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## **FINANCIAL LIQUIDITY MANAGEMENT IN LOCAL GOVERNMENT UNITS OF THE EASTERN POLAND MACROREGION**

Key words: financial liquidity, cash pooling, local government unit

**ABSTRACT.** The aim of the study was to assess financial liquidity management in basic local government units of Eastern Poland. Aspects that were mostly considered include the awareness of the importance of financial liquidity among the chief accountants of the surveyed units, the occurrence of possible problems with the timely payment of liabilities and liquidity management instruments used. The research covered 210 local government units (100 rural municipalities, 100 urban-rural municipalities and 10 cities with district rights) from five voivodeships located in the Eastern Poland macroregion. The research methods that have been used include analysis of the subject literature and the method of the diagnostic survey using a questionnaire. The survey was conducted among chief accountants of the budget of selected local government units of the Eastern Poland macroregion. Based on the conducted surveys, it was found that the majority of managers of local government units noticed the importance of financial liquidity and in recent years did not notice problems with the timely payment of liabilities. Approximately 30% of respondents admitted to problems with financial liquidity. The main reason for the occurrence of disturbances in the timely payment of liabilities was achieving lower income and revenue than planned, as well as improper management. When analyzing applied liquidity management instruments, it was found that these were most often multi-annual financial forecasts and detailed schedules of income and expenses.

## **INTRODUCTION**

Financial liquidity management is one of the most important areas of financial management not only for enterprises but also for local government units (LGUs). Financial liquidity is a very important factor shaping the economic situation of an entity and a decisive element of financial credibility. Most often, it is understood as the ability to pay liabilities timely [Wędzki 2003, Sierpińska, Jachna 2009], as well as the ability of a given unit to achieve cash flows enabling it to settle its payables and cover unexpected cash expenses [Wojciechowska 2001, Kusak 2006, Drever, Hutchinson 2007].

The problem of financial liquidity is quite broadly analyzed in relation to enterprises, but rarely in relation to public sector entities, which results mainly from differences in business objectives. These units implement public tasks related to satisfying the needs of local communities, which means that they do not aim at achieving profit, as opposed to

private entities. Moreover, it should be noted that, in units of the public finance sector, the basic principle of registers of events is the cash accounting principle, which in practice means the application of other financial liquidity measurement techniques [Dylewski et al 2004, Hałaburda 2009].

The financial liquidity of LGUs means a state in which, at a given moment, they have funds to cover the necessary, planned expenditures and outlays. The statutory duty of each local government unit is adequate financial management, including financial liquidity. It is the guarantee of financial security manifested by the ability to meet obligations on determined dates [art. 3 and 44, par. 3 of the Public Finance Act]. Thus, financial liquidity is maintained when there is a proper symmetry of income and revenue as well as expenditures and outlays [Kosek-Wojnar, Surówka 2007]. This requires synchronizing the dates of their collection and spending [Jaworski 2009]. In the case of an insufficient amount of cash, LGUs may obtain support by taking loans [Staszal 2016].

The most important task of any business unit operating in a market economy should be to provide the company with financial liquidity, because its loss may lead to bankruptcy [Wędzki 2003]. In the case of LGUs, there is no threat of bankruptcy. Nevertheless, LGUs may also experience significant differences between the time a debt becomes due and the date of its settlement, and, similarly to enterprises, as a result of a loss of liquidity, they may have problems with the timely payment of liabilities [Filipiak 2014]. The level of indebtedness, the cost of debt instruments, as well as the social responsibility of the unit's management influence the ability to meet obligations. Excessive indebtedness may cause some difficulties in settling liabilities and, consequently, in decreasing financial credibility and social trust. In connection with the above, financial liquidity is also very important for LGUs and serves to strengthen their financial and payment credibility, and, above all, guarantees the implementation of tasks of a given unit and prevents perturbations in this respect [Denek, Dylewski 2013, Dylewski 2014].

Local government units may use different liquidity management instruments. One of them is the development of a schedule for the implementation of income and expenditure, i.e. a more detailed budget in terms of time. Such a statement requires defining a specific time of realization of income and expenses, which has an impact on the successful and effective management of financial liquidity with the rational shaping of financial costs related to its maintenance [Dylewski et al. 2006, Staszal 2016]. Cash pooling is another tool improving the financial management of LGUs. This concept consists of consolidating all accounts of entities related to each other in terms of organization and capital in order to manage the funds collected in this way more effectively. Cash pooling is a banking service that makes it possible to combine balances of all accounts into one, which reduces the cost of cash management, as well as streamlines the management of financial liquidity [Galiński 2013].

