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BY THE COMPTROLLER GENERAL

# Report To The Congress

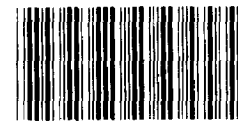
OF THE UNITED STATES

## Electronic Funds Transfer -- Its Potential For Improving Cash Management In Government

The Federal Government is making increasing use of electronic funds transfer for many of its payments and receipts. The Office of Management and Budget and the Department of the Treasury expect this technology to save millions of dollars.

Because it eliminates the time normally required for mailing, cashing, and clearing checks, electronic funds transfer accelerates the flow of funds and gives the Treasury opportunities to reduce its borrowing expenses and make more reliable forecasts of future cash flow. But the Treasury cannot always take advantage of these opportunities because of debt management and other economic constraints.

The Treasury can better realize forecasting benefits by requesting agencies to provide earlier notice when large receipts and payments will be made electronically, and it is exploring ways to do this.



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FGMSD-80-80  
SEPTEMBER 19, 1980

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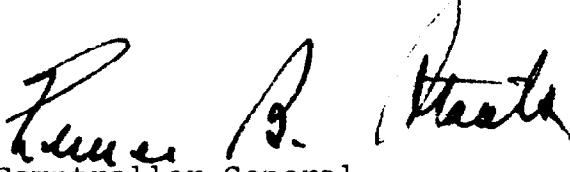
COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20548

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To the President of the Senate and the  
Speaker of the House of Representatives

This report discusses how the use of electronic funds transfer technology in Government can help reduce interest costs and improve the forecasting of cash flows. Because private industry is using this technology to improve its cash management, we made this review to determine whether the Government's expanding use of this technology is effectively improving cash management in Government.

We are sending copies of the report to the Director of the Office of Management and Budget; the Secretary of the Treasury; and the Chairman, Board of Governors of the Federal Reserve System.

  
Comptroller General  
of the United States



D I G E S T

Electronic funds transfer (EFT) technology is being used more and more in government and industry to replace checks for sending and receiving money. Because the computers and communication devices used in this technology provide for the near-instant transfer of money, the time normally needed for mailing, cashing, and clearing checks can be eliminated. This capability also offers better cash management because money is received more quickly and payments can be timed more accurately.

The Office of Management and Budget, the Department of the Treasury, and the President's Reorganization Task Force on Cash Management expect the increased use of EFT in the Federal Government to save \$350 million in interest costs between 1980 and 1984. In fiscal 1979 alone, the Treasury's interest costs were nearly \$60 billion.

EFT increases the Government's opportunities for realizing interest savings:

--Funds which flow faster into the Treasury's interest-earning tax and loan accounts at banks and other financial depositories begin earning interest sooner; in fiscal 1979, these funds earned interest at about 10 percent per annum. (See p. 5.)

--Funds which flow faster into the Treasury's accounts at the Federal Reserve can also begin earning income sooner. However, the extent to which more income is earned may be affected by the Federal Reserve's monetary policies. (See p. 5.)

But EFT has only limited ability to affect borrowing decisions. Although it can make

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funds available a few days earlier, borrowing decisions generally are insensitive to short term changes in the timing of receipts. The overriding consideration in the Treasury's borrowing decisions is debt management, not cash management. Because Government borrowing needs are so large, the Treasury must disperse its borrowing activities. Keeping to a regular schedule, it borrows cash days and weeks in advance. Responding to immediate cash needs would put widely fluctuating and irregular demands on the money markets and would very likely raise interest rates and adversely affect the Nation's economy. (See p. 8.)

Faster EFT receipts, however, can sometimes reduce the amounts borrowed. This can occur when the aggregate of such receipts effectively raises the monthly low points of the Treasury's projected cash balances. To avoid a shortage of cash, borrowing decisions tend to focus on these low points, which normally occur around midmonth and are created by the timing differences in Government disbursements and receipts. Outlays are usually concentrated in the first half of each month and receipts in the second half. To affect borrowing decisions, however, changes in the low points must be forecast at least 10 to 21 days in advance--the leadtime normally needed to make borrowing decisions. (See p. 9.)

For EFT to have a more positive influence on borrowing decisions, the faster flow of funds must be tied into the forecasting process. EFT can give the Treasury greater accuracy in forecasting its daily cash balances because it eliminates the timing uncertainties inherent in the mailing, cashing, and clearing of checks. Recurring EFT payments and receipts can provide more reliable data for estimating the future effect of these transactions on the daily cash balances. Nonrecurring EFT transactions can provide greater certainty in forecasting and can affect borrowing decisions if agencies report information

on these transactions to the Treasury at least 10 days in advance. Operational and cost factors, of course, sometimes make this impracticable. (See pp. 13 through 18.) GAO supports the continued efforts of the Treasury and other Federal agencies to realize the cash management potential of EFT.

GAO recommends that the Secretary of the Treasury ask all Federal agencies to report to the Treasury the amounts and timing of large receipts and payments to be made by EFT as soon as they know when such transactions will be made, preferably at least 10 days in advance.

#### AGENCY COMMENTS

The Treasury expressed some concern that the tone of this report may hinder its efforts to promote the use of EFT in Government. In response to this concern, GAO points out that the report confirms the potential EFT offers to produce interest savings. Nevertheless, it must also be recognized that the realization of potential savings is influenced by and sometimes constrained by other economic considerations. (See p. 11.) Treasury concurs with the recommendation and is exploring ways to implement it (see p. 18). The Federal Reserve submitted unofficial comments on the draft report; these comments were considered in the final report. (See p. 12.)





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ABBREVIATIONS

EFT	electronic funds transfer
FEDWIRE	Federal Reserve Communications System
GAO	General Accounting Office
OMB	Office of Management and Budget
TFCS	Treasury Financial Communications System

## CHAPTER 1

### INTRODUCTION

Interest costs have become a major expense for the Federal Government. They are the third largest item in the budget, ranking behind income security and defense. In fiscal 1979, interest costs were nearly \$60 billion, whereas 15 years ago they were only \$10.7 billion.

Spiraling interest costs in recent years have spurred financial managers in the private and public sectors to promote sound cash management principles, such as (1) accelerating the collection of cash receivables, (2) making timely disbursements--neither early nor late, and (3) preparing reliable cash forecasts. These efforts can minimize interest expenses by reducing or postponing borrowing, or increase interest earnings by providing more cash for investing.

Financial managers have found modern computer technology helpful in improving cash management. Electronic funds transfer (EFT)--a major application of this technology--provides the ability to receive and disburse funds almost instantaneously. It thus eliminates mail-handling and check-clearing time and adds greater certainty to cash forecasts.

### CASH MANAGEMENT IN GOVERNMENT

The Government's cash flow is the largest and most complex of any single organization in the world. In fiscal 1979 the Government received and disbursed over \$2 trillion. Over \$968 billion of this was received and disbursed in carrying out public debt operations, and over \$1 trillion in carrying out Government operations. Most of the cash income is tax receipts, but it also includes payments on Federal loans, royalties and fines, and sales of services or resources such as gold and timber. Major cash disbursements include payments for goods and services, grants, payrolls, interest on the public debt, tax refunds, social security, welfare, unemployment insurance, and pensions.

The Department of the Treasury, the Office of Management and Budget (OMB), individual agencies, and the Federal Reserve System play key roles in managing the Government's cash. Treasury is responsible for supervising and managing the Government's finances and for overall control of the Government's cash. In meeting this responsibility, Treasury collects and disburses public funds, borrows cash, maintains a central cash accounting and reporting system, and establishes cash management policies and procedures to be followed by individual agencies.

