the cash manager's task more efficient and reducing costs. It is clearly important for the debt manager to arrange for settlement of government securities redemptions to coincide with new issuance and auction payment dates, i.e. rollovers. In addition, the debt manager can coordinate issuance with projected times of cash shortage if he knows the cash manager's projections. Conversely, where debt issuance is fixed in advance without the option to alter its size, provision of this information by the debt manager as far ahead as possible will allow any cash surpluses to be managed efficiently. The debt manager often is tasked with monitoring contingent liabilities such as government guarantees. It is vital that, if the debt manager considers that it is likely that any contingent liability will materialize during the year, the cash manager is informed and can adjust the cash buffer level accordingly.

It is important that the issuance of T-bills or other short-term borrowing operations is coordinated with the DMO. Often, either the cash manager will request the DMO to manage all its cash management borrowings and its market relations, or the cash manager will retain a specific part of the short-term yield curve in which to perform cash management transactions; for example, the maturity of all cash management T-bill issuances will be six months or less and any greater maturity issuance will be for debt management purposes. In this way, market participants will be fully aware and informed of the purposes of government borrowing, leading to a more efficient market environment and lower borrowing costs.

A primary role of the debt manager is to develop the markets—both domestic and external—in which the government borrows. This role can often be at odds with the role of the cash manager. Tensions can be created between them when the debt manager borrows in order to maintain a presence in a market, without the specific need for funding, or when the market demands very large 'benchmark' issues to enhance market liquidity and reduce funding costs. In the former case, the tension

is due to the fact that borrowing is occurring at the same time as the cash manager is trying to place surplus resources on deposit, and almost by definition at a lower return than the cost of borrowing. In the latter case, redemptions can be far larger than necessary from a purely cash needs perspective and may create short-term borrowing problems for the cash manager.

These tensions must be managed well since they can cause a breakdown in this important relationship if allowed to get out of hand. Where cash surpluses would clearly eventuate, it may be necessary for the debt manager to adopt a pragmatic approach and avoid over-issuance for the purpose of market development. Careful design of pre-funding plans for large redemptions within the cash flow plan can allow benchmark issues to be redeemed without difficulty if prepared well in advance. Resolution of such problems highlights the importance of maintaining excellent coordination and relationships between the debt and cash managers.

The central bank and the cash manager can often provide mutual assistance in performing their respective tasks. Since the government is often the largest operator of cash flowing through the banking system at any one time, knowledge of its cash flow projections can assist in the management of banking system liquidity for monetary policy purposes. It should be incumbent on the cash manager to make its forecasts known to the central bank on a regular and updated basis. Smoothing the cash buffer level in the TSA also assists the central bank in implementing monetary policy.

#### **4.2.4. Short-Term Investment of Surplus Government Cash Balances**

Surplus balances are those held in excess of the targeted cash buffer level. Countries invest their surplus cash through various mechanisms related to the degree of risk for the expected returns. Gardner and Olden suggest that “times of expected cash surpluses (greater than the requisite buffer) are often more difficult for the cash manager than shortages.”<sup>6</sup> This can be due to the reluctance of the central bank to pay deposit interest to the government; the problems of credit risk associated with making deposits at commercial banks, the lack of liquid money and repo markets; and lack of coordination with the DMO regarding prepayment or buy-backs of existing debt instruments.

In many countries, the MOF negotiates with the central bank for interest to be paid on deposits of its surplus cash resources. These negotiations consider: (i) the

advantages to the central bank of not having to sterilize government balances held in commercial banks for purposes of monetary policy; (ii) the credit risk taken by the government when depositing with commercial banks; (iii) the costs to the central bank of providing retail banking services to the government for its receipts and payment transactions; and (iv) the likely effect on the dividend paid by the central bank to the government. Usually, this rate is lower than the actual market rate available from commercial banks, but this arrangement facilitates implementation of monetary policy and eliminates credit exposure risk. A rough desk review of 54 countries<sup>7</sup> suggests that around 25% of the sample, most of them developed economies, have an explicit agreement with their central bank for remuneration of surplus balances. In most cases it is pegged to the inter-bank lending rates; in some cases the interest rates apply only to term deposits; and in others the interest rate applies only to targeted balances.

Point (i) above often provides the most effective argument for the central bank to pay interest on surplus government cash balances. Governments can hold excess cash either temporarily, due to large imbalances between in-year revenue and expenditure flows, or continuously, due to structural budget factors such as increasing natural resource revenues. In the latter case, specific long-term solutions should be found to deal with structural surpluses including the formation and use of offshore budget stabilization and inter-generational savings funds conforming to legally-binding medium-term countercyclical fiscal rules. If these solutions are not in place, or where cash surpluses are temporary, the cash manager will need to manage the surpluses efficiently. This entails placing them on term deposit at interest rates which are the highest available within prudent risk characteristics.

If the central bank does not pay market-related interest on government surplus balances, the cash manager will need to place excess resources in the domestic commercial banking system. This will often lead to the central bank needing to drain this extra liquidity from the system in order to maintain its requisite stable monetary policy. The cost of open market operations (OMOs) to drain liquidity should be borne by the central bank and, where government surpluses are large, these costs can be very significant - and have even been known to compromise the capital structure of the central bank itself. In order to avoid such problems, the government should negotiate with the central bank for it to pay market-related term deposit rates - recognizing that by using the central bank commercial bank credit risk is avoided - and thereby maintain its excess cash within the central bank and outside the commercial banking system.

An advanced cash management function should lead to the maintenance of a stable, known buffer level in the TSA and this can assist the operation of monetary policy by ensuring that flows between the government and the banking sector are balanced. For this reason, and since developed countries have more options for secure short-term investments, they may place surpluses outside the central bank. Credit risks from placing surpluses in commercial banks are minimized by using repo markets. In many developed countries, repo markets are able to absorb large amounts of cash without affecting interest rates while involving little or no credit risk during the term of the deposit. France invests in very short-term unsecured deposits with euro-zone treasuries. Sweden resorts to reverse repos in government securities or mortgage bonds. The Australian Office of Financial Management invests in term deposits with the Reserve Bank of Australia or in money market instruments such as bank certificates of deposit.

Normally, the investments of surplus balances are made in domestic currency since they will be of a short-term nature associated with the least risk. If, however, foreign currency is maintained by the MOF for specific purposes while still considered as part of the overall government cash position, other securities might be available for short-term investment. If the government holds surplus balances of certain liquid currencies (U.S. dollars, yen, euros, pounds sterling), short-term high-credit securities are available for attracting a market return without the ensuing challenges of credit risks or impediments to monetary policy. Many commodity-producing countries use this method of obtaining an adequate return on their surplus cash while maintaining sufficient liquidity for budgetary needs.<sup>8</sup>

## **4.3. ACTIVE CASH MANAGEMENT AND BUDGET FINANCING IN INDONESIA**

### **4.3.1. Background**

The Government of Indonesia uses debt and non-debt sources of funding to finance the budget deficit. Non-debt financing sources are the accumulated surplus of excess cash from unrealized annual budget (SAL), the repayment of on-lending and Subsidiary Loan Agreement (SLA) installments, and sold asset or privatization proceeds (HPA). The non-debt financing also includes inflows from the Government's investment fund and equity participation (PMN), national education endowment fund, and contingent liability fund. Cash inflows to the budget from non-debt financing in nominal terms has shown a steady increase from year to year. In 2007, the inflow was IDR 11.2 trillion and in 2012 it rose

to IDR 63.9 trillion. However, the major source of budget deficit financing continues to be debts, which include Government securities (SBN), foreign loans and domestic loans.

From 2007 to 2012, the actual budget deficit financing required was a little lower than the target due to a combination of the revenue realization being above the budget and the low absorption of the expenditure budget. In percentage terms, the ratio of realization to target of budget financing during 2009 to 2012 was 86.7, 68.8, 86.8 and 81.1, respectively, as shown in the table below.

**Table 4.1 Budget Deficit and Financing in Indonesia**

Trillion IDR	FY 2009		FY 2010		FY 2011		FY 2012		FY 2013	
	Budget	Realiza- tion	Budget	Realiza- tion	Budget	Realiza- tion	Budget	Realiza- tion	Budget	Realiza- tion
State Revenue	871.0	848.8	992.4	995.3	1,169.9	1,210.6	1,358.2	1,338.1	1,502.0	1436.9
State Ex- penditure	1,000.8	937.4	1,126.1	1,042.1	1,320.8	1,295.0	1,548.3	1,491.4	1,726.2	1,638.0
Deficit to GDP (%)	(2.4)	(1.6)	(2.1)	(0.7)	(2.1)	(1.1)	(1.5)	(1.3)	(2.0)	(2.2)
Financing Budget	129.8	112.6 (86.7%)	133.7	91.6 (68.8%)	150.8	130.9 (86.8%)	190.1	153.3 (81.1%)	224.2	227.2 (101%)
Financing in excess of deficit		24.0		44.8		46.5		153.3		26.0

The table above illustrates the Indonesian practice of accumulating cash surpluses by over-financing the budget deficit. The SAL is created because of the policy of pursuing the borrowing amount set by the Parliament in the budget. The objective of the Key Performance Indicator (KPI) of the DG Debt Management is defined as meeting the financing target through borrowing. Consequently, if DG DM did not meet the financing target through debt as set in the law, its performance would be considered weak. This behavior, coupled with deficits that are regularly lower than the budget projections, led to an unnecessary buildup of cash in the form of SAL that could not be used by the government without further approval by the Parliament.

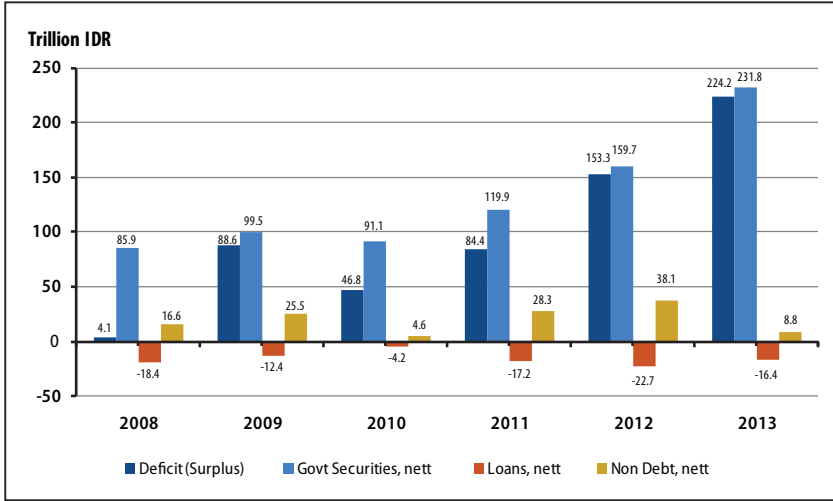
In terms of instruments, non-debt financing was closer to the targets set in the budget than debt financing. This is consistent with the policy of optimizing the use of the budget to meet financing needs from non-debt sources. Despite the

policy of optimizing the use of non-debt sources, the contribution of the non-debt financing is still small compared to the SBN financing, as shown in the table and graph below on the proportion of non-debt to debt financing.

