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Treasury Practices in the Public Sector

Global and Regional Perspective on Challenges and Trends

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Contents

Introduction

The Public sector's treasury is tasked to sustain a strong economy and create economic and job opportunities by encouraging an environment that enables economic growth and stability and protecting the integrity of the financial system, whilst effectively managing the government's finances and resources.

Whilst the same concept of shareholder value and profitability does not apply to the public bodies, they do have a public duty to ensure the most effective use of public funds. Common principles, such as those seen in the analysis of security, liquidity, and yield of an investment, apply and it is evident that there is a lot to benefit from the corporate point of view.

The Public sector's treasury role is highlighted as the driver of economic and financial systems and is usually mandated by legislative authorities to promote, among other things, the government's fiscal policy framework, to coordinate macroeconomic policy and intergovernmental financial relations, to manage the budget preparation and implementation process, and to facilitate an equitable distribution of nationally raised revenue between national, provincial and local governments.

This publication examines the modern financial challenges faced by public sector treasuries globally and regionally in the Middle East. It discusses and highlights the key trends that public sector treasuries can leverage to both overcome challenges and seize opportunities.

Treasury challenges in the Public Sector

Global perspective

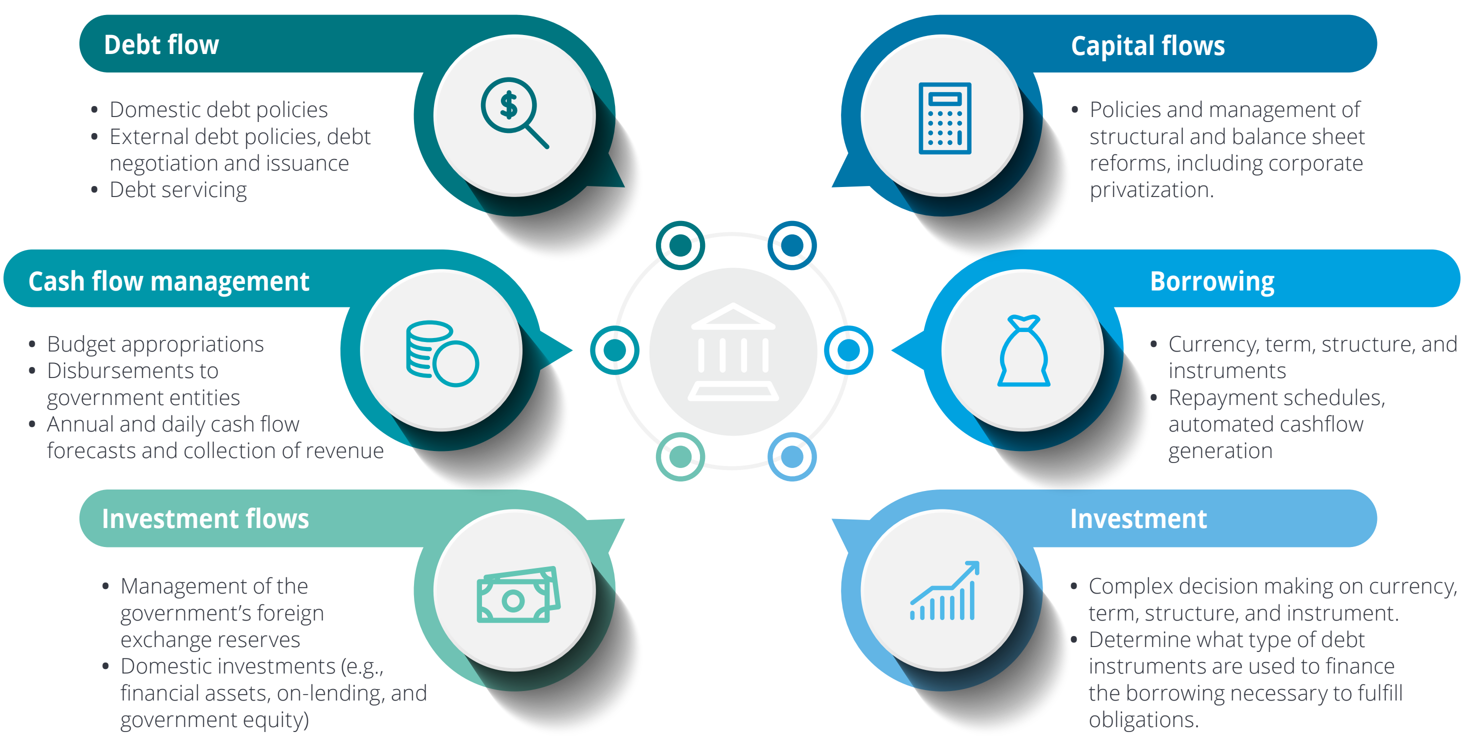
In today's global economy, public sector treasuries must shift from focusing on marginal efficiencies to providing strategic value. This is particularly challenging for developing economies, which lag behind developed counterparts in implementing advanced cash management reforms to streamline operations and optimize liquidity.