OMB exercises general oversight control of the cash management operations of all agencies, including Treasury. It also controls and administers the Federal budget. It provides guidance to agencies for estimating their cash outlays. Treasury uses these estimates in forecasting the Government's cash flow.

Individual agencies are, of course, the critical link in the management of the Government's cash because they are expected to carry out Treasury's cash management policies and procedures and to prepare the cash outlay estimates required by OMB.

The Federal Reserve's primary responsibility is to formulate and implement this country's monetary policies; however, it has other significant responsibilities, such as serving as the Government's fiscal agent, or banker. As the Government's banker, the Federal Reserve maintains the checking account on which all Government checks are drawn. On behalf of Treasury, the Federal Reserve also issues and redeems public debt securities.

With the rising cost of borrowing and the impetus for better management of the Government's resources, the need for improving Federal cash management is receiving greater attention. We have issued several reports on improving a wide range of cash management activities in the Government. Recently, President Carter directed his reorganization staff to review Federal cash management policies and practices with the objective of identifying "\* \* \* further opportunities to apply modern cash management techniques to our massive cash flow." The reorganization staff cited several cases in which Federal agencies could realize interest savings through EFT.

#### INCREASING USE OF EFT IN GOVERNMENT

The Federal Reserve is the major provider of EFT facilities to Federal agencies; these facilities include the Federal Reserve Communications System (FEDWIRE) 1/ and automated clearinghouses.

Treasury is tied directly into FEDWIRE through a computer-to-computer link between Treasury and the Federal Reserve Bank in New York. This link is known as the Treasury Financial

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1/FEDWIRE is a 40,000-mile, computer-based telecommunications network that interconnects Federal Reserve banks, their branches and offices, and over 450 commercial banks.

Communications System (TFCS). With this system, funds can be moved in a matter of seconds from a bank account anywhere in this country into Treasury's account, and vice versa. Funds transferred by TFCS are usually nonrecurring, large, dollar transactions, which are processed individually. During fiscal 1979, over 66,000 receipt and disbursement transactions valued at \$102 billion were processed on this system; the average transaction exceeded \$1.5 million. The transactions included the collection of receipts from foreign military sales and the payment of grant funds.

Treasury uses automated clearinghouses to carry out its Federal Recurring Payments Program. Because automated clearinghouses are designed to process recurring EFT transactions according to a predetermined time schedule, Treasury uses this system for making such payments as social security, civil service retirement, civilian payroll, veterans benefits, and revenue sharing. Except for revenue sharing, payments made under this program are usually high in frequency with a low dollar value per transaction. At the end of fiscal 1979, over 10 million payments had been made per month under this program; the average payment was about \$300.

#### Projected benefits of EFT

Under its Federal Recurring Payments Program, Treasury expects to lower its check processing costs and improve service to recipients. According to Treasury officials, the total processing cost per transaction is about 16 cents less with EFT than with a check. Other expectations include (1) eliminating check loss, theft, and forgery and (2) providing recipients with uninterrupted deposits.

With the TFCS, Treasury expects to lower its interest cost by reducing the amount it borrows. By eliminating mail-handling and check-clearing time, receipts can be credited to Treasury accounts at the Federal Reserve approximately 1 to 3 days sooner. Treasury estimated that it had reduced borrowing costs by \$9 million in its first year of operation because of this earlier availability of funds. Similarly, OMB and the President's Reorganization Task Force on Cash Management have estimated substantial savings in borrowing costs from faster EFT receipts. OMB estimated savings of \$26 million in fiscal 1978 and \$60 million in 1979. It expects to save at least \$350 million between 1980 and 1984.

Because of the savings that the Government expects to derive from this system, Treasury has instructed Federal agencies to consider using the TFCS for collecting large receipts.

## TREASURY'S OPERATING CASH ACCOUNTS

Treasury keeps its operating cash in accounts at the Federal Reserve and in tax and loan accounts at financial depositories, such as commercial banks. In fiscal 1979, about 56 percent of the Government's receipts were deposited directly into the tax and loan accounts. These included certain tax receipts--such as individual and corporate income tax and social security, excise, railroad retirement, and unemployment tax--as well as proceeds from the sale of savings bonds. The remaining 44 percent were deposited directly into Treasury's accounts at the Federal Reserve.

Treasury's Federal Reserve accounts function as checking accounts; all Treasury payments are drawn on them. To cover these payments, Treasury transfers funds from the tax and loan accounts to the Federal Reserve accounts.

In 1977 the Congress enacted Public Law 95-147 permitting Treasury to earn interest on cash held in the tax and loan accounts. The law requires Treasury to pay the depositories certain fees for maintaining the accounts and performing other services. 1/

On November 2, 1978, Treasury implemented a program to carry out the intent of this legislation. Participation is voluntary. If a depository participates, it must pay Treasury interest at one-fourth of 1 percent less than the Federal funds rate. 2/ If a depository does not participate, the funds must be transferred immediately to Treasury's accounts at the Federal Reserve. Whether or not a depository participates, it must be reimbursed for the services it provides. During the 11 months the program was active in fiscal 1979, gross interest earnings totaled \$646 million. The average interest rate was 10.04 percent.

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1/Before P.L. 95-147, laws prohibited depositories from paying such interest. To compensate Treasury for the use of these funds, the depositories handled tax deposits, issued and redeemed savings bonds, and performed other services free of charge. In reports dating back to 1954, we had recommended that the Congress amend the law to permit payment of interest and to allow the direct compensation of services rendered. In 1974, Treasury estimated that bank earnings on these accounts exceeded the costs of services performed by \$260 million.

2/This rate is the rate banks charge each other for lending or borrowing excess reserves.

## CHAPTER 2

### EFT CAN SPEED UP THE FLOW OF FUNDS AND

#### PROVIDE OPPORTUNITIES TO REDUCE INTEREST COSTS

The use of EFT for receipts gives Treasury earlier availability of funds and increased opportunity to earn more income on cash balances and reduce the amounts borrowed. When these earlier receipts increase Treasury's balances at the Federal Reserve, the amount of additional income earned will be influenced by the prevailing monetary policy of the Federal Reserve.

EFT is likely to have minimal impact on Treasury's borrowing; however, there may be times when earlier availability of funds will allow reduced borrowing.

#### EFT CAN INCREASE TREASURY'S INTEREST INCOME

The earlier receipt of funds by Treasury can increase its interest earnings. On those funds flowing directly into its tax and loan accounts, the rise in interest earnings is both immediate and direct, provided the funds go directly into accounts at financial depositories which have decided to pay Treasury interest on the funds. <sup>1/</sup> During fiscal 1979, the average interest rate on these funds was just over 10 percent.

On those funds flowing into Treasury's accounts at the Federal Reserve, income is not earned directly as interest. However, the ebb and flow of these funds may cause the Federal Reserve to buy and sell interest-earning securities in pursuing its monetary policy objectives. The net earnings from all Federal Reserve security holdings are paid to the Treasury.

#### Federal Reserve operations affect Treasury's earnings

According to the Federal Reserve, all Treasury deposits earn a form of interest. The Federal Reserve considers a portion of its holdings of Government securities as a counterpart to Treasury's deposits. The earnings on these securities

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<sup>1/</sup>If funds go directly into non-interest-earning tax and loan accounts, the depository must remit the deposited funds immediately to Treasury's accounts at the Federal Reserve.

are considered as interest paid to the Treasury on its deposits. The net earnings on the other portion of securities held by the Federal Reserve are then treated as profits and also forwarded to Treasury. The Federal Reserve uses this second portion for monetary policy purposes.