Table 4.2 Debt Financing

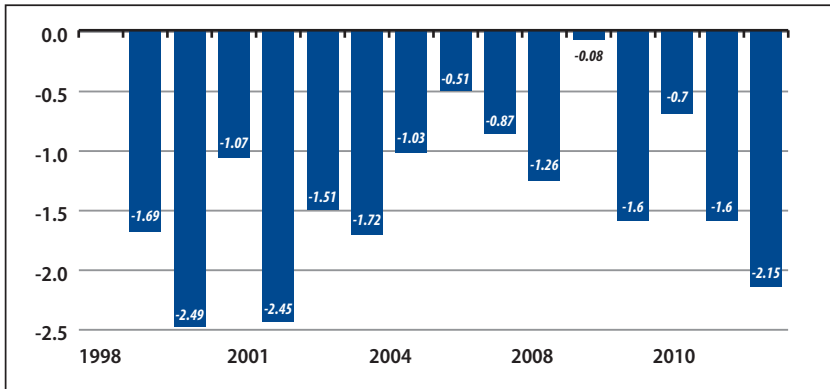
Trillion IDR	2008	2009	2010	2011	2012
Non-Debt sources	16.6	28.7	4.6	28.3	38.1
Debt Financing	67.5	87.1	86.9	102.7	142.0
Non-Debt-to-Debt Financing	25%	33%	6%	28%	27%

Figure 4.1 Budget Financing



Since 1998, the government budget has been in deficit with a peak of 2.5 per cent of GDP in 1999.



**Figure 4.2 Indonesia Budget Deficit (Percentage of GDP) in 1998-2013**

During the fiscal reforms in early 2000, the State Finance Law introduced a conservative budget deficit policy aimed at stimulating economic growth, and maintaining fiscal sustainability.

The actual budget deficit between 2007 and 2012 has always been lower than the deficit set in the annual budget law. Some contributing factors were:

- The realization of government revenues and grants exceeded specified targets.
- The realization of government expenditure was lower than the budget allocation, particularly as a result of lower budget absorption by ministries/agencies including expenditures on projects financed under foreign loans.

Budget deficit financing can be from either foreign or domestic sources consistent with the Government's financing capacity and the debt management policy. In its implementation, the Government aims to prioritize financing from domestic borrowing because of the relatively lower risks. In addition, domestic borrowing supports financial market development.

### 4.3.2. Coordination between Debt and Cash Management in Indonesia

#### Medium-Term Debt Management Strategy

The Government's Medium-Term Debt Management Strategy 2013-2016<sup>9</sup> sets the guidelines on the management of government debt in the medium term and on the formulation of the annual debt financing strategy. It covers the Government's strategies on the management of government debt which will directly impact the annual budget. Such debt consists of loans and securities that will be managed by the Directorate General of Debt Management (DGDM) of the Ministry of Finance. The box below highlights the main goals of the debt management strategy.

**Box 4.2 General Strategies for the Management of Debt and Contingent Liabilities for 2013 - 2016 are:**

- a. To optimize the potential debt funding from domestic sources, while complementing this using foreign sources.
- b. To develop debt instruments and widen the debt investor base to increase flexibility in the selection of funding sources that are in line with the financing of budget needs and can be obtained at minimal cost and tolerable risk.
- c. To utilize flexibility in debt in order to ensure the fulfillment of state budget financing with optimal cost and risk.
- d. To maximize the utilization of debt for capital expenditures, especially for infrastructure development.
- e. To perform active debt management within the Asset Liability Management framework.
- f. To discontinue the provision of blanket guarantees, such as the issuance of support letters for Independent Power Producer projects of PT PLN.
- g. To increase the capital of the companies established by the government to provide infrastructure guarantees, in order to enable them to provide guarantees without seeking government support.
- h. To increase the transparency of the management of debt and contingent liabilities through regular publication about debt information.
- i. To improve coordination with related stakeholders in order to enhance the efficiency of the State Budget, to support the development of financial markets, to upgrade the sovereign credit rating, and to identify potential risks from guarantees and recommend mitigation actions.

Based on the selected strategy, the cost and risk targets of the government debt portfolio at the end of each year from 2014 to 2016 are then determined, as shown below.

**Table 4.3 Cost and Risk Targets for Government Financing in 2014 – 2016**

Risk Indicator		Sep-12	Target			Notes
			2014	2015	2016	
Nominal debt as % of GDP		25.1	21.8	20.8	18.7	Maximum
Interest Cost *)	Interest to GDP (%)	1.3	1.2	1.1	1.1	Maximum
	Interest to Outstanding (%)	5.2	5.5	5.5	5.7	Maximum
Refinancing Risk	ATM Total Portfolio (yr)	9.8	9.4	9.1	8.8	Maximum
	Debt matures in 3 yrs (% Outs)	22.3	25.0	24.5	22.6	Maximum
Interest Rate Risk	ATR (yr)	8.8	8.7	8.4	8.2	Maximum
	Refinancing rate (% total)	23.3	21.5	19.5	17.6	Maximum
	Fixed rate debt (% total)	83.9	86.8	88.2	89.2	Maximum 80%
FX Risk	FX debt as % of total	44.8	40.0	38.0	37.3	Maximum
	Sort Term FX debt as % of reserves **)	5.6	6.6	6.2	5.7	

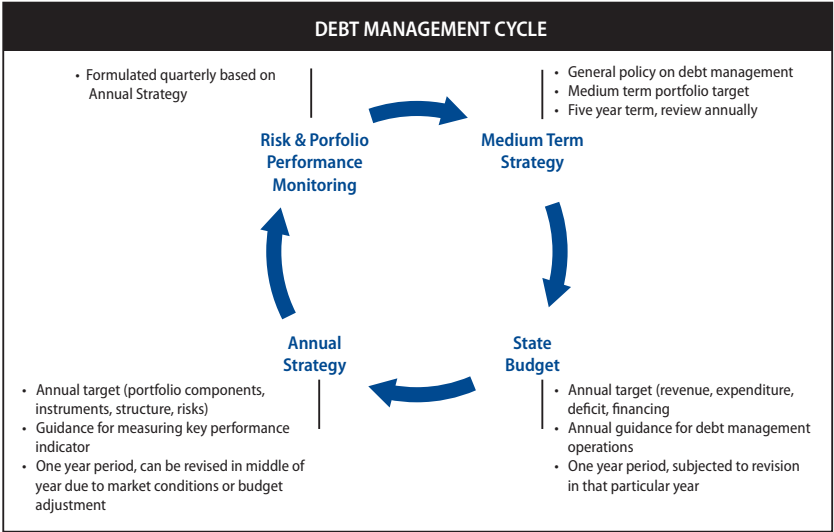
Notes

\*) Cost Indicator per September 2012 are the targets for the end of 2012

\*\*) Reserves are assumed to remain constant at USD 110 billion

The Medium-Term Debt Management Strategy is eventually used as an input in formulating the annual state budget and annual borrowing plan, as seen in the Debt Management Cycle below.

Figure 4.3 Debt Management Cycle

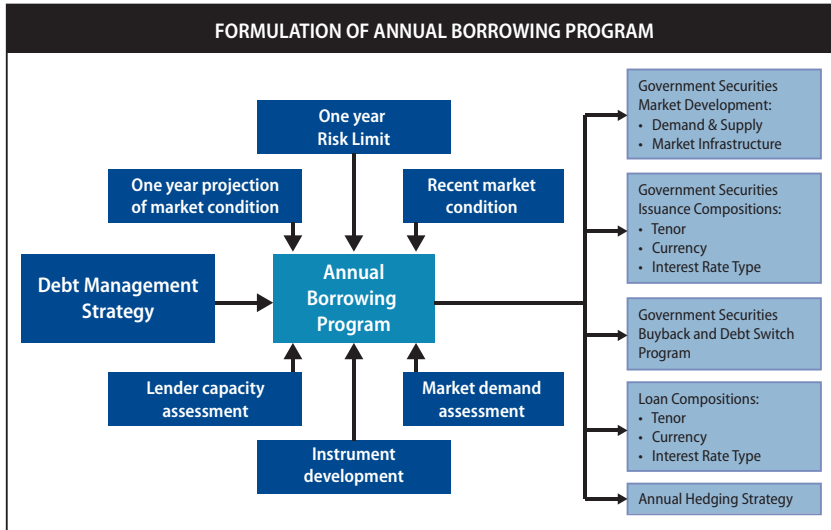


Annual Borrowing Plan (ABP)

Before the beginning of the fiscal year, DGDM prepares an ABP for financing the projected government deficit, refinancing requirements, and planned investments. Market participants are consulted during the preparation of the ABP, which must be in line with the annual state budget approved by parliament. The ABP determines the schedule for issuance of debt. The schedule is announced before the beginning of the year and coordinated with DCM during the year. The ABP is adjusted in response to the revised state budget (APBN-P), which is usually done in the middle of the year to capture the difference between initial assumptions and the on-going realization.

The various inputs that are used while developing the ABP are shown in the chart below.

**Figure 4.4 Formulation of Annual Borrowing Program**



### Coordination at the Policy Level through the ALM Committee (ALMC)

Typically, the ALMC reviews:

- i. the economic and market outlook (presented by FPO, DG Treasury and DG Debt Management);
- ii. the revenue projections (presented by FPO, DG Tax, DG Custom and Excise, and DG Budget);
- iii. the expenditure projections (presented by DG Budget and DG Fiscal Balance);
- iv. the cash projections and financing (presented by DG Treasury and DG Debt Management); and
- v. the assessment of risk to the balance sheet and budget activities, assessment of the future cash requirements and new financing, and recommendations on changes in policy if required.

Currently, the membership of this ALMC is limited to representatives from the different units within MOF. The role of each DG as a member of ALMC is prescribed in a Finance Ministry Decree.<sup>10</sup> Their roles are as follows:

- i. DG Tax is responsible for the monthly projection on tax revenue and return;
- ii. DG Customs and Excise is responsible for the monthly projection on customs and excise revenue;
- iii. DG Budget is responsible for the monthly projection on Non-Tax Revenues (PNBP), state expenditures, and grant revenues;
- iv. DG Fiscal Balance is responsible for the monthly projection on fiscal transfers to regional governments;
- v. DG Treasury is responsible for providing money market updates and for preparing a weekly and monthly projection on the cash deficit/surplus based on the revenue and expenditure projections. It also has a responsibility to set the cash management policy;
- vi. DG Debt Management is responsible for the weekly projection on issuances, buy-backs, debt switching, and debt service obligations; and for preparing a monthly securities market outlook. Knowing the projection on the cash deficit/surplus from DG Treasury, the DG DM will then be able to set the monthly Debt Issuance policy;
- vii. DG State Asset Management is responsible for the monthly projection on government investment in state owned enterprises (SOEs);
- viii. FPO is responsible for the monthly macro-economic outlook and revenue simulation model;
- ix. Secretary General of MOF supervises the daily maintenance database, application, and IT network; and finally
- x. The Expert Staff of the MOF is responsible for coordination among all units.