## RESEARCH MATERIAL AND METHODS

The aim of the study is to assess financial liquidity management in basic local government units of Eastern Poland. As part of the main goal, the importance of financial liquidity for chief accountants of LGUs' budget has been defined. It has been determined whether the examined units, in recent years, have registered any problems with the timely set-

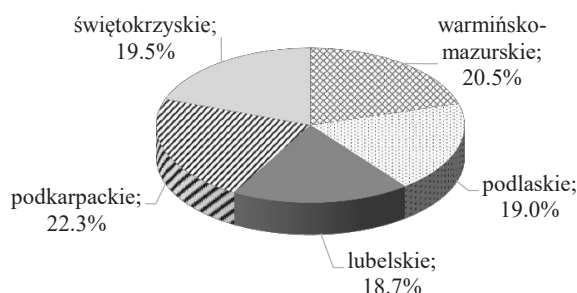


Figure 1. Structure of the research sample according to voivodeships of the Eastern Poland macroregion

Source: own elaboration

which was dictated by location (the structure of the research sample is presented in Figure 1), was employed in the study. It should be noted that these are peripheral areas, both in a spatial and socio-economic dimension. The level of economic development of these areas is one of the lowest in the European Union. A low level of innovativeness, competitiveness and investment attractiveness is also characteristic for these areas. Developmental delays of the Eastern Poland macroregion have deep historical roots and are examples of long-term processes [Kukliński 2010].

The article was based on literature studies and a questionnaire. In 2018, a diagnostic survey was carried out among the chief budget accountants (treasurers) of LGUs. A CATI questionnaire was used (telephone survey using a computer). The selection of respondents for the research was dictated primarily by the fact that treasurers are people who are the most savvy when it comes to the management of municipal finances, including financial liquidity management. Answers to the questions asked were provided by the treasurers of 210 local government units, including 10 cities with district rights, 100 urban-rural municipalities and 100 rural municipalities.

## RESEARCH RESULTS

The most important aspect of the effective functioning of the local government unit is efficient cash management and maintaining proper financial liquidity, which affects, e.g., the timeliness of tasks carried out and the degree of satisfying the needs of local communities. In connection with the above, it is important that the managers of a given unit become aware of the importance of financial liquidity.

Figure 2 presents the results of respondents' answers to the question regarding the importance of the ability to meet obligations and cover all unexpected expenses for the management of the unit. Most of respondents clearly notice the great importance of financial liquidity: 67% of rural municipalities, 73% of urban-rural municipalities and 60% of cities with district rights. The remaining respondents recognized the ability to meet their obligations in a timely manner as rather important. In the case of rural municipality managers, 1 of the respondents answered to this question by stating that it is "hard to say",

tlement of liabilities and financial liquidity management instruments used have been identified.

The subject of the research includes local government units of the Eastern Poland macroregion, which were divided into three groups: rural municipalities, urban-rural municipalities and cities with district rights. A targeted selection of 5 voivodeships (Warmian-Masurian, Podlasie, Lubelskie, Podkarpackie, and Świętokrzyskie voivodeships),

while 5 of them said that financial liquidity is rather irrelevant. A similar situation was noted in urban-rural municipalities, where 3% of respondents did not see the importance of financial liquidity. This is a worrying situation and may be due to a lack of knowledge and appropriate substantive preparation of LGUs' budget accountants in the field of effective financial management.

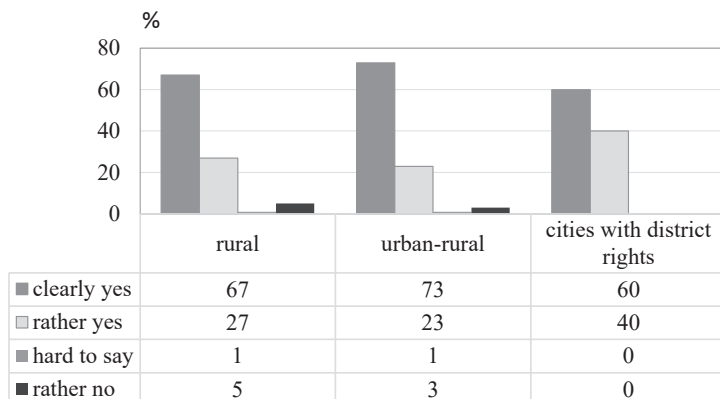


Figure 2. The importance of financial liquidity for managers of a local government unit of the Eastern Poland macroregion, depending on type