Traditionally, the public sector relies on manual processes, cash and check-based transactions, multiple bank accounts with large idle balances, and a focus on budget expenditure rather than optimizing cash flow. This contrasts with regions like Europe and Asia-Pacific, where automated treasury systems and centralized operations enhance efficiency. Rapid economic changes, technological advancements, and innovative solutions add pressure for more centralized and automated treasury operations.

Public sector treasuries globally are at a critical juncture, needing to balance enhanced efficiency and strategic value within existing frameworks. Embracing modern technologies and redefining the treasury's role to emphasize effective cash management is vital for boosting financial resilience and strategic impact amidst ongoing global and regional shifts.

Figure 1: Critical processes in Public Sector treasuries

The chart below focuses on some of the most challenging roles within the treasury framework.



Regional perspective - Middle East

Cash management in the Middle East and developing countries is often fragmented, with various public sector entities setting policies and managing cash flows without effective communication to determine the consolidated cash position daily.

The Middle East holds significant political, economic, and cultural importance due to its strategic location at the intersection of Asia, Africa, and Europe, and its wealth of natural resources.

Economic and financial reforms in the region promote growth while ensuring stability and financial sustainability, improving the business environment. For instance, Saudi Arabia's Vision 2030 aims to diversify the economy by reducing its dependence on oil, enhancing public service sectors such as health, education, infrastructure, recreation, and tourism. According to the Saudi Arabian Monetary Authority (SAMA), non-oil economic growth in Saudi Arabia reached 5.4% in 2022, driven by significant investments in these sectors (source: SAMA Annual Report – 59th Edition).

Despite these reforms, many Middle Eastern governments still use manual treasury and cash management processes, leading to significant opportunity costs from inefficiencies. The lack of centralized systems and real-time data reporting prevents effective cash flow management and decision-making. The International Monetary Fund (IMF) has highlighted that adopting digital and automated treasury systems can reduce these inefficiencies by up to 30%. (source: IMF Working Paper, 2020)

These Public Sector Treasuries in the Middle East must reform to adopt international best practices and overcome these inefficiencies.

> Countries like Saudi Arabia and the UAE are experiencing rapid growth. Saudi Arabia is expected to be one of the fastest-growing economies, driven by pro-business reforms and rising oil prices and production (source: World Bank, Global Economic Prospects, 2023). These reforms are pivotal in aiding the recovery from the 2020 recession and setting the stage for sustainable long-term growth.

Despite the growth witnessed in the region, there are some critical challenges that governmental and public treasuries face.

Figure 2: Challenges and imperatives for Public Sector treasuries

Cash management & payments

Effective cash management and payments in public sector treasuries are crucial, typically through Central Bank accounts. Prioritizing accounting over cash management leads to inefficiencies. Efficient cash management optimizes funds, reduces borrowing costs, and enhances returns.

A robust payments system would ensure timely disbursements, lowered transaction costs, and improved financial control, along with real-time tracking.

Manual processes

Public sector cash and treasury management in most developing countries relies on manual processes, such as processing cheques, manual reconciliations, and reporting.