### **Coordination at the Operational Level through the Cash Planning Information Network (CPIN)**

During the fiscal year, an inter-directorate committee called CPIN (Cash Planning Information Network) represented by technical staff from various DGs and directorates (DG Budget, DG Treasury, DG Debt Management, Fiscal Policy Office, and others) holds periodic discussions to update the monthly cash forecasting report for the MOF. The committee uses historical data of revenues,

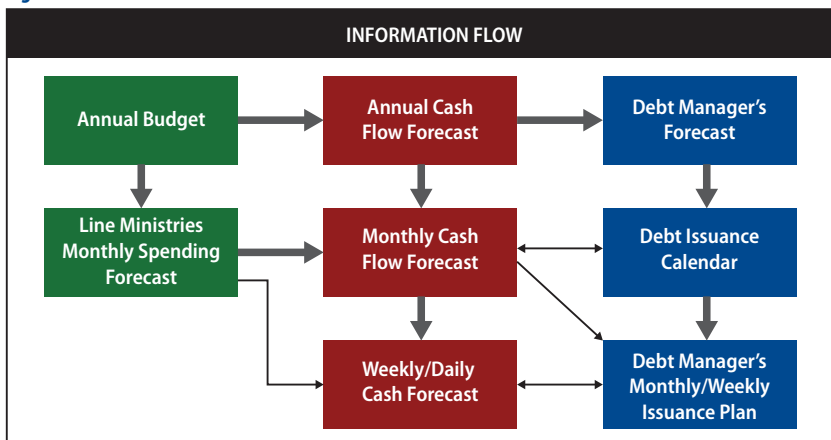
as well as recent data and assumptions of key macroeconomic and monetary indicators. This committee meets at least once every month and more frequently if required.

The DCM of DG Treasury proposes to subsume the CPIN functions within the ALMC. Once this happens, the focus of the in-year ALMC meetings will shift more towards active cash management rather than limiting the discussions to the macro-economic situation and fiscal policy issues. The annual strategic ALMC meetings would continue to review the annual targets for cash balances, the annual debt strategy, and the annual investment strategy; however, the CPIN data sharing mechanism would continue to compile and circulate the cash position outlook for the rest of the year. Hence, although the regular ALMC is in place, it would still be worthwhile for CPIN to continue to meet provided the discussions focus on cash management and short-term cash planning (daily and/or weekly forecasts).

### Coordinating the Information Flow between DG Debt Management and DG Treasury.

The coordination of information flows related to debt and cash management is brought out in the diagram below.

**Figure 4.5 Information Flow**



*Note: Green boxes refer to the information in DIPA documents managed by DGB, red boxes refer to processes managed by DG Treasury, and blue boxes refer to processes managed by DGDM.*

There is frequent exchange of information between DG Debt Management and DG Treasury. DGDM always informs DG Treasury when it plans to conduct an SBN auction. In addition to the synchronization of the annual budget targets on debt issuance, information is exchanged monthly, weekly and daily through coordinating arrangements such as the ALMC and CPIN. The implementation of SPAN and the proposed interface of DMFAS with SPAN will provide real-time on-line access to both organizations on the status of government cash requirements and the debt portfolio.

### 4.3.3. Planning and Managing Cash Flows for Financing the Budget

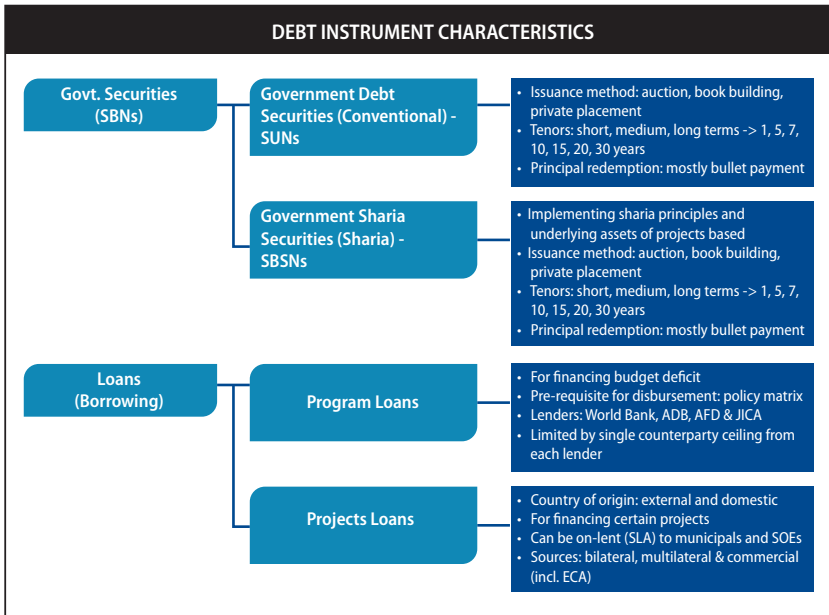
#### Financing Instruments

Law no. 24/2002 regulates SBN.<sup>11</sup> Article 5, paragraph 1 of the law authorizes the Finance Minister to issue SBN after receiving the parliament's approval, which is reflected in the annual state budget law. The types of SBN consist of:

- Treasury Notes (SPN/T-Bills) with a tenor of up to 12 months and a principal discounted interest cost payment;
- Treasury bonds with a tenor of more than 12 months and with a coupon and/or principal discounted interest cost payment;
- Islamic/Sharia securities in Rupiah or foreign currency, including Ijarah, Musyarakah, Istisna;
- SBN can be issued in:
  - Rupiah or foreign currency;
  - tradable or non-tradable form, fixed, variable or zero coupon.

The characteristics of the debt instruments currently used in Indonesia are shown in the chart below:



**Figure 4.6 Debt Instrument Characteristics**

## Managing Cash Flows related to Financing

DG Debt Management prepares information on debt payments falling due in a financial year for inclusion in the government budget for both government direct and guaranteed debt. The State General Cash Account (SGCA/RKUN) held by DG Treasury is used to defray expenses related to debt servicing. Foreign Loan transactions are routed through a separate LTB<sup>12</sup> so as to ensure accountability and ease of reconciliation of cash flows related to foreign loan. DG Treasury maintains separate accounts for debt servicing of external and domestic transactions.

DGDM manages several IT applications such as (i) Debt Management Financial Analysis System (DMFAS) and its interface application; (ii) BI-SSSS for settlement; (iii) MOFID for debt switching/buy-back; (iv) DSS as the decision support system; and (v) the MTDS application. The latest version of DMFAS 6, which was originally limited to administer external loans/grants, has been interfaced with an in-house developed application to also record the domestic debt. Indonesia is the first country to implement “DMFAS plus,” which integrates the external and domestic debt databases.

As part of its efforts to consolidate general government information, DG Fiscal Balance is collecting the sub-national debt information. However, there is no established plan yet with regard to the integration of the central government debt database with the sub-national debt database. The reason is that, under the decentralization law, there is no mandate for DGDM to manage the sub-national debt information. The future plan is to have an integrated database of central and sub-national government debts.

#### 4.3.4. Short-Term Placement of Surplus Government Cash Balances

The DGDM usually tries to ensure the availability of cash by mobilizing funds to cover the bulk of the budgeted deficit in the early part of the fiscal year (front loading policy) soon after the Appropriation Act is passed. The expenditure pattern, however, is invariably back-loaded, with as much as 40% of the budget appropriations being expended in the last quarter of the year. Moreover, the mobilization of debt at the beginning of the year has insulated government funds from market risks such as exchange rate fluctuations. This was highlighted in 2013 when a departure from this strategy was tried and a lower IDR exchange rate from the middle of the year reduced investor confidence and caused a sharp rise in the yield on Government bonds. However, the conservative policy of front loading has resulted in a high carrying cost of money for the government, because the excess funds remained unutilized until the last quarter. The table below shows that in FY 2014 more than one-third of the debt issuance target for the year has been completed in less than two months (19 February 2014), as opposed to the slower issuance in FY 2013 when only 10.7% of the debt was issued within the first two months of the fiscal year.

**Table 4.4 Debt Issuance in Indonesia by Quarter in 2012-2014**

Year	Issuance Need (in Revised Budget) Million IDR	Issuance by end of February (% to total)	Issuance by end of Q2 (% to total)	Issuance by end of Q3 (% to total)	Issuance by end of Q4 (% to total)
2014	430,182,745	33.7% by Feb 19, 2014	68.5% by July 25, 2014	n.a	n.a
2013	323,234,377	10.7% by Feb 25, 2013	53.2% by July 16, 2013	75.8% by Oct 3, 2013	100%
2012	268,547,858	18.5% by Feb 23, 2012	65.2% by July 16, 2012	86.3% by Oct 17, 2012	100%

With the implementation of cash management reforms, it is expected that government cash resources in BI will be targeted to cover immediate expenditures and any surpluses will be invested at market rates of return. There are two advantages to targeting cash balances and investing surpluses. First, there is interest income if the funds are invested; second, there is a profit from the reduction in the interest burden which comes from interim SBN purchases made in the context of cash management.

The Government has issued a comprehensive regulation for dealing with any cash surplus and deficit.<sup>13</sup> The regulation defines the objectives of the management of any surplus/deficit in state cash, the types of investment in case of a cash surplus, the procedures for the selection of commercial banks to place state money, the types of deposit in commercial banks, the mechanism to purchase bonds and implement reverse repo, management of the cash deficit, and finally the provisions for risk management and accountability.

The recently issued MOF regulation<sup>14</sup> further elaborates the rules and procedures for the placement of surplus government funds in commercial banks. The regulation sets out the stringent requirements for commercial banks to be selected as the government's partner banks for the placement of state cash,<sup>15</sup> the placement procedures and types of deposit, the maximum amount that can be placed in one particular bank, the minimum remuneration/interest rate, which is at least 70% of the BI rate, and the conditions for withdrawal.

Currently, the minimum daily reserve balance target is set at IDR 2 trillion so as to optimize the cash holding while ensuring liquidity for payments. There is no overall calculated optimal cash buffer level. A cash excess consists of any currency in excess of the cash balance target. Those funds can be used for short-term investments (including placement in the commercial banks) by taking into account the principles of safety and caution in the effective allocation of state funds. The instruments available for placement of surplus funds comprise:

- Placement of state cash in the central bank;
- Placement of state cash in the commercial banks:
  - in the overnight deposit (1–3 days);
  - in the Deposit on Call that can be withdrawn by early notification;
  - in the Time Deposit that can be withdrawn at maturity date.
- Purchase of Government bonds from the secondary market; and/or
- Repo/Reverse Repo

Although the comprehensive technical regulation is in place, surplus government cash continues to be held in BI and is remunerated at interest rates below market rates. There are differences of interpretation between BI and the MOF with regard to the authorization of the Minister of Finance to invest state money and manage/administer placements. BI interprets the law<sup>16</sup> as requiring the Minister of Finance to deposit all government funds and invest surpluses in the TSA with the central bank only. The view of the MOF is that, while the Treasury Law mandates the deposit of government money in the central bank, it is silent about the investment of surplus cash outside of the State General Cash Account in BI.

Should DG Treasury begin to place idle cash outside of BI, then accurate forecasts of the daily cash balance are needed by DG Treasury to make informed decisions regarding the term of placement for surplus cash, in order to maximize returns with minimum risk. Investing state cash outside of BI would offer the potential for higher returns to the government. Greater investment activity by the MOF could also contribute to the development of the domestic money market, by providing a catalyst for greater activity by other players. However, before the placement of the state cash balance outside of central bank can be implemented, the MOF should coordinate with BI since this proposal has significant implications for monetary policy.