However, total income received by Treasury from the Federal Reserve as a result of earlier receipts from EFT depends upon Federal Reserve action to meet its monetary policy objectives. Other things being equal, any increase in Treasury operating balances at the Federal Reserve decreases the supply of reserves available to the banking system. <sup>1/</sup> This, in turn, reduces the supply of money available to the economy and serves to tighten credit. The Federal Reserve is unlikely to allow such a buildup to disturb the degree of pressure it is trying to maintain on the banking system--the posture of monetary policy.

If such an increase in Treasury's operating balances at the Federal Reserve is inconsistent with the thrust of monetary policy, the Federal Reserve will offset the deposit buildup by buying Government securities. This purchase will restore the reserves lost by banks. Other things being equal, the Federal Reserve would now own more Government securities, and Federal Reserve profits would rise. Under these circumstances, EFT will serve to increase Treasury income.

However, if such a buildup of Treasury balances supports Federal Reserve monetary policy--that is, if the Federal Reserve desires tighter monetary conditions--the buildup of Treasury operating balances will evoke no offsetting action by the Federal Reserve. Federal Reserve profits will remain unchanged as will Treasury income from this source. Under these circumstances, EFT will not serve to increase Treasury income.

Nevertheless, in the latter situation it would be incorrect to conclude that EFT has no effect on Treasury income. In the absence of EFT, the Federal Reserve would usually take action to decrease bank reserves by selling securities from its own portfolio. As a result, Federal Reserve profits would decline, as would Treasury income from this source. Hence, while EFT does not increase Treasury income, it acts to forestall a decrease in income due to lower Federal Reserve profits.

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<sup>1/</sup>Several factors--changes in amount of currency in public circulation, "Federal Reserve float"--also affect the level of reserves available to the banking system. The net effect of all factors influences the action ultimately taken by the Federal Reserve.



In summary, the earlier receipt of funds by the Treasury increases its opportunities for additional income. There may be instances where additional income cannot be realized because of monetary policy considerations. In those instances, EFT can avoid a decrease in Treasury income due to diminished profits of the Federal Reserve.

#### Paying by EFT can offset earnings

The increased earnings EFT can provide from faster receipts can be offset by the use of EFT for payments because funds are withdrawn earlier from Treasury's account. Treasury is experiencing this "loss of float" in its Federal Recurring Payments Program; it estimates that its loss averages about 6 cents in interest cost per transaction. <sup>1/</sup> Nonetheless, this is more than offset by its estimated savings in check processing costs of 16 cents per transaction and improved service to payees.

The loss of float, however, could be significant. In fiscal 1979, EFT payments outstripped receipts. Payments under this program and TFCS totaled \$75 billion, while EFT receipts totaled \$63 billion. According to Treasury, about 25 percent of its payments are now made by EFT; it estimates this could increase to 55 percent by 1985.

Treasury officials, however, point out that the use of EFT for nonrecurring payments can produce cash flow benefits. For example, Treasury is testing a new application of TFCS for making letter-of-credit payments to grant recipients. The use of TFCS for these payments is expected to reduce balances of funds held outside Treasury by grantees as a result of guaranteed payment time and preaudit of requests for funds. <sup>2/</sup> To allow for mail and processing times for paper-based payments, grantees sometimes submit their requests for Federal funds before they know their actual cash needs. Some grantees tend to overestimate their needs to compensate for this uncertainty. The expected reduction in grantee balances would keep funds in the Treasury accounts longer. Results of these tests will not be available until March 1981, but

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<sup>1/</sup>This figure will vary as interest rates change. Treasury has studies underway to update its cost data.

<sup>2/</sup>In its comments on an earlier draft of this report, Treasury cited other examples in which it also expects to realize cash flow benefits on nonrecurring payments (see p. 29).

Treasury expects the cash flow savings to be significant because the total letter-of-credit activity for this fiscal year is projected at about \$110 billion.

POTENTIAL FOR EFT TO REDUCE  
BORROWING COSTS IS LIMITED

Although EFT can reduce the amounts borrowed, it is not likely to have a large impact because borrowing decisions are not heavily influenced by the faster flow of funds. The ability of EFT to reduce borrowing requirements is limited primarily to situations when the faster flow of funds effectively raises the midmonth low point of Treasury's cash balance.

Borrowing decisions are usually  
insensitive to faster flow of funds.

Over the last few years, Treasury has developed a borrowing strategy based upon a concept known as "regularization." Under regularization, Treasury offers different types of bills, notes, and bonds at predetermined, frequent intervals. For example, 91-day bills are auctioned every Monday (except holidays) and 2-year notes are announced in the third week of each month. Timetables have been set for each type and maturity rate of security.

A major objective of this strategy is to minimize the impact on the money markets of the Government's very large borrowing requirements. In each of several recent years, Treasury has raised \$40 billion to \$82 billion in new money to help finance the Government's operating deficits. In some years these requirements made up over 50 percent of all new money raised by both Government and non-Government borrowers. In addition, Treasury must refinance the public debt, which now exceeds \$800 billion. At the present average maturity rate of this debt, about 30 percent--or about \$240 billion--will mature and require refinancing each year.

Regularization enables Treasury to avoid pressuring the money markets for large sums at one time, and it helps Treasury to reduce uncertainties in the money markets as to when it will be borrowing money with specific debt instruments. According to Government securities dealers and Federal Reserve and Treasury officials, regularization creates greater stability in the money markets and results in lower interest rates overall.

By spreading out its borrowing activities, Treasury borrows in advance of its immediate cash needs. In the first quarter of calendar 1979, for example, Treasury raised about

\$10.5 billion in new money. Under regularization, Treasury raised major portions of this money on several dates during the quarter, beginning early in January. Treasury estimated that without this borrowing, its cash balance would have been reduced to zero during the first week of March and would have accumulated to a net cash deficiency of about \$3 billion at the end of the month. By borrowing new money in the first 2 months, Treasury was able to meet its cash needs in the third month and accumulate a \$7.7 billion balance at the end of the quarter. This ending balance was needed to cover an expected large cash outflow in the first half of the following month.

Because Treasury borrows in advance of its needs and raises large sums of new money, the earlier availability of funds resulting through EFT is not likely to change the amounts and timing of Treasury's borrowing decisions. EFT merely speeds up the flow of funds by a few days; it does not change the amounts received. Other factors also cause borrowing decisions to be relatively insensitive to the faster flow of funds. These factors, the concept of regularization, and the impact of both on cash management are discussed in appendix I.

#### Exception: raising of midmonth low point

Borrowing decisions can be affected by the faster flow of funds when such funds effectively raise Treasury's projections of the midmonth low points of its cash balances. Treasury considers these low points in its borrowing decisions to make sure it does not temporarily run out of cash.

The Government's monthly cash balances follow a cyclical pattern of peaks at the beginning and end of the month. This pattern is caused primarily by a general disparity in the timing of payments and receipts. Generally, payments are concentrated in the first half and receipts in the second half, creating a low point around midmonth.

In its borrowing plans, Treasury includes enough funds to make sure that midmonth cash balances do not go below zero. Treasury usually targets for at least a \$3-billion minimum balance at these points. It considers this amount sufficient to guard against the uncertainties inherent in forecasting the balances used to develop borrowing plans.

Because borrowing decisions tend to focus on the low points, the earlier availability of funds through EFT can reduce the amounts Treasury borrows if such earlier funds raise the low points. For borrowing decisions to be affected, however, at least two conditions must exist. First, the

cumulative effect of the earlier receipts must be quite large-- we have been told it must be \$250 million or more. Second, the earlier receipts must be forecast at least 10 days to 3 weeks in advance because this is the normal leadtime for public announcement of Treasury borrowing decisions.