Source: own elaboration based on a questionnaire addressed to the treasurers of local government units

Another important issue that has been highlighted in this study is the determination of the ability to timely pay liabilities in the opinion of the managers of a given unit. The treasurers of the municipalities and cities tested were asked whether in the last 5 years there were problems with financial liquidity, both during and at the end of the financial year. The distribution of responses by type of local government unit is presented in Figure 3. The obtained data shows that the vast majority of respondents denied that such problems occurred in the last few years: rural municipalities – 77% of respondents, urban-rural municipalities – 76% and cities with district rights – 70%. Some respondents indicated that there were temporary problems with financial liquidity, but only during the financial year. Most often, this was the answer of managers of budgets of cities with district rights (30%). In this group of units, no liabilities were due at the end of the financial year. In turn, 6% of respondents from rural municipalities and one treasurer of an urban-rural municipality admitted to problems with financial liquidity. To sum up, about 30% of the surveyed local government units had problems with financial liquidity, which means that units of the public finance sector may also be at risk of losing financial credibility.

The implementation of lower than planned income and revenues was one of the most frequently indicated reasons for the occurrence of problems with financial liquidity of local government units. Moreover, in the opinion of managers of rural and urban-rural municipalities, the reason for problems with the timely payment of liabilities was the improper management of financial liquidity (29% and 59% of municipalities, respectively) and higher expenses compared to planned expenditures and expenses (45% and 57% of municipalities, respectively). The increase in debt servicing costs was most often

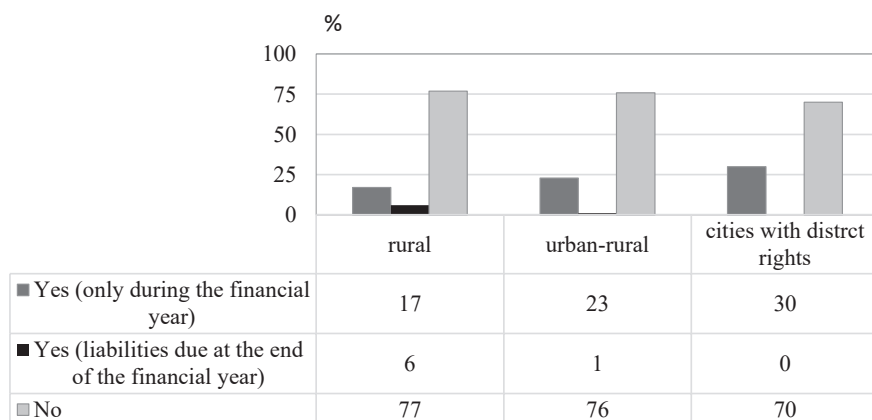


Figure 3. The occurrence of problems with financial liquidity in the opinion of managers of the local government unit of the Eastern Poland macroregion, depending on type

Source: own elaboration based on a questionnaire addressed to the treasurers of local government units

indicated by cities with district rights (60% of respondents). This is probably because these units generally use external budgeting to a greater extent than municipalities. Some respondents see the cause of problems with financial liquidity in the significant burden of local government by public debt. The detailed distribution of responses by type of units surveyed is presented in Figure 4.