DG Treasury is establishing the infrastructure for active cash management, and is actively pursuing a proposal to set up a Dealing Room. The highlights of the proposal are described in the box below:

#### **Box 4.3 The Treasury Dealing Room (TDR)**

DG Treasury is currently in discussions with BI and DG Debt Management regarding the setting up of a dealing room within DCM for handling the asset side of cash management.

Regulations have been developed for underpinning the TDR activities. Funds have been allocated to meet the operational costs of the TDR. Sufficient capacity has been created within the Treasury through the training by external experts of 36 DCM staff to be the market dealers. The infrastructure for TDR operations includes: (i) Direct Dealing System and Communication System; (ii) Money Market Information System (Reuters and Bloomberg); and (iii) Treasury Application Software. The TDR is expected to be in operation by early 2014.

It is proposed that the TDR's initial operations would be restricted to the placement of short-term surplus cash balances in an appropriate amount either with the BI or with selected commercial banks.

The Treasury is currently in the process of addressing BI concerns that large placements by the government with financial institutions would adversely affect monetary policy implementation. The plan of the Treasury is to start by making small placements outside of BI so as to minimize any risks to monetary policy operations.

The Treasury is also in discussions with DG Debt Management to find ways to ensure that financial markets see the financing operations of both organizations as complementary. The table below describes the differences in the operations of the TDR and the DG DM Dealing room.

	DG DM Dealing Room	Treasury Dealing Room
Aim	Issuance and redemption of the Government securities	Manage cash liquidity through money market instruments
Instruments to be traded	Debt instruments; T-Bonds; T-Bills; State Sharia Securities	Money market instruments; cash placement in commercial banks, foreign currency management; and Repo/ Reverse Repo
Horizon	Long term (90 days or more)	Short term (maximum 90 days)

#### 4.4. CONCLUSION

With improved coordination and communication between cash and debt managers through regular ALMC meetings, Indonesia is gradually becoming better placed to move to active daily cash management. Information on idle cash balances that could be used to fund the financing requirement are starting to be factored into the government's borrowing strategy. The Treasury continues to refine cash flow projections to improve the accuracy of forecasts, the period of projections and the exact timing of large-value transactions. However, coordination between the cash manager, the government debt manager, and the monetary authorities needs to be further strengthened by including central bank representatives in the ALMC and CPIN.

The preparation of the Treasury Dealing Room (TDR) is underway. Once the TDR is established and adequately staffed, the Treasury would be able to participate in the money markets to secure financing and placement of funds at competitive market rates. The operation of two front offices by MOF (i.e., DGDM and DG Treasury) raises some risks that need to be addressed. In particular, it is important to ensure that financial markets see the operations of both dealing rooms as complementary and not conflicting, as that would confuse the market. Furthermore, the Treasury is in discussion with BI to clarify individual roles and

responsibilities. These need to be formalized through an appropriate service level agreement and/or decrees. At the initial stages, it would be advisable to limit the operations of the TDR to the placement of short-term surplus cash balances for appropriate periods and amounts with financial institutions, other than BI.

The implementation of SPAN and the proposed interface of DMFAS with SPAN will provide real-time access to both organizations on the status of government cash requirements and the debt portfolio. As already mentioned, a number of countries are now configuring their debt management systems to interface with their IFMIS. Indonesia also proposes to interface its IFMIS (SPAN) with DMFAS, which has already been configured to record both domestic and external debt. The electronic interface between these two systems and giving BI on-line access to the integrated database will greatly facilitate coordination between cash management, debt management and monetary policy.

In-year cash management should be more coordinated with debt management borrowing patterns. The previous practice has been to front load the debt financing to meet the fiscal deficit approved in the budget for the year, but this conservative strategy incurs a high carrying cost. Starting in 2013, the government decided to refine the strategy so as to borrow more during the year. This should provide greater certainty about the effects of debt management activities on the cash flow forecasts. Enhanced cash and debt management coordination would ensure that debt market dynamics used in determining the domestic borrowing strategy integrate better with cash management objectives during the year.

It would also be useful to provide greater certainty in the ABP for financing the budget, especially with respect to the use of the Budget Surplus Balance (SAL). The rigidities associated with the use of the SAL are an unusual feature of Indonesia's financing practices and are an impediment to good cash management. The practice relates to requirements introduced by the parliament and it would be useful to explore with the budget committee of the parliament, options for relaxing the constraints to provide more flexibility in the financing.

The rate of remuneration for surplus government cash balances held in BI continues to be well below market rates. While the MOF is keen to obtain interest rates that are closer to market rates, it would be beneficial for the MOF and BI to review the prevailing remuneration rates based on mutual interest in maintaining the stability and reducing the cost of fiscal and monetary policy. If

the MOF decided to invest its balances in government owned commercial banks, this proposal would have additional cost for BI in implementing monetary policy that would reduce the overall beneficial effects of placement funds in the market. The modalities for investment should also ensure that government balances held outside the BI are fully securitized. While the proposal to invest government balances at interest rates closer to those prevailing in the market is desirable for the purpose of securing optimal returns on idle balances, it should be approached with a prudent regard to the associated credit and liquidity risk.

## **Notes**

<sup>1</sup> A task of the macroeconomic department – not the cash or debt managers

<sup>2</sup> Guidelines for Public Debt Management –World Bank and IMF

<sup>3</sup> Credit can be from suppliers; loans from financial institutions; government securities; loans from governments (bilateral sources); loans from multilateral agencies.

<sup>4</sup> Creditors can be: central government; central bank; local government; mixed enterprise; official development bank; and private borrower.

<sup>5</sup> For this reason, some countries such as Sweden have a target of zero for their cash buffer level.

<sup>6</sup> Public Financial Management and Its Emerging Architecture- IMF

<sup>7</sup> By Mike Williams in 2011

<sup>8</sup> PFM and its emerging architecture

<sup>9</sup> Finance Minister regulation No. 37/2013

<sup>10</sup> Finance Minister Decree No. 335/2012

<sup>11</sup> The legal basis for debt management also comes from: Law #19/2008 on Islamic Sharia securities; Government Regulation No 10/2011 on the procedures in obtaining foreign loans and grants; Government Regulation No 54/2008 on the procedures for obtaining and on-lending domestic loans.

<sup>12</sup> KPPN for Loan and Grant

<sup>13</sup> PP No. 39 of 2007 and Finance Minister Regulation No. 05/2010

<sup>14</sup> Finance Minister Regulation No. 03/2014

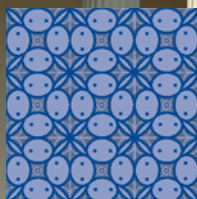
<sup>15</sup> BUMPUN= Bank Umum Mitra PenempatanUang Negara = the government's partner bank for the placement of state cash

<sup>16</sup> Law 1/2004 on state treasury





KEMENTERIAN KEUANGAN RI



Appendices



## APPENDIX 1

### Comparison with IMF Generic Milestones for Implementing Cash Management

The International Monetary Fund's Public Financial Management (PFM) technical guidance note on cash management of February 2008 outlines four phases involved in moving from primitive cash management to active daily cash management. The stages from the note are reproduced below along with the current status of implementation in Indonesia:<sup>1</sup>

Indicators	Status	Remarks
<b>Phase 1: Addressing Fundamentals</b>		
Establishing a cash management unit (CMU) that normally is located in the Treasury Department.	Done	Directorate of Cash Management (DCM) under DG Treasury, Ministry of Finance
Establishing a policy-making cash management body.	Done	Asset and Liability Management Committee (ALMC) chaired by the Minister of Finance launched its first meeting in early 2013.
Highlighting the importance of effective cash management	Done	Finance Minister Decree (KMK) 335/2012 on ALMC technical meetings and Finance Minister Regulation (PMK) 169/2012 on the role of DG Treasury regional branches (RTB/Kanwil) and local branches (LTB/KPPN) to assist 24,000 spending units in preparing their cash plans
Ensuring realistic annual budget projections.	Done	Regular ALMC meetings to update monthly budget projections
Establishing an operational Treasury Single Account (TSA).	Done	Implementation of TSA with the implementation of (i) zero balance accounts for expenditure at LTBS/KPPNs; (ii) daily sweep of the commercial partner banks that collect revenue from tax payers; and (iii) Notional Pooling Account to virtually consolidate 24,000 spending units' petty cash accounts.

<sup>1</sup> The IMF Guidance note indicates that "The speed at which cash management can be improved depends on: (1) the starting point, especially the extent to which basic conditions for effective cash management are in place; (2) the willingness of national authorities to reform cash management practices, to confront resistance to full treasury oversight of all government bank accounts, and to enhance the transparency of government operations at transaction level; (3) the infrastructure available for rapid transfer of funds by electronic means; (4) the degree to which financial markets have developed, including end-of-day bank account "sweeping" and financial market instruments available for daily cash management; and (5) human capacity and organizational arrangements."

Indicators	Status	Remarks
Avoiding use of physical cash.	Done	Applying direct payment using real time gross settlement transfer from the TSA account in the central bank to the end beneficiary account in a commercial bank
Limiting cash advances.	Done	Strict regulation to limit the petty cash amount that can be held by each of the 24,000 spending units
Improving government accounting.	Done	Government regulation No. 70/2010 on government accounting standard and PMK No. 238/2011 on the General Guidance of the Central Government Accounting System (PUSAP)
Modifying the legal framework.	Done	Issuance of Law 1/2004 on State Treasury, GOI regulations No 39/2007 and 45/2013; and Finance Minister regulation 192/2009
<b>Phase 2: Preparing cash plans and developing cash management skills</b>		
Preparing short-term projections of cash flows.	Done	Cash Management directorate staff do regular updates on short-term cash flow projections, although the accuracy can still be further improved through an increase in the submission rate of the updated cash flow projections by the large spending units.
Establishing information-sharing arrangements	Done	DG Treasury holds regular meetings with line ministries. This mechanism can be further improved by having a fixed agenda and schedule of meetings.
Ensuring information exchanges for cash projections take place.	Mostly Done	Regular monthly reconciliation meeting between Treasury regional office and spending units to discuss the updated cash plan. The implementation of a new IFMIS (SPAN) will further improve the information exchange through the provision of on-line and real time data.
Preparing cash plans. Monthly, bi-monthly, or weekly cash plans should be prepared in the first instance.	Mostly Done	Distribution of Spending Unit Forecasting Application (AFS) to all 24,000 spending units in 2010. This application will soon be upgraded and replaced by SAKTI, which will be interfaced with SPAN. However, the compliance rate of cash plan submission is still low. It needs to be supported by a policy on sanctions or penalties for those who are not submitting updated cash plans.