The opportunities for reducing the amounts borrowed to maintain the \$3-billion minimum balance are usually limited to those months when tax receipts are traditionally heaviest-- March, April, June, September, and December. In these months, Treasury tries to keep the actual midmonth low point as low as possible to avoid extraordinarily high end-of-month balances (even with such efforts, cash balances have sometimes exceeded \$22 billion).

In the remaining 7 months, Treasury gives less emphasis to minimum midmonth balances and takes advantage of borrowing opportunities in the money markets to build up the balances in anticipation of cash needs in later months. As a result, the midmonth low points in these months are usually much higher than the \$3 billion target. In 1977 and 1978, they averaged \$7 billion and \$9 billion, respectively.

#### OBSERVATIONS

Compared with the paper-based check system, EFT can put funds into Treasury's accounts at the Federal Reserve approximately 1 to 3 days earlier. This will provide Treasury with opportunities to earn interest earlier on its cash and help offset the Government's interest expenses. For those funds which flow directly into interest-earning tax and loan accounts, interest earnings will begin accruing immediately. For those funds which flow into the Treasury's account at the Federal Reserve, the amount of increased income may be influenced by the prevailing monetary policy of the Federal Reserve. Should the rise in Treasury operating balances be inconsistent with monetary policy, the Federal Reserve will offset the rise by buying more Government securities. As a result its profits will increase, as will Treasury income from this source. On the other hand, if the rise supports monetary policy, the Federal Reserve will not have to sell Government securities and the Treasury will not suffer a decrease in income from lower Federal Reserve profits.

Borrowing decisions are complicated by two--sometimes competing--desires: (1) to further debt management and monetary policy objectives and (2) to minimize borrowing costs. While Treasury's borrowing strategy emphasizes lower interest costs on the public debt when it can, its more important concern is to promote and ensure greater stability in the

financial markets and the economy. In this regard, cash management considerations understandably are second to debt management and monetary policy objectives. Despite this secondary importance of cash management in Treasury's borrowing decisions, we believe the aggregate effect of faster EFT receipts does increase the opportunities for Treasury to lower its borrowing requirements for the midmonth low points.

Even though the opportunities for reducing interest costs may be constrained at times, using EFT to get funds into Treasury's accounts faster is a sound practice. Other benefits are available, as Treasury has already demonstrated under its Federal Recurring Payments Program. Control and accountability over the custody of funds can be improved. And, as discussed in the next chapter, forecasting of the Government's cash flow can be improved.

#### AGENCY COMMENTS

In commenting on a draft of this report (see app. II) the Fiscal Assistant Secretary of Treasury expressed concern that the tone and scope of the report may hinder efforts to accelerate the collection of Government receipts and increase participation in direct deposit programs for recurring benefit and salary payments to individuals. In his opinion the draft seemed to give a "lukewarm endorsement" of the cash-flow benefits of EFT systems.

We are fully supportive of the potential for EFT to produce interest savings, and our review was directed at confirming that such savings will in fact occur and determining how. The analysis shows that the savings will occur primarily through increased interest earned on deposits and to a lesser extent through reduced interest expense from reduced borrowings, but also that interest savings from EFT are not necessarily automatic; at times there are certain constraints. Nonetheless, as stated earlier, we believe savings will occur and we endorse the continued efforts of Treasury and other Federal agencies to realize these savings.

The Fiscal Assistant Secretary also expressed concern that the report left essentially unaddressed the financial management benefits other than cash flow of these systems. He suggested that the report should also mention such other financial management benefits as:

- "o Reduction of Government-wide paperwork associated with TFCS system design to consolidate Government transactions (deposits and payments) and related accounting and reporting;

- "o Improved timeliness and accuracy of Federal financial reporting by agencies and central Treasury related to earlier accounting for transactions;
- o Reduction of collection problems related to the highly critical Government bid sales program, e.g., commodity sales (GSA), Treasury gold bullion sales;
- o Earlier identification of erroneous repayments, thereby allowing agencies to begin earlier corrective action, e.g., earlier reduction of receivable balances and arrearages charges that may not offset current interest costs;
- o Physical security of receipts and payments with wire transfer as opposed to mailed checks."

The scope of this study did not include an evaluation of these other financial management benefits. We believe, however, that these benefits are possible. In those cases where these benefits can be realized, they will add further justification to and incentive for the use of EFT. As pointed out by the Fiscal Assistant Secretary, a significant impediment to the expanded use of EFT in Government has been the lack of incentive in the form of direct benefits to the Federal agency involved because, in many cases, the cash flow benefit accrues to the Treasury's general fund rather than to the program agency. Consequently, we also endorse Treasury efforts to assure that Federal agencies are made aware of these potential benefits.

The Federal Reserve provided some suggestions to clarify the effect of monetary policy on the income Treasury can earn on its Federal Reserve cash balances. We adopted these suggestions.

## CHAPTER 3

### EFT CAN PROVIDE GREATER

#### CERTAINTY IN CASH FLOW FORECASTS

One of Treasury's major problems in preparing its cash forecasts is estimating when check transactions will affect its daily cash balances. In part, this is caused by the inherent characteristics of the paper-based system, namely the variability in mail-handling and check-clearing time. Because EFT can eliminate this time, it can provide greater certainty in forecasting the daily cash balances, which is important information used in determining the amounts of Treasury borrowings.

#### FORECASTS ARE A KEY ELEMENT IN BORROWING DECISIONS

Treasury's daily cash projections, which extend up to 6 months into the future, provide Treasury's debt managers the basis for developing their borrowing plans. The projections, revised periodically, consider expected receipts and disbursements, rollovers of maturing debt, and new borrowings already announced at the time the forecasts are prepared. An internal Treasury financing group uses these forecasts along with other information to decide how much to borrow and when, consistent with its regularization program. The amounts and timing of these borrowing decisions usually are announced to the public 10 to 21 days before the settlement dates of the securities (the dates Treasury actually receives the cash proceeds). Consequently, the forecasts for these dates are critical in determining the amounts to borrow.

Due to the uncertainties in forecasting the amounts and timing of receipts and disbursements, Treasury cannot place complete confidence in its estimates. To compensate for this, Treasury's borrowing plans are designed to provide a \$3-billion cushion to protect it from overdraft should it overestimate its balances and not borrow enough. 1/

#### RELIABILITY OF FORECASTS VARIES

As can be expected with any forecast, Treasury's forecasts become less reliable the farther into the future the

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1/Particularly during its midmonth low points in March, April, June, September, and December. (See p. 10.)

projections extend. In analyzing the first 30 days of each forecast prepared in calendar 1978, we found that for the first 10 days of each forecast, the deviation from the actual cash balance had averaged about 5 percent. <sup>1/</sup> This increased to 7 percent for the next 10-day period (11 to 20), and 14 percent for the 21- to 30-day periods. These deviations varied from \$100 million to over \$5 billion; they averaged \$0.86 billion.

While the Treasury frequently overestimated its cash balances, it had a slightly greater propensity to underestimate them. Overall, 58 percent of the Treasury's forecast balances were underestimated. Also, as shown in table 1, this occurrence showed a positive relationship to time--that is, the farther out in time, the greater the frequency of underestimated balances.