These methods often lead to inefficiencies, reduced fund availability, and increased operational risks.

Inaccurate forecasts

Many countries in the region struggle with accurate daily and monthly cash flow forecasting due to the prevalent use of cash accounting in government entities. This method offers limited insight into financial health, omitting liabilities and long-term finances, thus leading to inaccurate cash flow forecasts.

Effective cash management necessitates precise forecasting of cash flows between the government and the banking system, as well as end-of-day cash balances in government accounts.

Expenditure control

Monitoring and controlling expenditure and revenue against budget appropriations is essential, focusing on preventing overspending and reducing financing costs. Government entities typically have limited control over cash management and payments, leading them to maintain multiple accounts at commercial banks for payment scheduling. This results in significant costs due to lost interest on idle balances and high transaction fees.

In large developing countries, the float often exceeds $1 billion, with borrowing costs at 4-6% and minimal interest earned. This can cost up to $50 million annually. Improved cash management targeting near-zero float can significantly reduce debt service costs.

Adoption of IPSAS accounting standards

Public sector treasuries in the Middle East are transitioning from cash-based to accrual-based accounting, aligning with International Public Sector Accounting Standards (IPSAS). This shift aims to enhance financial transparency and accuracy. Key examples in the Middle East include Saudi Arabia, integrating these standards into its Vision 2030 and the United Arab Emirates, advancing its public sector's efficiency.

Treasury management trends

The role of treasury management has evolved, becoming more strategic. Today's treasurers provide crucial financial insights, guiding organizations towards optimal financial paths and beyond traditional norms.

The need for self-sufficiency in public sector treasuries necessitates stringent funding controls and optimized cash management to minimize external borrowing and reduce state financial liabilities. Effective cash management, accurate cash flow forecasting, and centralized treasury operations are critical. This ensures efficient resource use and long-term financial sustainability for the sector.

Treasury technology

Advancements in treasury technology are set to accelerate. In 2024, technology will further shape treasury operations through centralized interfaces. Deploying Fintech, adopting digital assets, and using the latest treasury management systems (TMS) can enhance efficiency.

These technologies enable treasurers to automatically consolidate data, access necessary information, work optimally, and eliminate unnecessary administration.

Automation & digital solutions

A key trend is vendors offering best-of-breed solutions, allowing companies to select only what they need instead of an entire Treasury Management System. The Middle East is adopting innovative technologies, but significant investment is crucial. Public sector entities are eager for innovative solutions for business goals and sustainable growth.

Manual treasury processes often lead to human errors and unreliable outcomes. Automation is expected to dominate in 2024-25, making manual systems like Excel obsolete. Treasurers are automating tasks such as data consolidation, analysis, reporting, payments, trade finance, liquidity management, and cash flows.

Enhanced cash and liquidity management

The focus on cash and liquidity positions around the world have increased. Treasuries with manual processes and disparate account structures may face more pressure and uncertainty. Treasurers in Saudi Arabia, as the case in most countries in the region, are looking for comprehensive cash management solutions that include the integration of back-office systems, a regional network with global connectivity, innovative product solutions and increased technological capability.

Recent years have been marked by volatility, with high inflation, rising interest rates, and unstable FX rates. This economic uncertainty is expected to persist in 2024, affecting treasuries. Cash flow forecasting remains a priority for treasurers, but volatile markets, political tensions, and economic instability must be factored into cash flow planning to mitigate risks and ensure business continuity. Security in treasury management is crucial, with evolving regulations and compliance requirements. Treasurers must collaborate with internal departments and external vendors to implement robust security measures as financial and phishing frauds continue to rise globally.

The way forward

Treasury reforms in the Middle East are crucial for government entities, with commitment being the first essential step. Given recent fluctuations in revenues and expenditures, a well-structured treasury with clear responsibilities and efficient cash management is more important than ever. The scope and timeline of these reforms vary across entities and countries, but commitment and dedication are key to overcoming challenges and achieving goals.
Government efforts should be directed into the following milestones to achieve efficiency in treasury and cash management:

Adopting accrual accounting

The way forward for public sector treasuries in the Middle East involves adopting IPSAS and transitioning to accrual-based accounting. This phased approach enhances financial transparency and strategic planning. Accurate cash flow forecasting under IPSAS enables better decision-making, optimizing resources during high liquidity periods and preventing shortfalls. This significantly improves cash forecasting and liquidity management, marking a progressive step in public sector financial management.