Indicators	Status	Remarks
Developing cash projection skills.	Mostly Done	Training of spending unit staff members that manage 70% of the budget to familiarize them with Finance Minister regulation No. 192/2009. The training must be regularly and continuously held and supported by sufficient budget.
<b>Phase 3: Going beyond prerequisites and basic cash planning</b>		
Shortening revenue transmittal delays	Done	Signing an agreement with all commercial banks as persepsi (partner) to deposit tax revenue paid by tax payers and carry out a daily sweep to the TSA account in the central bank, with a penalty being imposed for any floating funds
Coping with seasonality and "lumpiness" in cash inflows.	Done	Regular ALMC meetings to update monthly revenue projections
Assessing the impact on cash projections of expenditure commitments in the pipeline.	Done	Implementing budget commitment module in SPAN to perform automated registration of payment schedule based on the committed contract
Processing expenditure approvals and payments efficiently.	Done	PMK 190/2012 requiring DG Treasury to process any request for payment in one day at maximum
Computerizing expenditure processes.	Done	Legacy and SPAN
Maintaining minimum cash balances.	Done	IDR 2 trillion and equivalent of USD 1 million for daily cash requirement
Remunerating idle cash balances.	Done	MOU with central bank for remunerating cash above IDR 2 trillion and equivalent of USD 1 million kept in central bank
Extending TSA coverage.	Partially Done	TSA has covered expenditure accounts; revenue accounts and petty cash at spending units. However, there is a need to also consolidate the other government owned accounts, such as Public Service Agency accounts, and to report on the government managed accounts, such as: the bail-out funds; haj funds; endowment funds
Coordinating cash and debt management.	Partially Done	Through regular CPIN and ALMC meetings

Indicators	Status	Remarks
Using banking facilities.	Done	Central Bank RTGS (Real Time Gross Settlement) system for fund transfer; Central Bank BIG-eB (Bank Indonesia Government electronic banking) for closed internet banking with government
Formalizing relations with banks for treasury services.	Done	Signing an agreement with the appointed commercial banks as the partner for paying expenditure (bank operational) and collecting revenue (bank persepsi)
Clarifying the relationship between the treasury and the central bank.	Done	MOU and regulations
<b>Phase 4: Introducing active daily cash management:</b>		
Becoming more active in daily management of cash balances.	Partially Done	The preparation of Treasury Dealing Room (TDR) is underway
Introducing daily bank account "sweeping" arrangements.	Done	Daily sweeping for tax revenue payment to TSA
Ensuring the security of short-term placements by the treasury.	Not Yet started	
Refining cash flow projections to improve accuracy of projections, period of projection and the exact timing of large-value transactions.	Partially Done	PMK 192/2009 to be further improved by applying "80-20" rules focusing more on large spending units' budget and imposing a penalty without delaying budget expenditure
Strengthening coordination between the cash manager, the government debt manager, and the monetary authorities.	Partially Done	ALMC is held by MOF internally. The inclusion of the central bank as a participant would be beneficial.

## APPENDIX 2

### The Structure of Government Bank Accounts Held in BI and its Balance at End of 2012

	Type of Account	Account #	Balance at end 2012 (IDR)	Remuneration	Legal basis
<b>I. MOF/Central Treasury's Main Account held in Central Bank of Indonesia (BI)</b>					
1	SGCA (state general cash account) or RKUN in Rupiah	502.000000980	2,199,992,464,994	0.1%p.a x avg. daily balance	MOU MOF-BI
2	SGCA (state general cash acct) or RKUN in foreign currency				
	a. USD	600.502411980	6,339,139,103	0.1%p.a x avg. daily balance	MOU MOF-BI
	b. YEN	600.502111980	680,372,438,864		
	c. EURO	600.502991980	n.a		
3	Placement account in Rupiah	518.000122980	940,127,275,397	65% x SBI rate	MoU
4	Placement acc. in Foreign Currency				
	a. USD	608.001411980	4,985,649,807,746	65% x Fed rate	MoU MOF-BI
	b. YEN	608.000111980	n.a	65% x BOJ cash rate	
	c. EURO	608.000991980	564,701,567,195	65% x ECB reference rate	
<b>II. MOF/Central Treasury's Revenue Accounts held in Central Bank of Indonesia (BI)</b>					
1	Special (Imprest) Account: to temporarily place the foreign loan/grant revenue in Rupiah/ other currency from donors	1 account for 1 loan/grant	1,907,213,434,609	65% x home currency rate	PMK 206/2010
2	Income Tax Revenue (PPH) account in USD	600.500411980	n.a	N.A (directly to RKUN)	DGT Kep 169/2009
3	RDI/RPD (repayment revenue) account in Rupiah/ YEN/ AUD/ USD/ GBP/ SDR/ EUR	513000000980 607.000.xxx 519000102980		65% x BI rate 65% x home currency rate	DGT Kep 5/2011; 244/2010

	Type of Account	Account #	Balance at end 2012 (IDR)	Remuneration	Legal basis
4	Grant revenue (natural disaster in Sumatera) account in Rupiah	519.000124980	8,492,000,735	65% x BI rate	PMK 173/2010
5	Finance Minister account to deposit revenue from the T-bonds issuances	500.000003980	n.a	65% x BI rate	Law 19/2008
<b>III. Other MOF accounts held in Central Bank of Indonesia (BI)</b>					
1	Account to deposit the accumulated annual budget surplus (SAL)	500.000002980	25,755,966,698,308	65% x BI rate	DGT kep 48/2010
2	Account to deposit bridging funds to pay the "backlog" of imprest accounts waiting for replenishment from the Lenders/donors	500.000001980	n.a	65% x BI rate	Law 19/2008
3	Account for expense of SBN issuance	502.000001980	n.a	65% x BI rate	SKB
4	Account on bonds for guarantee	502.00002980	n.a	65% x BI rate	SR 176/99
5	Oil production sharing contract agreement (KPS) revenue	600.000411980	13,005,460,815,909	65% x BI rate	PMK 113/2009; 114/2009
6	Mining and Fishery revenue	508.000071980	n.a	65% x BI rate	
7	Geo Thermal revenue	508.000084980	347,992,721,305	65% x BI rate	



## APPENDIX 3

### MOU between the Minister of Finance and the Governor of Bank Indonesia on Coordination of Government Cash Management

The detailed arrangements stated in the memorandum of understanding (MOU) are as follows:

**JOINT DECREE OF MINISTER OF FINANCE AND GOVERNOR OF BANK INDONESIA  
NUMBER 17/KMK.05/2009 AND NUMBER 11/3/KEP.GBI/2009**

**CONCERNING: COORDINATION OF GOVERNMENT CASH MANAGEMENT  
THE MINISTER OF FINANCE AND THE GOVERNOR OF BANK INDONESIA**

**FIRST :** To stipulate the amount of average daily minimum cash balance including holidays in State Treasury Account with Bank Indonesia at IDR 2,000,000,000,000.00 (two trillion rupiah) for rupiah account and equivalence of USD 1,000,000.00 (one million United States dollars) for foreign exchange USD and non-USD accounts.

**SECOND:** The State Treasury may invest any excess balance of the State Treasury Account in Investment Spending Account with Bank Indonesia comprising Rupiah Investment Spending Account, USD Foreign Exchange Investment Spending Account, and Non-USD Foreign Exchange Investment Spending Account.

**THIRD :** The interest rate on Government Cash (rupiah and foreign exchange) in the State Treasury Account is 0.1% (zero point one per one hundred) per annum and the interest rate on each Investment Spending Account per annum is : a. For Rupiah Investment Spending Account, at 65% (sixty five per one hundred) of Bank Indonesia policy rate (BI Rate); b. For Foreign Exchange USD Investment Spending Account, at 65% (sixty five per one hundred) of Fed Fund Rate; c. For Non-USD Foreign Exchange Investment Spending Account, at 65% (sixty five per one hundred) of the foreign exchange home currency policy rate.

**FOURTH:** Calculation of interest shall be based on end of day average balance in one month for each account either State Treasury Account or Investment Spending Account.

**FIFTH:** By the enactment of this Joint Decree of Minister of Finance and Governor of Bank Indonesia: a. Bank Indonesia shall conduct calculation and payment of interest on Government Cash in the State Treasury Account and Investment Spending Account with Bank Indonesia which the interest shall be calculated as of January 2009 and the payment of interest on end of day average balance for the current one month shall be calculated at the end of the current month. b. Especially for the interest for January 2009, the payment shall be carried out together with the payment of the interest for March 2009 because the interest for January 2009 shall be calculated manually while automatic calculation shall be implemented as of February 2009. c. The Government shall implement a full Revenue Treasury Single Account (TSA) no later than January 1, 2009, as the schedule agreed by the Ministry of Finance and Bank Indonesia and becoming an inseparable Appendix of this Joint Decree of Minister of Finance and Governor of Bank Indonesia.

**SIXTH:** Any other Government Account may be treated as Investment Spending Account as far as it complies with provisions in Article 15 and Article 36 of Government Regulation Number 39 of 2007 concerning Central/Regional Government Cash Management and after the Government notifies Bank Indonesia that the other Government Account has been categorized as Investment Spending Account.

**SEVENTH:** In the implementation of the full TSA the balance of any State Treasury Account with commercial banks functioning as Revenue Account and Spending Account shall be made null at end of day to be deposited to the State Treasury Account with Bank Indonesia.

**EIGHTH :** The minimum cash balance in the State Treasury Account and the interest rate on Government Cash in Investment Spending Account with Bank Indonesia may be revised every 6 (six) months and in the event of any disagreement with the interest rate, the applicable interest rate shall be extended up to a new agreement is reached.

**NINTH:** The Minister of Finance may invest any excess balance in the State Treasury Account in commercial banks under coordination with the Governor of Bank Indonesia in regard to the investment amount and time.

**TENTH:** In case of any failure in the implementation of any matter agreed in this Joint Decree of Minister of Finance and Governor of Bank Indonesia by any party, one of the parties may request for a meeting between the Governor of Bank Indonesia and the Minister of Finance to review the implementation of this Joint Decree of Minister of Finance and Governor of Bank Indonesia.

**ELEVENTH:** To implement this Joint Decree of Minister of Finance and Governor of Bank Indonesia the Ministry of Finance shall issue Minister of Finance Regulation and Bank Indonesia shall issue Board of Governors Regulation in accordance with respective authority.

**TWELFTH:** This Joint Decree of Minister of Finance and Governor of Bank Indonesia shall come into force as of the date of its enactment and retroactively be effective since January 1, 2009.

Enacted in Jakarta

Dated January 30, 2009

## APPENDIX 4

### Illustrative Example of Agreements with Commercial Banks for Provision of Banking Services for Expenditures

Extracted from:

The Agreement on State Budget Funds Disbursement Cooperative Agreement Through Commercial Banks (Bank Operation) Between The Directorate General of Treasury and Bank XXX.

The agreement signed by the DG Treasury (as the first party) and the Management (Director) of the commercial bank/Bank Operation (as the second party).

THE FIRST PARTY and THE SECOND PARTY, collectively referred to as THE PARTIES, agree to enter into and sign a State Budget Funds Disbursement Cooperative Agreement through Commercial Banks, with the following stipulations:

#### PURPOSE AND OBJECTIVE

The purpose of this Cooperative Agreement is to arrange the work of the fund disbursement services of 2013 by the Central BO I which are the working partners of the Directorate General of Treasury and the BO I which are the working partners of KPPNs.