Table 1

Accuracy of Forecasts

	<u>Interval projected (in days)</u>		
	<u>1-10</u>	<u>11-20</u>	<u>21-30</u>
	----- (percent) -----		
Forecasts equaled actuals	5	3	1
Forecasts overestimated	54	36	21
Forecasts underestimated	41	61	78

Also, 62 percent of the estimates--whether over or under--differed from actual cash balances by at least \$0.5 billion, and the underestimates differed from this amount far more often than the overestimates. In the first 10-day period, for example, 28 percent of the daily estimates were less than actual balances by at least \$0.5 billion, whereas only 15 percent

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<sup>1/</sup>Treasury's estimates do not include (1) borrowing proceeds from marketable securities that are announced after the estimates are prepared and (2) proceeds from securities issued to the Federal Reserve for their account or as agents for foreign and international monetary authorities. To account for the variances caused by these factors, we adjusted Treasury's estimates by including these borrowing proceeds.



of the estimates exceeded actuals by at least this amount. As shown in table 2, the tendency to underestimate by \$0.5 billion or more became stronger the farther into the future the projections extended.

Table 2

Percentage of Estimates Off by \$0.5 Billion and More

	<u>Interval projected (in days)</u>		
	<u>1-10</u>	<u>11-20</u>	<u>21-30</u>
Forecasts overestimated	15%	24%	14%
--high variance	\$1.2 B	\$1.8 B	\$1.8 B
Forecasts underestimated	28%	39%	73%
--high variance	\$1.8 B	\$2.7 B	\$5.2 B

Treasury's tendency to underestimate its balances, particularly for the time periods critical to borrowing decisions (10 to 21 days), is insurance against the risk of overdrawing its accounts. As shown in table 2, the underestimated forecasts for the 11- to 20-day period ranged as high as \$2.7 billion. The frequent underestimating, together with the \$3 billion minimum cash balance objective, can cause Treasury to borrow more than it needs to meet debt management objectives or immediate operating cash requirements. The interest to borrow only \$0.5 billion more than needed is over \$140,000 per day, or nearly \$51 million per year. <sup>1/</sup>

Timing uncertainties affect forecasts

Treasury must answer two questions in preparing its cash forecasts. (1) What will agencies' actual net spending be? (2) How will the timing of agencies' spending affect the Treasury's daily cash balances?

On this latter point, Treasury records reveal frequent timing variances. In 1978, over 39 percent of the daily

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<sup>1/</sup>Based upon the 10.11-percent average interest rate on Treasury bills as of September 30, 1979.

forecasts were affected by timing variances. <sup>1/</sup> Furthermore, the aggregate effect of timing variances can cause Treasury's estimated cash balance to deviate significantly from its actual balance. For example, Treasury's cash balance on January 11, 1978, was underestimated by \$3.5 billion. According to its records, Treasury estimated that timing could have accounted for \$1.8 billion, or over 50 percent of this variance. Similarly, the forecasted balance for April 28, 1978, was overestimated by \$1.2 billion. Treasury attributed this principally to timing problems which caused both receipts and outlays to be overestimated by \$1.9 billion and \$0.9 billion, respectively.

Daily outlay projections are difficult to make because 85 percent of the Government's spending is done by check. Treasury cannot precisely determine when check payments will affect its accounts because of the uncertainties of check-cashing practices as well as mail-handling and check-clearing time. Even when Treasury knows the day an agency will make its payments by check, such as social security payments, these uncertainties still exist.

Likewise, accurately forecasting large daily check receipts is difficult. For example, Treasury forecast that it would receive, on certain days, \$1.2 billion from the sale of oil leases on the Outer Continental Shelf. While oil companies paid the amounts due by check on time, only \$145 million was actually available to Treasury on the days expected. The remaining balance, over \$1 billion, did not become available until several days later because of check-clearing delays.

#### EFT CAN IMPROVE FORECASTS

EFT can eliminate the timing uncertainties of the check payment method, and Treasury is now experiencing this benefit under its Federal Recurring Payments Program. Because payments under this program are made by EFT and because they are relatively consistent in amount from month to month, Treasury can reasonably estimate the amounts and identify the specific dates when they will reduce the cash balance. For example, forecasters know that about \$2 billion (of \$7 billion) in social security payments is paid from Treasury's accounts on the third of each month. In this way, EFT provides reliable trend information for forecasting recurring payments.

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<sup>1/</sup>In computing this figure, we counted only those forecasts which Treasury records showed were affected by timing variances. For many forecasts, however, no causes were given; in these cases, timing could also have caused variances.

However, the usefulness of EFT for improving forecasts of nonrecurring payments and receipts is limited. In contrast to social security payments, nonrecurring payments or receipts can vary widely in amounts and generally do not provide the periodic receipt and outlay patterns needed for estimating daily dollar volumes of future transactions. For example, historical payment patterns for construction projects and procurement actions are not very reliable indicators for developing future estimates. The timing and size of such future payments can be affected by weather, strikes, litigation, and authorizing and appropriating legislation.

A related problem in forecasting when nonrecurring payments will be made is the lack of a consistent Federal policy defining when a payment is due. In a February 1978 report, we pointed out that Federal policies called for payments to be made promptly when due, but that there was no definition of when payment was due. <sup>1/</sup> In March 1978, Treasury issued regulations requiring that all bills be paid when due, and if not specified, the due date will be assumed to be 30 days from receipt of the invoice. A soon-to-be-released revision of this regulation will also require that procurement agreements contain payment terms specifying when payment is due. As recommended in our 1978 report, OMB has agreed to develop due date standards to help agencies determine the payment terms to be included in contracts and purchase orders for major goods and services. As these standards are developed and implemented, agencies should be better able to schedule their bills for payment and give the Treasury better advance information on the timing of expected outlays.

## CONCLUSIONS

Because EFT can eliminate many timing uncertainties normally associated with the paper-based system, it can improve the reliability of Treasury's forecasts of its daily cash balances. More reliable forecasting will not automatically reduce borrowing costs because of debt management and other economic considerations. But to the extent that borrowing decisions can be made more sensitive to cash needs, greater reliability in the forecasts can help reduce borrowing costs.

Recurring EFT payments and receipts can help improve forecasts. The certainty of timing provided by EFT and the relatively stable size of these transactions provide reliable

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<sup>1/</sup>"The Federal Government's Bill Payment Performance Is Good But Should Be Better" (FGMSD-78-16; Feb. 24, 1978).

data for estimating the future effect of these transactions on the daily cash balance. As Treasury expands the use of EFT for Federal recurring payments and receipts, it should see a corresponding improvement in its forecasts.

Using EFT for nonrecurring payments and receipts, on the other hand, is not likely to improve forecasting unless the timing and amounts of the transactions are known by the agencies and reported to Treasury at least 10 days in advance. The practicality of obtaining and reporting such information in advance depends upon such factors as

- the establishment and use of due date standards so that agencies can better anticipate and schedule non-recurring bills for payment,
- the availability of information on nonrecurring transactions before their consummation, and
- the effort needed to obtain the information and report it to Treasury at least 10 days in advance.

The faster movement of funds must be tied to the forecasting process whenever practical if EFT is to have a more positive impact on borrowing decisions. On balance, the expanded use of EFT should enhance the reliability of Treasury's forecasts. Over time, these more reliable forecasts will begin to influence borrowing decisions.

#### RECOMMENDATION

To avoid missing opportunities to realize the forecasting benefits afforded by EFT, we recommend that the Secretary of the Treasury request all Federal agencies to report to Treasury the amounts and timing of large receipts and payments to be made by EFT as soon as they know when the transactions will be made, preferably at least 10 days in advance.

#### AGENCY COMMENTS

Treasury concurred with this recommendation. Treasury agreed that advance information on large dollar transactions is quite important and it is exploring ways to improve its present notification procedures.

## CHAPTER 4

### OBJECTIVES, SCOPE, AND METHODOLOGY

Our objective was to review EFT's impact on the Government's cash management.