A centralized treasury function responsible for overall cash management at government, respective ministries, autonomous bodies and closely integrated with the government debt managers to enhance visibility into cash flows, optimize liquidity, increase efficiency by reducing redundancies, and manage risk more effectively.

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Accurate cash flow forecasts

Cash flow forecasting remains a top priority for treasurers, with constant room for improvement due to often limited accuracy and projection horizons. To manage financial risk, public sector treasuries can use predictive analytics techniques such as statistical analysis, data modeling, real-time processing, and scoring to establish accurate cash flow forecasts during uncertain economic times.

New technologies

Technology is a high priority for treasury departments as economic challenges continue into 2024. Implementing sophisticated technologies like blockchain and digital assets, along with integrated tools and functions, benefits entities of all sizes and regions. A sound cash management framework benefits sector public entities, beneficiaries of government payments, banks, and lenders.

Our offerings

The Deloitte Middle East Treasury Advisory Services team offers integrated advisory on treasury strategies, operations, hedge strategy and accounting, automation, risk, and valuation. Our dedicated treasury professionals, supported by a global network, serve leading organizations, governments, and ministries. Some of our treasury advisory services include:

Treasury operations

- Design and Implementation of frameworks for enhancement of treasury operations.
- Assessment of policies, procedures, strategies, and methodologies of cash and liquidity management.
- Re-designing policies and procedures to layer a structured, consistent workflow, as well as approval procedures and protocols.
- Support in the deployment of in-house banking, with a cash pooling structure to enable the optimal utilization of funds.

Treasury strategy

- Design and implementation of the global treasury management architecture and operating model.
- Benchmarking treasury strategy and operations with global practices across industry verticals.
- Treasury setup and operationalization.
- Design and implementation of treasury performance metrics and KPIs for treasury personnel.

Hedging strategy and accounting

- Assisting with protocols to keep an entity within set limits while identifying critical metrics that capture sensitivities.
- Implementing the new derivatives and hedging accounting standard.
- Design, implementation, and testing of controls related to the derivatives and hedge accounting processes.
- Implementation of accounting and disclosure framework for financial instruments (GAAP and IFRS).

Treasury technology and digital assets

- Define a future state vision and identify how to achieve the desired level of automation of the treasury department.
- Explore application of digital assets, blockchain and smart contracts.
- Run a pulse check of the current systems and advise how to optimally utilize these systems.
- End-to-end support on the vendor selection process for treasury systems and solutions & leverage our partnerships with some of the industry's finest Treasury Management System (TMS) providers to present the best possible solutions.
- End-to-end implementation of the TMS.

Risk management and valuation

- Advise on the preparation and implementation of risk management policies aligned with the overall corporate strategy.
- Design and implementation of processes and methods to identify, analyze, report, and manage commodity risks.
- Design modelling methodology for mark-to-market of financial instruments.
- Support in benchmarking of risk models to manage the financial risk and be resilient against risks associated with business.

Contact us

Understanding the complex nature of treasury assignments, Deloitte Middle East has a team of seasoned professionals that thrives at the forefront of treasury innovation and challenges.

If you would like to talk to us about any of the aspects covered in this document or would like to understand how our service offerings can benefit your organization, please feel free to contact the below personnel:

Steve Punch
Partner
Enterprise Risk
spunch@deloitte.com
+971 04 376 8888

Syed Sohaib Moid
Partner
Regulatory & Financial
smoid@deloitte.com
+966 55 218 0537

Shahrag Trikha
Assistant Manager
Regulatory & Financial
shtrikha@deloitte.com
+971 55 631 5825

Paul Khattar
Manager
Regulatory & Financial
pakhattar@deloitte.com
+966 50 612 6953

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