#### SCOPE OF WORK

- Opening and management of MOF's account upon the requests of the DG of Treasury;
- Receiving funds from the TSA at Bank Indonesia and entering it in the books at that time for the benefit of MOF account;
- Distributing/dispersing funds based on the request of DG Treasury;
- Submitting the reports of bank statements of the MOF's account to the Directorate of PKN;
- Zeroing out the balances of the MOF's account at the end of the working day ;
- Cooperating with THE FIRST PARTY in building a data application and communication system

#### LIMITATION OF RESPONSIBILITIES

- In implementing the work as referred to in this Cooperative Agreement, THE SECOND PARTY is obliged to keep confidential all the existing data and information, and may not use them for any other interest or purpose, or share them with any other parties outside of the defined scope of work, except with a written consent of THE FIRST PARTY.

#### IMPLEMENTATION COSTS

- Costs for the formulation of business processes upon the distribution of SP2D funds become the burden of THE FIRST PARTY.
- Costs for the development of application and communication systems is become the burden of THE SECOND PARTY.
- Costs for the provision of application at the BO Is which conform to KPPN applications become the burden of THE SECOND PARTY.
- Costs for the provision of the CMS network and system become the burden of THE SECOND PARTY.

#### PROHIBITIONS

- KPPN are prohibited to submit SP2Ds to the BO after 3:00 PM local time in order to transfer them to the authorized accounts on related working days.
- The BO are prohibited to:
  - a. Charge any service costs, including costs for BI RTGS /Local Clearance to any authorized parties.
  - b. Perform any actions, both directly and indirectly, which may result in:
    - i. Delayed transfers to the authorized accounts
    - ii. Delayed crediting of Returned SP2D funds.
    - iii. Withdraw funds from the MOF's account before such SP2Ds are received from the KPPN.
    - iv. Withdraw funds from the MOF's account in excess of the total funds listed in the SP2Ds.

Warning Letters are submitted by THE FIRST PARTY to THE SECOND PARTY when:

1. The Central BO Is submit invalid reports to the Director of State Cash Management.
2. The Central BO Is are late to submit reports to the Directorate General of Treasury with attention to the Directorate of State Cash Management.
3. The Central BO Is do not pay the penalty charged by the Directorate of State Cash Management.
4. The Central BO Is do not perform other duties and obligations

#### PENALTY SANCTIONS

THE FIRST PARTY imposes penalties to THE SECOND PARTY if:

1. The Central BO Is do not zero out and/or do not perform full zeroing out of the balances of MOF's account.
2. The Central BO Is are late to distribute funds to the receiving accounts in accordance with the request received from the MOF.
3. The Central BO Is are late to credit the Returned SP2D funds from the receiving banks to the MOF's account.
4. The Central BO Is charge costs to any parties listed in the SP2Ds/R-SP2Ds.

The total amount of penalty is set at 1‰ (one per thousand) per day, including holidays/ days given off from the total amount of funds that were not zeroed out/late to be distributed/late to be credited, calculated per day including the holiday.

The total amounts of penalties are set at 300% of the total charge cost imposed on any party listed in the SP2Ds/R-SP2Ds.

## APPENDIX 5

### Mechanism of State Receipts and Expenditures Before and After the Implementation of the TSA (Treasury Single Account)

No	Item	Before TSA	After TSA
<b>A. For Cash Receipts</b>			
		Persepsi Banks are appointed by the Minister of Finance and are not paid for services related to state receipts.	Persepsi Banks are appointed by the Ministry of Finance and are paid for services related to state receipts, based on a working agreement/ contract (at present IDR 5,000 per transaction).
1.	Persepsi Banks	State Receipts in Persepsi Banks are sent every Tuesday, Friday and last day of the month to BI (funds are idle in Persepsi Banks outside of those days/times).	Each day the State cash Receipts in Persepsi Banks must be sent to the RKUN in BI (there are no idle funds in Persepsi Banks)
<b>B. For Cash Expenditures</b>			
		No payment is given for services related to state expenditures	Payment is given for services related to state expenditures, the amount of which is established based on open bidding.
1.	Operational Banks (BO)	<ul style="list-style-type: none"> <li>• BOs as KPPN working partners are directly appointed by the Directorate General of the Treasury.</li> <li>• There are three BOs according to type/function: <ul style="list-style-type: none"> <li>➤ BO I = Hold Salary and Non-Salary Funds</li> <li>➤ BO II = Hold salary funds (monthly salaries and salary shortages)</li> <li>➤ BO III = Hold land and property tax (PBB) and transfer of the ownership of the land and property tax (BPHTB)</li> </ul> </li> </ul>	<p>The selection of BO as LTB/ KPPN working partner is done through a competitive bidding process. However, in 2013, direct appointment was temporarily applied to support the development of new IFMIS (SPAN) in which the appointed banks are required to establish banking IT connectivity with the SPAN. In the future, the competitive bidding process will be applied again when the SPAN is already stabilized.</p> <ul style="list-style-type: none"> <li>• Based on their duties/ functions, there are 2 types of BOs: <ul style="list-style-type: none"> <li>➤ BO I = Hold non-salary funds (including salary shortages)</li> <li>➤ BO II = Hold salary funds (monthly)</li> </ul> </li> </ul>

No	Item	Before TSA	After TSA
2.	Fund ceiling/balance in BOs	<ul style="list-style-type: none"> <li>• The fund ceiling amounts in BO I have been set for both salaries and non-salaries. BO II is given funds for payment of salaries 6 days before the 1st of the month.</li> <li>• Each day BO I and II have balances as reserves for the payment of state expenditures.</li> </ul>	<ul style="list-style-type: none"> <li>• There is no ceiling set for BO I. BO I funds are provided based on the KPPN need for each day. BO II, at present, is given funds for payment of salaries 3 calendar days before the salary payment date.</li> <li>• Balances in BO I must be zeroed out every day, while for BO II (at present) balances must be zero after payment of salaries.</li> </ul>
<b>C Others</b>			
1.	KPPNs	<p>In connection with the process of providing funds for channeling State Budget funds, KPPN are divided into:</p> <ol style="list-style-type: none"> <li>1. (core) KPPN</li> <li>2. (non-core) KPPN</li> <li>3. non-KBI KPPN</li> </ol> <p>In principle, KPPNs provide their own funds.</p>	<p>There is no longer a difference between KBI (core) KPPN, KBI (non-core) KPPN, and non-KBI KPPN.</p> <p>The provision of funds for channeling State Budget funds is done through the central Treasury (HQ) office.</p> <p>Funds are provided in the Expenditures Account of the Central Proxies of the State General Treasurer (RPK-BUN-P) at the headquarters of BO I.</p> <p>The provision of funds for BO I working partners with KPPN is done by each BO I by withdrawing funds from the RPK-BUN-P. Hence, in essence KPPN does not hold any cash at all.</p>

## APPENDIX 6

### Types of Intergovernmental Fiscal Transfers in Indonesia

DBH (Revenue Sharing Fund)	DBH from income tax (PPh) Article 21	Share of the region is 20 per cent: 12 per cent for district/city (in which 8.4 per cent shall be distributed to producing region where the tax payer registered location) and 8 per cent for province
	DBH from PPh Article 25/29 Domestic Individual Tax Payer	Share of the region is 20 per cent: 12 per cent for district/city (in which 8.4 per cent shall be distributed to producing region where the tax payer registered location) and 8 per cent for province
	PBB, BPHTB	PBB and BPHTB are not included in DBH anymore, because these categories of taxes have been transferred to Regional Tax
	Excise on Tobacco Products (CHT).	The ratio of 30 per cent for the province and 70 per cent for the district/city (in which 40 per cent for producing district/city and 30 per cent for the other district/city within the province).
	DBH Natural Resources (SDA) on natural oil mining and natural gas mining	15.5 per cent for the gas mining and 30.5 per cent from the oil mining revenue after tax component and other collection deduction will be distributed to the regions.
	SDA forestry, general mining, fishery, and geothermal.	regional sharing from SDA Public Mining, Forestry, Geothermal and Fishery was decided at 80 per cent from its revenue
General Allocation Fund (DAU)	The amount of National DAU extremely depends on the amount of Net Domestic Revenue (PDN) stated in APBN. However, in order to sharing the pain of APBN burden and taking into consideration that some subsidy was also intended for the region, PDN Net also taking into account among others the amount of fuel (BBM) subsidy, electricity subsidy, fertilizer subsidy and foodstuff subsidy as reduction factor.	According to Law Number 33 Year 2004, the total amount of DAU is established no less than 26 per cent from PDN net stated in APBN.  DAU to be distributed to each province and district/city was calculated based on: (1) basic allocation, calculated based on the amount of PNSD salary, among others include basic salary plus family allowance and professional allowance according to the payroll regulation of civil servants; and (2) fiscal gap, which was the difference between the fiscal need and fiscal capacity. Fiscal needs is reflected by the variable of total inhabitants, area, construction expense index, human development index, and PDRB per capita, while fiscal capacity is represented by PAD variable, Tax DBH, and DBH SDA, but not included DBH SDA Reforestation Funds.

**ATTACHMENT:****The World Bank “Treasury Single Account Rapid Assessment Toolkit”<sup>1</sup>**

The World Bank has recently issued a technical note on the TSA rapid assessment toolkit/ checklist<sup>2</sup> which includes 65 questions/statements under five main components:

1. Legal and regulatory framework of TSA operations (11 questions)
2. TSA processes and interbank systems (25 questions)
3. Capacity and competencies (7 questions)
4. Information security controls (14 questions)
5. Oversight mechanisms (8 questions)

The use and application of this TSA assessment toolkit will require certain conditions, including that it must be jointly performed by two dedicated teams from the Ministry of Finance and Bank Indonesia. Other requirements are: an understanding about the results/gaps on the current status and remaining challenges, a site inspection, feedback from the relevant officials, and a rigorous assessment for the rating/scoring of each aspect being reviewed.

This book is not intended to apply the toolkit’s methodology. The objective of this attachment is solely to provide narrative information on the current status of TSA operations in Indonesia, based on the questions/statements set in the TSA rapid assessment toolkit. The information is purely descriptive, with no attempt being made to draw conclusions and/or make recommendations from the findings. The methodology used for this assessment was based solely on the self-assessment by officials of the DG Treasury Ministry of Finance and Central Bank of Indonesia on the current situation. Other main sources of information were: (i) the responses to the questionnaire completed by the DG Treasury and Bank Indonesia officials; (ii) legislation and/or regulations governing the payment systems and TSA; and (iii) rules and procedures relevant to the operations of payment systems and issued by both the Ministry of Finance and Bank Indonesia.

<sup>1</sup> This toolkit was originally developed in response to a request from the Public Sector and Institutional Reform Cluster (ECSP4) of the Europe and Central Asia (ECA) Region for the assessment of Treasury Single Account (TSA) operations in Kyrgyz Republic in October 2012. Its transformation into a generic TSA rapid assessment toolkit was supported by the then Governance and Public Sector Management Practice (PRMPS) of the World Bank’s Poverty Reduction and Economic Management (PREM) Network. The unit is now part of the World Bank Governance Global Practice. The toolkit was shared with a number of government officials and project teams for field testing, and has benefited from additional feedback for possible improvements since then.