We analyzed in detail Treasury's cash and debt management policies and practices. We interviewed officials from Treasury, OMB, the Federal Reserve Bank in New York, and selected Government securities dealers. Also, Federal Reserve officials helped us identify the income earned by Treasury on its cash balances at Federal Reserve banks.

We analyzed procedures and interviewed officials at various other Federal agencies on EFT's impact on cash management. Our review also included work at State and local governments to assess the impact of using EFT for making Federal payments to them. Most of our work on this was done in California.

TREASURY'S DEBT MANAGEMENT STRATEGY--HOW IT AFFECTS CASH MANAGEMENT

Treasury's borrowing decisions are influenced more heavily by debt management than by cash management objectives. Because its cash needs are so large, Treasury's overriding concern is the adverse impact its financing activities might have on the financial markets and the economy. Treasury borrows according to a regular schedule; that is, it borrows when it has the opportunity, not necessarily when it needs cash. This approach minimizes disruption in the money markets and reduces the uncertainty about when Treasury will raise cash. According to Treasury and money market specialists, this increased stability and greater certainty in the market tends to keep interest rates lower.

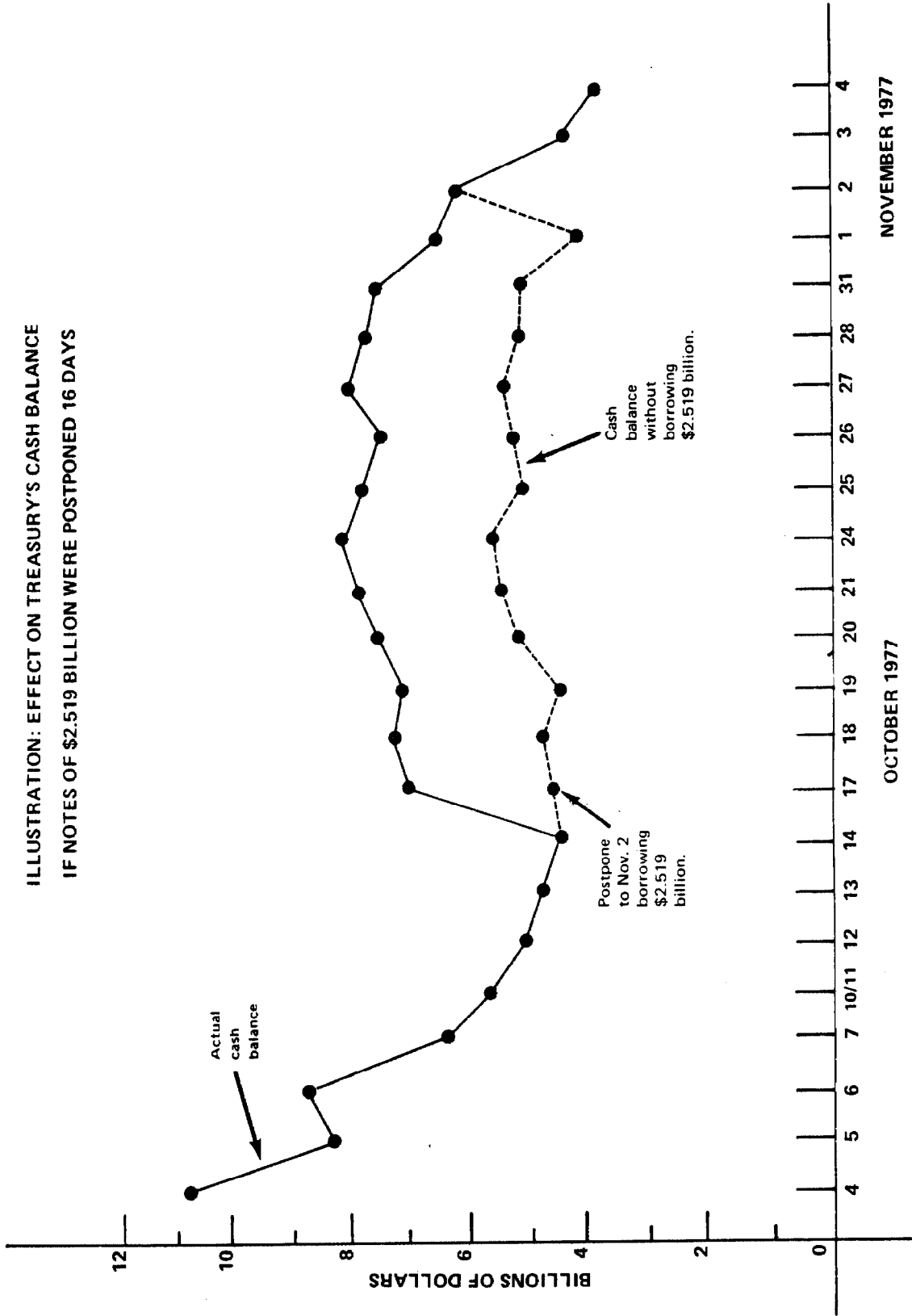
Other factors contributing to the relative insensitivity of Treasury's borrowing decisions to short term changes in its cash flow are (1) the need for a large monthly cash buildup, (2) the objective of maintaining a \$3-billion minimum cash balance, and (3) the constraints against reducing the size of an already announced debt offering.

REGULARIZATION AND ITS  
IMPACT ON CASH MANAGEMENT

Treasury's borrowing practices are based upon an approach known as regularization. This approach emphasizes the offering of different types of bills, notes, and bonds at frequent, predetermined intervals. For example, 91-day bills are auctioned every Monday except holidays, and 2-year notes are announced in the third week of each month. Timetables have been set for all other securities.

Regularization causes Treasury to borrow when it can, not necessarily when it has an immediate cash need. Under regularization, for example, Treasury borrowed \$2.5 billion on October 17, 1977, raising its cash balance to about \$7.1 billion. Treasury could have postponed this borrowing and still have had ample cash during the latter part of October because of its historically favorable end-of-month cash flow (normally receipts exceed disbursements during the latter part of each month). When the cash balance reached a low of \$3.6 billion on November 2 and forecasts showed subsequent days' disbursements would exceed receipts, Treasury could then have borrowed the \$2.5 billion. (See graph on p. 21.) Considering only immediate needs in its borrowing decision, Treasury would have saved 16 days' interest expense, or about \$7.7 million. However, this would have been a departure from

ILLUSTRATION: EFFECT ON TREASURY'S CASH BALANCE  
IF NOTES OF \$2.519 BILLION WERE POSTPONED 16 DAYS



regularization practices and would have created greater market uncertainties--which generally translate into higher interest rates.

#### Why treasury adopted regularization

Regularization facilitates the market's ability to anticipate and absorb the Government's very large borrowing requirements. At the same time it helps Treasury extend the average maturity date of the public debt. If there were no means for issuing securities on an orderly basis, the enormity of the Government's borrowing needs could disrupt market conditions and cause interest rates to rise.

In recent years, Treasury has had to raise very large sums of new money because Government expenditures have grown sharply and greatly outstripped receipts. The cumulative deficit for the 10-year period ended in 1968 was nearly \$56 billion, while the cumulative deficit for the next 10 years grew nearly five times to about \$272 billion. This large expansion caused Government borrowing activities to dominate the money markets. In 1975 and 1976, Treasury's borrowing made up over 50 percent of all new money raised in the market. In calendar 1977, Treasury borrowed nearly \$58 billion of a total of \$147 billion for the Nation.