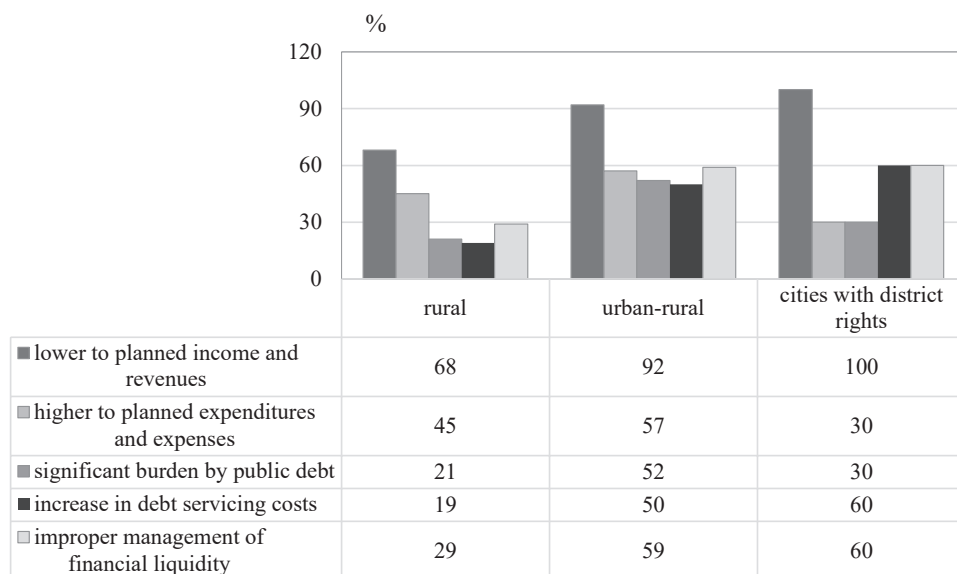


Figure 4. The causes of problems with financial liquidity in the opinion of managers of the local government unit of the Eastern Poland macroregion, depending on type

Source: own elaboration based on a questionnaire addressed to the treasurers of local government units

Figure 5 presents the employed liquidity management instruments in the examined LGUs. This analysis showed that the long-term financial forecast, which is a document combining the current and future activity of an individual, is the most frequently used instrument. This instrument was indicated by 57% of rural municipalities, 76% of urban-rural municipalities and 100% of cities with district rights. In the opinion of local government managers, it is also equally important in managing financial liquidity to create detailed schedules for the implementation of income and expenses, that is, time-specific financial plans. Apart from the fact that it enables effective financial liquidity management, such a statement also helps in the effective placement of possible financial surpluses. The introduction of limits of supply in cash of subordinate units as well as an obligatory analysis and assessment of financial consequences of investment decisions taken were most often indicated by the treasurers of cities with district rights (70% and 50%, respectively) and urban-rural municipalities (64% and 61%, respectively).

One of the liquidity management instruments that can be used in LGUs is cash pooling, which is an instrument that improves the efficiency of cash management by consolidating the accounts of entities related to each other in terms of capital and organization. The use of cash pooling was indicated by the managers of 10% of rural municipalities, 17% of urban-rural municipalities and 30% of cities with district rights (Chart 5). This instrument is particularly useful in the case of units that are characterized by an extensive organizational structure, i.e. mainly cities with district rights. In cities with district rights, there is a larger number of bank accounts in relation to municipalities, which justifies their consolidation.

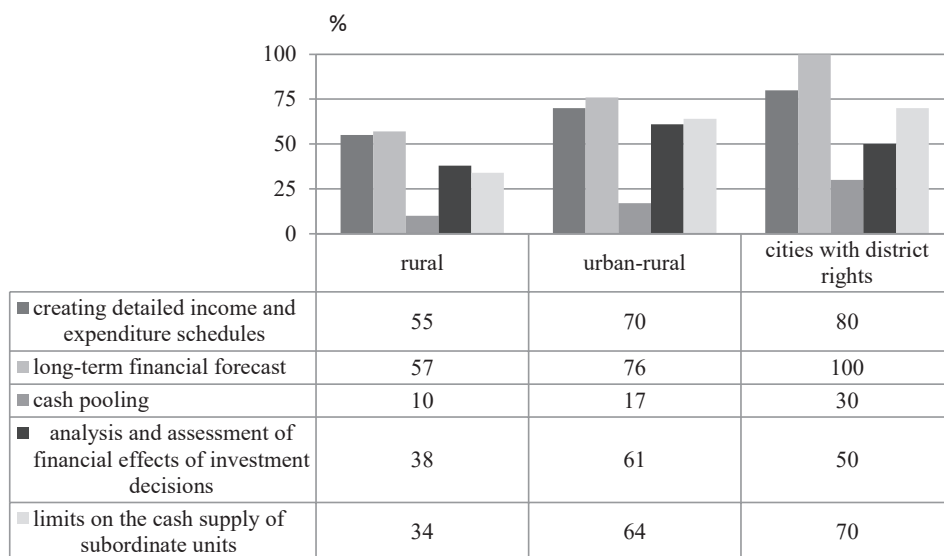


Figure 5. Financial liquidity management instruments used by managers of the local government unit of the Eastern Poland macroregion, depending on its type

Source: own elaboration based on a questionnaire addressed to the treasurers of local government units