<sup>2</sup> Mr. Cem Dener (GGODR, World Bank) is the author of this technical note in October 2013



## Treasury Single Account (TSA) Rapid Assessment Toolkit: Indonesia

Ref.	TSA Assessment Components	Q Ref.	Questions / Statements	PIC	Comments
<b>1</b>	<b>Legal and regulatory framework of TSA operations</b>				
1.1	Central Bank of Indonesia legislation				www.bi.go.id
	Clear legal and regulatory framework for interbank systems has been established with appropriate and effective sanctions for non-compliance.	Q.1	Banking law and regulations are in place	BI	<ul style="list-style-type: none"> <li>- Law of Republic of Indonesia (RI), No. 7 year 1992 on commercial bank; and</li> <li>- Law of RI, No. 23 of 2009 on the Central Bank of Indonesia and its amendment of Law of RI, No. 3 year 2004</li> </ul>
		Q.2	Electronic Signature law / regulations are in place.	BI	<ul style="list-style-type: none"> <li>- Law of RI, No. 11/2008 on Electronic Transaction and Information (ITE); and the Government of Republic of Indonesia Regulation No. 82 year 2012 on the management of electronic systems and transactions.</li> </ul>
		Q.3	RTGS law / regulations are in place.	BI	<ul style="list-style-type: none"> <li>- The central bank of Indonesia regulation (PB) No. 10/2008 on Bank Indonesia Real Time Gross Settlement system; the circular letter No. 12/1/2010 on the management of Bank Indonesia Real Time Gross Settlement system; and the Circular of the Deputy Governor of the Bank of Indonesia dated 16 August 2007 Number 9/5/DG/DASP regarding Exemptions from RTGS Costs for State Receipt and Spending Transactions of Treasury Single Accounts (TSAs) in KPPIs all over Indonesia.</li> </ul>

Ref.	TSA Assessment Components	Q Ref.	Questions / Statements	PIC	Comments
1.2	DG Treasury legislation	Q.4	Automated Clearing House (ACH)/ Bulk Clearing Small (BCS) retail and regular payments laws / regulations are in place.	BI	- The central Bank of Indonesia regulation (PBI) No. 7/2005 and its amendment of PBI No. 12/2010 on Bank Indonesian National Clearing System (SKNBI); and the central bank of Indonesia circular letter No. 12/8/2010 and its amendment No. 12/34/2010 on Bank Indonesia national clearing system (SKNBI).
		Q.5	Laws / regulations for oversight of payment & settlement system are in place.	BI	- Law of RI, No. 3 year 2011 on transfer of funds; and the central bank of Indonesia regulation (PBI) No. 14/2012 on transfer of funds.  <a href="http://www.depkeu.go.id">www.depkeu.go.id</a>
		Q.6	Legal and regulatory framework for IFMIS (SPAN) operations is in place.	MOF	- The Government of Republic of Indonesia Regulation No. 45 year 2013 on the State Revenue and Expenditure Budget Implementation Guidelines; and the Government of Republic of Indonesia Regulation No. 90/2010 on the work plan and budget preparation of Ministries/ Institution (RKA-KL)  - SPAN (IFMIS) related implementing regulations are expected to be approved late 2013 before the piloting phase of the system

Ref.	TSA Assessment Components	Q Ref.	Questions / Statements	PIC	Comments
		Q.7	TSA protocol signed between the DG Treasury (CT) and Bank Indonesia (BI)-legally binding.	MOF	- Memorandum of Understanding (Joint Decree) between Finance Minister (No. 17/KMK.05/2009) and Governor of Bank Indonesia (No. 11/3/Kep.GBI/2009) on Coordination of the Government Cash Management, January 30, 2009
		Q.8	TSA instructions describing the details of revenue / expenditure processing are in place.	MOF	- Law Number 1 of 2004 regarding the State Treasury, Article 12 Paragraph (2) and Article 22 Paragraphs (2) and (3) "All state receipts and expenditures are made through a Single Account –the State General Cash Account (RKUN)" - Regulation of the Minister of Finance No.98/PMK.05/2007 Regarding the Implementation of Zero-Balance Expenditure Bank Accounts at Commercial Bank Working Partners of KPPNs in the Context of TSA Application at 181 KPPNs - Regulation of the Minister of Finance No. 61/PMK.05/2009 Regarding the Application of Treasury Notional Pooling for Expenditure Treasurer Accounts. - Regulation of the Minister of Finance No. 126/PMK.05/2009 Regarding the Application of Treasury Notional Pooling for Receivables Treasurer Accounts.

Ref.	TSA Assessment Components	Q Ref.	Questions / Statements	PIC	Comments
	Clear legal and regulatory framework for Treasury Single Account operations has been established with appropriate and effective sanctions for non-compliance.	Q.9	Legal basis for the operations of electronic payment center is in place.	MOF	<ul style="list-style-type: none"><li>- The Government of Republic of Indonesia Regulation No. 45 year 2013 on the State Revenue and Expenditure Budget Implementation Guideline;</li><li>- The Finance Minister Regulation No.190/PMK.05/2012 on the mechanism of conducting payments for the purpose of implementing the State Budget.</li></ul>
		Q.10	Agreement with the BI to maintain DG Treasury TSA bank accounts is in place.	CT/BI	<ul style="list-style-type: none"><li>- Government Regulation Number 39 of 2007 Regarding the Management of State/Regional Funds, Article 14 Paragraph (2) "All state receipts are deposited in the State General Cash Account and all state expenditures are made out of the State General Cash Account".</li></ul>
		Q.11	Agreement with the DG Treasury and Bank Operational(s) for TSA operations is in place.	MOF	<ul style="list-style-type: none"><li>- Signed Agreement between DG Treasury and 81 Commercial Banks and post office on Banking Services as a Persepsi (collector) Bank/post office for the implementation of TSA Receipts;</li><li>- Signed Agreement between DG Treasury and commercial banks as a payment bank for the implementation of TSA expenditure.</li></ul>

Ref.	TSA Assessment Components	Q Ref.	Questions / Statements	PIC	Comments
2	TSA processes and interbank systems				
2.1	Segregation of key TSA functions				
	Segregation of key TSA duties (payment management and control, settlements, and accounting/ reconciliation) is enforced through organizational structures, user access in the treasury/payment systems and procedural documents.	Q.12	Payment management functions are executed by the DG Treasury through automated processes supported by IFMIS.	MOF	The payment management (PM) module of Oracle EBS (COTS) has full capability to manage payment transactions executed by DG Treasury local offices (KPPNs).
		Q.13	Payment control functions to check compliance with approved budget limits are performed by CT through automated processes supported by IFMIS (SPAN)	MOF	The commitment module of Oracle EBS (COTS) has full capability to check compliance with the approved budget limit

Ref.	TSA Assessment Components	Q Ref.	Questions / Statements	PIC	Comments
		Q.14	Payment control functions to check compliance with the banking legislation are performed by BI through automated processes supported by BI information systems.	BI	Bank Indonesia operates BI RTGS (real time gross settlement) system to provide real time on-line fund transfer of the government money to the appointed commercial banks as the government partner banks for revenue collection (bank persepis) and expenditure payment (bank operational).
		Q.15	Accounting functions for TSA operations (reconciliation and reporting) are performed by MOF through automated processes supported by IFMIS.	MOF	SPAN will be capable of carrying out reconciliation and reporting of TSA operations in an automated process using the GL Module available in the Oracle EBS
		Q.16	Accounting of the TSA operations (recording all daily flows and providing daily bank statements) is performed by the BI through automated processes supported by the BI information systems.	BI	Bank Indonesia operates BI SOSA application system (BI Centralized Automated Accounting System) to provide administration and accounting of the Government's account managed by the central bank.

Ref.	TSA Assessment Components	Q Ref.	Questions / Statements	PIC	Comments
	Segregation of key TSA duties (payment management and control, settlements, and accounting/reconciliation) is enforced through organizational structures, user access in the treasury/payment systems and procedural documents.	Q.17	Oversight functions for payment and settlement systems (financial + information security controls) are performed by the BI through automated processes.	BI	Bank Indonesia operates BIG-eB application system (Bank Indonesia Government Electronic Banking) to provide an internet banking connection for the Government as the financial and information security controls.
2.2	Daily recording and reporting of TSA transactions				
	All TSA transactions related with budget revenues (receipts) and expenditures (payments) are recorded and reported through BI payment and settlement systems, as well as the MOF's IFMIS solution on a daily basis.	Q.18	RTGS system is capable of recording/reporting the details of all TSA payments on a daily basis.	BI	RTGS records/reports TSA flows on a daily basis. MOF's Agent Bank for collecting revenue (Bank Persepsi) reports via electronic docs (DBF format) sent as email attachments, every day.
		Q.19	ACH (BCS) system is capable of recording/reporting the details of all TSA payments on a daily basis.	BI	BCS records/reports TSA flows on a daily basis. MOF's Agent Bank for collecting revenue (Bank Persepsi) reports via electronic docs (DBF format) sent as email attachments, every day.

Ref.	TSA Assessment Components	Q Ref.	Questions / Statements	PIC	Comments
		Q.20	Bank Indonesia GL captures all flows in TSA bank accounts through their accounting system/GL on a daily basis.	BI	BI SOSA (accounting) system captures all RTGS/BCS flows on a daily basis. MOF has real time online access to its bank account statements through BIG-eB system.
	All TSA transactions related with budget revenues (receipts) and expenditures (payments) are recorded and reported through BI payment and settlement systems, as well as the MOF's IFMIS solution on a daily basis	Q.21	Bank Operational (Agent Banks) transfer all revenues to the MOF's designated TSA bank account at the BI on a daily basis through online connections to RTGS/BCS.	BI	Currently, Agent Banks (Bank Persepsi) transfer all MOF revenues to the TSA in the central bank on a daily basis at end of day. Revenue data from agent banks will be reconciled with the MPN and discrepancies will be immediately resolved.
		Q.22	DG Treasury submits all payment requests in required formats through MOF-BI TSA interface from a secure electronic payment center through automated processes supported by IFMIS on a daily basis.	MOF/BI	DG Treasury is a direct participant of RTGS through a workstation to automate expenditure payments from Central Bank to the Bank Operational for expenditure.
		Q.23	BI sends bank statements from the RTGS and BCS about the details of all TSA transactions through automated processes on a daily basis.	BI	DG Treasury can download RTGS statements from central bank BIG-eB systems online.