Besides raising new money, Treasury must also refinance the large and growing public debt as it matures. In 1975, the public debt was \$533 billion; it now exceeds \$800 billion. The complexity of Treasury's large financing activities has been accentuated by the shortening maturity of its debt. From 1965 to 1975, Treasury's average debt maturity dropped from more than 5 years to about 2.5 years because of the heavy reliance on Treasury bills for raising additional funds. <sup>1/</sup>Allowing this trend toward shorter terms to continue would have meant that about 40 percent of the public debt would be refinanced each year, causing higher administrative costs. Treasury believed also that this represented an imbalance in its debt structure and entailed several significant risks, including competition for funds with the home mortgage market; raising short-term interest rates; and creating liquid assets which, if converted to cash and spent, could effectively blunt Federal Reserve efforts to control inflation.

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<sup>1/</sup>In part, this contracting maturity can be attributed to the 4-1/4 percent interest rate ceiling imposed by law on long term obligations. See our report entitled "The Congress Should Consider Repealing the 4-1/4 Percent Interest Rate Limitation on Long-Term Public Debt" (OPA-76-26; Apr. 16, 1976).



To minimize the possible adverse impact on the Nation of its debt financing activities, Treasury developed a strategy of issuing longer term securities regularly and more often. According to Government bond dealers and Federal Reserve and Treasury officials, this strategy offers advantages both to Treasury and to other segments of the economy. First, it can facilitate the financing of Treasury's needs at a lower interest rate because it (1) reduces uncertainties in the markets as to when Treasury will be borrowing money with specified debt instruments and (2) avoids pressuring the markets for large sums of money at any one time.

Secondly, regularization can minimize the conflict that Treasury's entry into the money markets might have on the financing activities of other Federal agencies, State and local governments, and private corporations, because it allows them to plan around the Treasury's borrowing calendar.

Thirdly, regularization can facilitate Treasury's effort to lengthen the average debt maturity by making longer term securities available more often. Before 1975, notes and bonds were issued only during Treasury's quarterly financing--the second month of each quarter. By the end of 1978, regular and more frequent offering of longer term securities had extended the average debt maturity to about 3.3 years on the public debt of about \$800 billion.

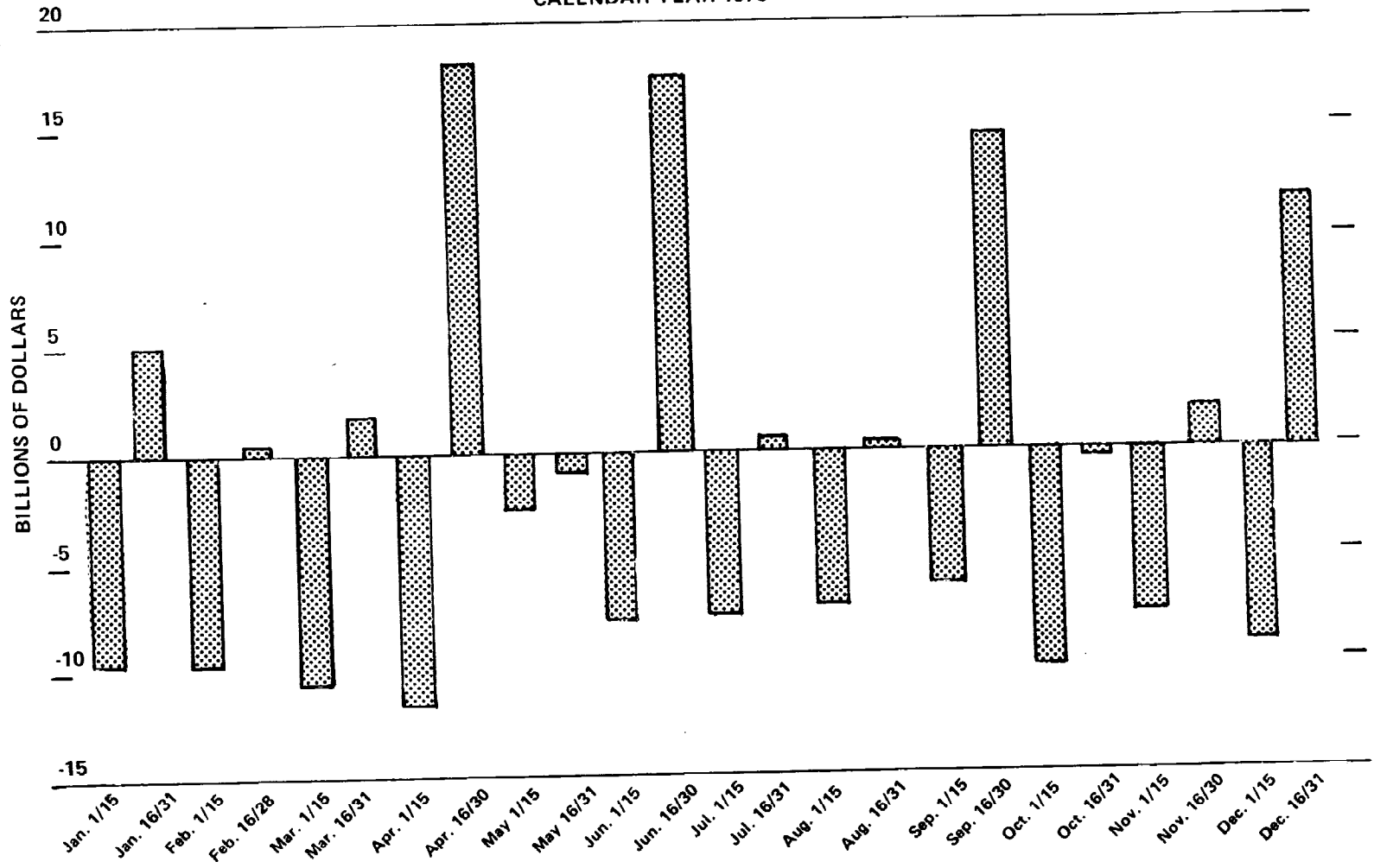
#### OTHER FACTORS MAKE BORROWING INSENSITIVE TO EARLIER EFT RECEIPTS

Several other factors cause Treasury's borrowing practices to be insensitive to earlier EFT receipts. These are (1) the need for a large monthly cash buildup, (2) the objective of maintaining a \$3-billion minimum cash balance, and (3) the constraints against reducing the size of a debt offering already announced to the market.

#### Need for large monthly cash buildup

A major characteristic of the Government's cash flow is its unevenness, which is caused by a disparity in timing between receipts and outlays. This disparity results from a general concentration of payments in the first half of a month and of receipts in the second half. (See chart on p. 24.) Large payments, such as social security and revenue sharing, are made in the first few days of the month, while large receipts from income and social security taxes usually come in during the last half.

NET RECEIPTS AND OUTLAYS  
(excludes borrowing)  
CALENDAR YEAR 1978



Because of the timing mismatch, Treasury must build up its cash balance in the second half of each month so it can meet large cash outlays in the first part of the next month. So earlier receipts from EFT during the buildup period will not reduce Treasury's borrowing. For example, the Department of the Interior deposited checks totaling \$937 million in the Treasury from July 25 through 27, 1977. On those days, Treasury's cash balance exceeded \$9 billion. If these receipts had been made by EFT, the total amount of cash received would have been the same and Treasury would not have changed the amount borrowed because it still needed to build up enough cash to meet a net outflow of \$9.5 billion in the first half of August.