## SUMMARY AND CONCLUSIONS

The ability to pay liabilities in a timely manner is one of the basic factors shaping the economic situation of each business unit, including local government units. This problem is relatively rarely analyzed in the case of public sector entities, which results mainly from differences in the rules of operation and financial management between these units and enterprises. These differences primarily result from business objectives, local government units perform tasks that are related to meeting the needs of local communities, and enterprises are primarily focused on maximizing profits. In addition, in local government units, the budget is recorded using the cash accounting method, and cash is generated mainly from public levies. In connection with the above, the classic measures of financial liquidity should be adjusted to the specifics of local government units. With respect to these units, financial liquidity will be maintained when cash inflows are sufficient to cover planned expenses and outlays, which requires constant control of the inflow of cash to ensure the settlement of current liabilities. Local government units, similarly to other entities, are exposed to the risk of losing financial liquidity, which is why it is important to introduce procedures and use appropriate instruments to effectively manage financial liquidity, the maintenance of which strengthens payment and financial credibility.

Based on the conducted analyzes, it was found that the majority of managers of local government units of the Eastern Poland macroregion recognizes the importance of the ability to pay liabilities on time, which indicates the awareness of the risk of losing financial liquidity and the consequences of its lack. In the case of rural and urban-rural municipalities, for 8% of respondents, the ability to meet obligations and cover unexpected expenses is irrelevant, which is worrying.

Over 70% of respondents declared that they have not had problems with liquidity within the last 5 years. Other entities recorded periodic problems with the timely payment of liabilities, usually during the financial year, which indicates the importance of the problem and the need to maintain short-term liquidity. When analyzing respondents' opinions on the causes of perturbations in the area of financial liquidity, it was found that they were generally caused by achieving lower than planned revenues as well as the improper management of liquidity. In the case of cities with district rights, also an increase in debt servicing costs was indicated by the majority of budget chief accountants as the cause of problems (60% of respondents).

In the opinion of the surveyed treasurers of self-government units of the Eastern Poland macroregion, the most frequently used liquidity management instrument was the use of a long-term financial forecast and the creation of detailed income and expenditure schedules. These are the simplest instruments of short-term liquidity management based on the financial plans of an entity that facilitate effective cash management. A small percentage of managers, except for the managers of cities with district rights, declared the use of cash pooling, involving the consolidation of accounts of related entities. It mainly stems from numerous barriers in the practical application of this instrument in the local government sub-sector.



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ZARZĄDZANIE PŁYNNOŚCIĄ FINANSOWĄ W JEDNOSTKACH  
SAMORZĄDU TERYTORIALNEGO MAKROREGIONU POLSKI WSCHODNIEJ

Słowa kluczowe: płynność finansowa, cash pooling, jednostka samorządu terytorialnego

## ABSTRAKT

Celem opracowania jest ocena zjawiska zarządzania płynnością finansową w podstawowych jednostkach samorządu terytorialnego Polski Wschodniej. Szczególną uwagę zwrócono na świadomość znaczenia płynności finansowej wśród głównych księgowych badanych jednostek, występowanie ewentualnych problemów z terminowym regulowaniem zobowiązań oraz stosowane instrumenty zarządzania płynnością. Badaniami objęto 210 jednostek samorządu terytorialnego (100 gmin wiejskich, 100 gmin miejsko-wiejskich i 10 miast na prawach powiatu) z pięciu województw zlokalizowanych na obszarze makroregionu Polski Wschodniej. Wykorzystano takie metody, jak analiza literatury przedmiotu i metoda sondażu diagnostycznego z zastosowaniem kwestionariusza ankiety. Ankiety przeprowadzono wśród głównych księgowych budżetu wybranych jednostek samorządu terytorialnego makroregionu Polski Wschodniej. Na podstawie przeprowadzonych badań stwierdzono, że większość zarządzających jednostką samorządu terytorialnego dostrzegała znaczenie płynności finansowej i w ostatnich latach nie odnotowała problemów z terminowym regulowaniem zobowiązań. Do problemów z płynnością finansową przyznało się około 30% respondentów. Główną przyczyną występowania zakłóceń w terminowym regulowaniu zobowiązań było osiągnięcie niższych dochodów i przychodów niż zaplanowano oraz niewłaściwe zarządzanie. Analizując stosowane instrumenty zarządzania płynnością finansową stwierdzono, że najczęściej były to wieloletnie prognozy finansowe oraz szczegółowe harmonogramy dochodów i wydatków.

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