Ref.	TSA Assessment Components	Q Ref.	Questions / Statements	PIC	Comments
		Q.24	BI sends bank statements from the BI General Ledger about the flows in TSA bank accounts through automated processes on a daily basis.	BI	Central Bank produces daily GL statements and reconciles Central Treasury account daily in an automated way
		Q.25	Reconciliation of the BI (and Agent Bank/BO) bank statements is performed by the MOF through the IFMIS General Ledger (GL) module on a daily basis.	BI	SPAN has capacity to reconcile bank statements automatically on a daily basis
	All TSA transactions related with budget revenues (receipts) and expenditures (payments) are recorded and reported through BI payment and settlement systems, as well as the MOF's IFMIS solution on a daily basis	Q.26	Each TSA transaction must contain a unique identifier which can be used to link the payment or receipt to the accounting entries in the MOF's IFMIS GL.	MOF	New generation of the State Receipt System (MPN G-2) provides a unique billing code (per payment made by tax payer) and these are captured in RTGS/BCS transaction ref numbers.
2.3	Audit trails				
	Audit trails are enabled and effectively used in BI and MOF information systems	Q.27	"Audit trail" is enabled in BI RTGS platform and effectively used.	BI	Yes, the Central Bank of Indonesia system has enabled an effective audit trail

Ref.	TSA Assessment Components	Q Ref.	Questions / Statements	PIC	Comments
		Q.28	"Audit trail" is enabled in BI ACH (BCS) platform and effectively used.	BI	Yes, the Central Bank of Indonesia system has enabled an effective audit trail
		Q.29	"Audit trail" is enabled in BI accounting/GL operations and effectively used.	BI	Yes, the Central Bank of Indonesia system has enabled an effective audit trail
		Q.30	"Audit trail" is enabled in MOF FMIS databases and effectively used.	MOF	- Existing system has limited capabilities to support an "audit trail". - "Audit trail" will be enabled in SPAN once operational.
		Q.31	"Audit trail" is enabled in MOF EPC databases (in case of indirect participation) and effectively used.	MOF	MOF ICT center (Pusintek) as the unit to manage the MOF databases center has enabled a quite effective audit trail in its system.
2.4	Inventories of bank accounts				
	An inventory of existing Bank accounts to be used in TMIS and TSA operations exist and regularly updated	Q.32	BI has an inventory of all Bank accounts to be used in TSA operations.	BI	Central Bank's interbank system (RTGS) has an inventory of all participant bank accounts. Beneficiary bank accounts are automatically checked before payment.

Ref.	TSA Assessment Components	Q Ref.	Questions / Statements	PIC	Comments
2.5	Transaction level controls	Q.33	MOF FMIS has an inventory of all bank accounts to be used in TSA operations and this is synchronized with the BI inventory.	MOF/BI	<ul style="list-style-type: none"> <li>- Existing treasury system has an inventory of bank accounts.</li> <li>- SPAN will have further capability to maintain the inventory not only of all relevant bank accounts but also of suppliers (vendors/contractors/public employees)</li> </ul>
		Q.34	BI has RTGS/BCS payment system checklists managed through automated processes and reports the results of all transactions in well-defined formats (SWIFT).	BI	BI interbank systems have the necessary automated payment controls. Results of operations are reported to participants automatically, based on an expanded version of the SWIFT format.
		Q.35	RTGS and BCS payment controls include checking the bank accounts against the "black list" maintained by the BI.	BI	BI interbank systems have capabilities to check the bank accounts against the "black list".
		Q.36	DG Treasury submits all payment orders electronically from FMIS to RTGS/BCS, without any manual intervention. BI disables manual entry mode for CT.	MOF/BI	DG Treasury submits all RTGS payment requests automatically through a secure channel

Ref.	TSA Assessment Components	Q Ref.	Questions / Statements	PIC	Comments
3	Capacity and competencies				
3.1	Bank Indonesia capacity				
	BI units (payment systems and IT) have adequate number of trained staff to manage interbank payment systems	Q.37	For each interbank payment system related position, there is a job description specifying the duties of the position, reporting lines, delegations of authority and qualification requirements.	BI	BI has the necessary instructions and training programs for the interbank system users/managers.
		Q.38	Total number of authorized personnel to manage payment systems is adequate compared to the volume of transactions and intensity of work.	BI	Yes, at present the BI staff that manage the payment systems are adequate in terms of number and qualifications. The standard of services has also followed the ISO. All staff are properly trained. However, in the future, with the increase in the types and volume of transactions, more staff might be needed.
3.2	DG Treasury capacity				
	DG Treasury units (electronic payment system and IT) have adequate number of trained staff to manage TSA operations	Q.39	For each TSA related position, there is a job description specifying the duties of the position, reporting lines, delegations of authority and qualification requirements.	MOF	DG Treasury has sufficient staff in Directorate Cash Management, 181 KPPNs and Directorate Treasury system to manage TSA operations.

Ref.	TSA Assessment Components	Q Ref.	Questions / Statements	PIC	Comments
	DG Treasury units (electronic payment system and IT) have adequate number of trained staff to manage TSA operations	Q.40	Total number of authorized personnel to manage TSA operations is adequate compared to the volume of transactions and intensity of work.	MOF	Yes, but continued and sustained training and capacity building programs will be required.
		Q.41	The Treasury staff is experienced in the operation of electronic payment system (EPS) and can execute TSA transactions on the interbank payment systems securely.	MOF	Yes, DG Treasury staff is experienced and capable of making secure use of the automated BIG-eB system provided by BI to execute TSA transactions on the interbank payment systems.
3.3	ICT infrastructure				
	ICT infrastructure is capable of handling the workload to support full scale centralized TSA operations	Q.42	BI data center is well prepared to handle all TSA transactions and store relevant details.	BI	Bank Indonesia RTGS and BCS data centers are fully operational and capable of handling the existing work load.
		Q.43	MOF data center is well prepared to manage all TSA operations and store the details of all transactions.	MOF	MOF's new data center is ready to manage and store all TSA transactions within the IFMIS/SPAN operations. COTS Oracle EBS application software has been substantially developed (to be applied in FY 2014).

Ref.	TSA Assessment Components	Q Ref.	Questions / Statements	PIC	Comments
<b>4 Information security controls</b>					
4.1	BI information security controls				
	Information security controls are actively used in the BI information systems	Q.44	Authentication and authorization (type of digital signature used; storage of the digital certificates issued).	BI	Bank Indonesia has a well-established user authentication solution based on smart cards. There is a dedicated unit providing access rights and issuing digital signatures.
		Q.45	Privileged access (who has privileged access to TSA databases and interbank system platforms).	BI	Bank Indonesia information technology department has dedicated specialists for system admin and network management functions. Access logs are monitored regularly.
		Q.46	Data security and integrity (solutions for secure data transfer + encryption of data in transit).	BI	Bank Indonesia has a secure Virtual Private Network (VPN) established over dedicated fiber optic lines connecting all participants to the BI data center.
		Q.47	Network and web application firewalls (solutions for reviewing logs, restricting access).	BI	Bank Indonesia has a secure IT infrastructure and necessary monitoring tools.

Ref.	TSA Assessment Components	Q Ref.	Questions / Statements	PIC	Comments
		Q.48	Password for all user types.	BI	Bank Indonesia system users have clearly defined roles and access rights; linked with individual user names and passwords.
	Information security controls are actively used in the BI information systems	Q.49	Physical security (access control and data center security).	BI	All Bank Indonesia data centers have necessary access control solutions (card readers, cameras, motion sensors, etc.). Fire alarm and extinguishing (gas), air conditioning, UPS and generator backup are in place.
		Q.50	Backup and storage (all transactions for the last 5 years stored actively in databases; older records are archived; who maintains TSA records).	BI	All Bank Indonesia data centers have data storage and automatic backup/restore units. Storage and server capacities need to be increased to support future TSA/FMIS.
4.2	DG Treasury (CT) information security controls				
	Information security controls are actively used in the CT information systems	Q.51	Authentication and authorization (type of digital signature used; storage of the digital certificates issued)	MOF	DG Treasury has limited capabilities for the user authentication solution based on smart cards. SPAN implementation is expected to improve the use of digital signatures.
		Q.52	Privileged access (who has privileged access to TSA databases and interbank system platforms)	MOF	DG Treasury has dedicated specialists for system admin and network management functions. However, staff capacity may not be adequate for full-scale SPAN/FMIS operations. Also, access logs are not monitored regularly.

Ref.	TSA Assessment Components	Q Ref.	Questions / Statements	PIC	Comments
		Q.53	Data security and integrity (solutions for secure data transfer + encryption of data in transit)	MOF	MOF has a secured Virtual Private Network (VPN) established over Indonesia Telkom backbone, connecting all treasury offices to the data center.
		Q.54	Network and web application firewalls (solutions for reviewing logs; restricting access)	MOF	DG Treasury has a secure IT infrastructure and necessary monitoring tool. SPAN implementation is expected to improve the network monitoring capabilities.
	Information security controls are actively used in the CT information systems	Q.55	Password for all user types	MOF	DG Treasury system users have passwords for access to existing treasury system. SPAN/IFMIS is expected to improve the user roles and access rights.
		Q.56	Physical security (access control and data center security)	MOF	Necessary access control solutions are installed in MOF data center (card readers, cameras, motion sensors, etc.). Fire alarms and extinguishers (gas), air conditioning, UPS and generator backup are in place.
		Q.57	Backup and storage (all transactions for the last 5 years stored actively in databases; older records are archived; who maintains TSA records)	MOF	MOF data center (PUSINTEK) has modern data storage and automatic backup/restore units capable of supporting new IFMIS/SPAN and TSA operations.



Ref.	TSA Assessment Components	Q Ref.	Questions / Statements	PIC	Comments
<b>5</b>	<b>Oversight mechanisms</b>				
5.1	BI is subject to regular review by internal audit; external audit or by peer auditors.	Q.58	Financial/compliance audit of the BI operations	BI	BI is regularly audited by the Supreme Audit Agency (BPK)
		Q.59	IT Audit of the BI information systems (payment systems and accounting)	BI	BI information systems are regularly audited by internal audit (Department of Internal Audit, Division of Information System Audit).
5.2	DG Treasury is subject to regular review by internal audit; external audit or by peer auditors.	Q.60	Financial/compliance audit of the DG Treasury operations	MOF	MOF is regularly audited by the Supreme Audit Agency (BPK); internal audit by G-MOF
		Q.61	IT Audit of the MOF information systems (FMIS and electronic payment center)	MOF	IT Audit of the MOF information system (FMIS and electronic payment center) was rarely conducted by external and/or internal auditors. However PUSINTEK (MOF IT Center) maintains and updates the IT system on a regular basis.
5.3	IMF Safeguards Assessment is performed regularly as a review of the BI's governance framework	Q.62	The BI governance framework is up to the standards as evidenced by the IMF's Safeguards Assessment	BI	An IMF safeguards assessment has never been performed.

Ref.	TSA Assessment Components	Q Ref.	Questions / Statements	PIC	Comments
5.4	PEFA assessment is performed as a core diagnostic to review the overall PFM and accountability performance	Q.63	The TSA operations and the CT/BI practices are reviewed during the PEFA assessment, and related assessments are used to monitor the progress.	MOF/BI	- 2007 PEFA assessment (public) - 2011 repeated PEFA assessment (public)
5.5	Financial risks and controls are regularly reviewed and attached to the annual financial system reviews of the BI and MOF.	Q.64	The risk and controls report is prepared annually, describing the overall assessment of the BI information systems, the controls and any deficiencies.	MOF/BI	Bank Indonesia has oversight mechanisms and risk assessment procedures in place. A risk and control review is performed annually.
		Q.65	The risk and controls report is prepared annually, describing the overall assessment of the MOF information systems, the controls and any deficiencies.	MOF	A risk and control review is recognized as an important part of the oversight functions.