As the Government's expenditures become larger, Treasury will be forced to increase its monthly cash buildup to meet the larger payments made in the beginning of the month. In the first half of October 1974, Treasury's net cash outflow was nearly \$8 billion. By 1978, Treasury's net outflow for the same period was over \$10 billion. The need to raise cash for such large expenditures will make regularization even more important because such large amounts cannot be raised on short notice without disrupting the money markets. According to Government bond dealers, this problem will reinforce Treasury's need to continue with regularization.

Along this line, the Social Security Administration is studying the feasibility of spreading its benefit payments cycle over several days. Under the agency's present system, benefit payments exceeding \$7 billion each month are usually paid on the third of each month. Provided this approach is operationally, economically, and socially feasible, it would give Treasury more opportunities to reduce its high cash balance and borrowing requirements.

#### The \$3 billion minimum balance objective

Among the other factors considered in borrowing decisions are the projected midmonth low points of the cash balances; these low points are caused by the mismatch in the timing of receipts and disbursements. In determining how much to borrow, Treasury includes enough to cover any projected negative balance plus \$3 billion, which acts as a cushion against the uncertainties in forecasting receipts and outlays. Because borrowing decisions tend to focus on the low points, the earlier receipt of funds in the days and weeks before and after the low points has no effect on the amounts borrowed unless the aggregate of such receipts effectively raises these low points. Even here, at least two conditions must exist. First, the cumulative effect of the earlier receipts must be quite

large--we have been told it must be \$250 million or more. Secondly, earlier receipts must be predictable since Treasury borrowings are announced to the public 10 days to 3 weeks in advance.

The opportunities for reducing or postponing borrowing to maintain a \$3-billion minimum balance are further limited because the minimum balance is stressed usually only in those months when tax receipts are traditionally heaviest--March, April, June, September, and December. In these months, Treasury tries to keep the actual midmonth low points as low as possible to avoid extraordinarily high end-of-month balances (even with such efforts, the balances have sometimes exceeded over \$22 billion).

In the remaining 7 months, Treasury gives less emphasis to minimum midmonth balances and takes advantage of borrowing opportunities to build up the balances in anticipation of cash needs in later months. As a result, the midmonth low points in these months are usually much higher than the \$3-billion target. In 1977 and 1978, they averaged \$7 billion and \$9 billion, respectively.

Constraints on reducing  
the size of announced borrowings

After Treasury announces to the markets how much it plans to borrow, it will not accept a lower amount if earlier EFT receipts increase its expected cash balance. Although Treasury is authorized to make such a change, Treasury, other Government officials, and bond dealers believe a change would create uncertainty in the markets and would cause interest rates to be higher than they might be otherwise.

Also, Treasury is not likely to make such a change because the amount it announces is expected to cover operating needs projected for the next several days or weeks; an EFT receipt, on the other hand, does not increase the total amount received; the money just arrives earlier. Furthermore, even if actual receipts are underestimated and this is detected before the borrowing date, Treasury is unlikely to reduce the size of an already announced borrowing, although the information might affect subsequent borrowing announcements.



## DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

FISCAL ASSISTANT SECRETARY

MAY 16 1980

Mr. D. L. Scantlebury  
Director, Financial and General  
Management Studies Division  
U. S. General Accounting Office  
441 G Street, N. W., Room 6011  
Washington, D. C. 20548

Dear Mr. Scantlebury:

This is in response to Mr. Stanton's letter of April 16, 1980, to Secretary Miller requesting comments on the General Accounting Office's draft report entitled "Electronic Funds Transfer--Its Limitations and Potential for Improving Cash Management in Government".

My principal concern with the draft is that, in its present tone and narrow view, it may hinder our joint efforts to accelerate the collection of Government receipts, as well as the efforts to increase participation in direct deposit programs for recurring benefit and salary payments to individuals. The report seems to be, at best, a lukewarm endorsement of the beneficial cash flow aspects of these more efficient cash transfer systems. It leaves essentially unaddressed the financial management benefits, other than cash flow, derived from these systems. Finally, the draft draws attention to problems related to cash flow management in the Federal Government without mention of new initiatives, of which I assume GAO is supportive or at least aware. These would include mandatory usage of wire transfer facilities in appropriate instances, specification in procurement contracts of payment due dates, acceleration of payment of certain tax liability accruals, cycling of payments in large benefit programs, TFCS cash transfers to fund letter-of-credit requirements, etc.

In our efforts to persuade agencies to utilize wire transfer systems, either for collections or recurring payments, we have run into a variety of impediments. A significant impediment has been the lack of incentive in the form of direct benefit to the Federal agency involved, since in many cases the cash flow benefit accrues to the Treasury's general fund rather than the program agency. Yet the program

agency is mainly responsible for altering its business relationship with the private client in order to effect the benefit for the Treasury.

The recent heightening of interest in improved cash management generated by the President's Reorganization Project and the Office of Management and Budget's initiatives has been immensely helpful in this regard. A GAO report which leaves the impression that accelerated and certain cash flow is only marginally beneficial will not contribute to that effort.

I believe that the report would be considerably improved by mention of the other financial reporting and management information benefits of cash wire transfer systems, such as:

- Reduction of Government-wide paperwork associated with TFCS system design to consolidate Government transactions (deposits and payments) and related accounting and reporting;
- Improved timeliness and accuracy of Federal financial reporting by agencies and central Treasury related to earlier accounting for transactions;
- Elimination of return check items, thereby reducing costs of charge-back actions;
- Reduction of collection problems related to the highly critical Government bid sales program, e.g., commodity sales (GSA), Treasury gold bullion sales;
- Earlier identification of erroneous repayments, thereby allowing agencies to begin earlier corrective action, e.g., earlier reduction of receivable balances and arrearages charges that may not offset current interest costs;
- Physical security of receipts and payments with wire transfer as opposed to mailed checks.

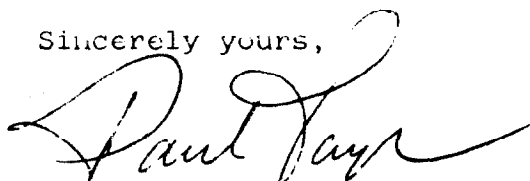
I would also like to point out that the comment on page 13—that the "loss of float (associated with EFT payments) could be significant" ignores the beneficial cash management ramifications of making non-recurring payments via TFCS, such as:

- TFCS letter-of-credit payments, a new application currently in the testing stage, will considerably reduce balances of funds held outside Treasury by grant recipients as a result of guaranteed payment time and pre-audit of requests for funds. With total letter-of-credit activity for this fiscal year projected to reach about \$110 billion, the cash management implications of this initiative are significant. Each one-day delay in average outflows that is achieved will increase Treasury's average daily availability by approximately \$440 million. In addition, the LOC-TFCS centralizes the charges related to letter-of-credit payments at our account in New York, thus facilitating the cash forecasting process.
- Payments due on a particular date can be disbursed by TFCS on the latest possible day rather than by check days early to provide for the uncertain transit time in the mail. This not only ensures that the funds are held within Treasury for as long as possible, but also improves cash forecasting aspects of such payments. Payments to the States from the Unemployment Trust Fund are a good example of this type of payment.
- Payments by TFCS to the States representing reimbursable items improve Federal/State financial relationships and satisfy the Federal Government's obligation to pay its bills when due.

Also attached are some technical comments.

In conclusion, we believe that the potential negative ramifications which the current report might generate would be considerably reduced if consideration were given to the above comments.

Sincerely yours,



Paul H. Taylor

Attachment

GAO notes: (1) Attachment not included in this report. (2) Although Treasury did not address our recommendation on forecasting (see p. 18) in these comments, Treasury officials later told us that Treasury concurs with it. (3) Page numbers in this letter have been changed to correspond to the pages in the final report.

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