REPUBLIC OF ALBANIA
MINISTRY OF FINANCE

Liquidity Management

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Liquidity Management

Definition:

LM is used as a general term, which includes both cash management and cash-flow forecast, all the activities aiming to ensure the availability of sufficient liquidity.

Cash management (CM) is a daily task aiming to ensure that sufficient liquidity is available for solving daily liquidity needs.
Cash-flow forecast or **cash flow (CF) management** is a key aspect of the financial management of a business (govt), planning its future cash requirements to avoid a crisis of liquidity.

Cash flow forecast

Cash Management

Treasure

Background

1. Until 2012 year the CM focuses on short term targets and was a passive tool, which was not able to ensure long term sustainability.
2. The CF practice was mostly considered as an administrative task, basically it was a seasonally adjusted version of the budget plan and therefore its version does not show real projected cash in-outflows.
3. LM did not form a coherent system and meant only the application for short term interventions, basically stopping of the payments and budget allocation for a month ahead, because BIs submitted to TDO the contracts signed and invoices received not when they are actually received but rather after they had compiled a number of them (batch processing).
4. Treasury didn't had accurate sufficient data on the short term expected payments. This practice limited the potential of an effective liquidity management.
5. CF and risk management were not used for the purpose of planning and measuring planned action results, it means long term effects were not taken into consideration.
6. Tools available for CM purposes was extremely limited and only certain elements have been well predefined and regulated (daily limits, i.e. the stopping of payments and prioritization of payments) .

Goal

Planning to implement a fiscal rule

- Although Albania's economy continues to grow, the country is still one of the poorest in Europe. In December 2012 the Albanian Parliament removed the 60%-of-GDP ceiling on public debt (including the debt of sub-national authorities and guarantees) from the Organic Budget Law (article 58). Quantitative medium-term targets guided Albania's fiscal policy.

- One of the pillars of the PFM reform strategy is the implementation within 2015 of an appropriate fiscal rule which will help to insure the long term sustainability of public debt in order to anchor the sustainability of public finance.

- Mitigation of optimistic biases in the forecasting of macroeconomic and fiscal variables will be another aspect we think should be addressed by the fiscal rule.

Rules to anchor fiscal policy

- In order to have a long lasting fiscal rule, which would effectively enhance the market credibility as regard the discipline of fiscal policies, we will try to enforce it on a <u>qualified majority law</u> (which would be amendable only with at least 3/5 of Parliamentary Members).
- Ideally, a fiscal rule <u>should be</u> clearly defined, transparent, simple, flexible and adequate to promote the final goal, enforceable, consistent, supported by sound policies and easy to communicate.
- The government could reinforce <u>procedural rules</u> to ensure that fiscal consolidation remain on track. It could also again consider a <u>numerical rule,</u> but one potential disadvantage of numerical rules is that if they have to consider cyclical fluctuations, they soon become very complex. A procedural fiscal rule might be more beneficial and would have advantages for e.g.:

  a) The country would not be tied to a permanent numerical target, which would be desirable given the volatile external context.

  b) The government will have to set its owned target, which could increase political commitment to meet it.

  c) A procedural fiscal target could help lay the foundation for an eventual credible permanent fiscal target.

Rules to anchor fiscal policy

A fiscal rule can targets one or more <u>variables</u>, such as:

1. The budget balance (sustainability-a “golden rule”, which targets the overall balance net of capital expenditures, is less linked to debt),

2. The public **debt ratio** (ceilings can requires ad hoc fiscal adjustment, which mostly take place at the expense of capital expenditures; it can also be significant effected by variables outside the control of government, such as the exchange rate, interest rates, or the realization of contingent liabilities),

3. Revenues (improving revenue collection or limiting tax increases)

4. Expenditures, such as ceiling on primary and current spending, expenditure growth, or % of GDP, can help limit of the budget deficit, but they can’t ensure fiscal sustainability unless combine with a balanced, debt or revenue rule. They can, however, provide operational guidance for the required fiscal consolidation when they are accompanied by debt or budget balance rules. Nominal expenditures ceilings for each ministry have to be binding. Sufficient budget controls and initiatives for policy makers to abide by the rules.

Revenues and grants:
VAT
Profit tax
Excise tax
Personal income tax
Other taxes
Social insurance contributions
Non-tax revenues
Grants
Expenditures:
Personnel
Interest
Operations and maintenance
Social insurance outlays
Local government expenditures
Other expenditures
Total current expenditure
Capital expenditure
Reserves and contingency funds
Total spending
Overall balance

Liquidity Management Process

1. TDO's currently captures and manually input all relevant information about commitments and budget execution from the BIs. The process, which is essentially manual, requires BIs to take their transactions and all relevant supporting documentation to the TDO, where the documentation is reviewed and stamped "processed" to avoid double payment of the same invoice or recording of the same contract.

2. More than a "managerial accounting issue", pre-commitments are an integral part of establishing sound internal public financial management controls to ensure there are sufficient funds to cover government commitments. Lack of formal recognition of pre-commitments in the AGFIS could lead to initiating procurement processes for which there might not be sufficient funds to ensure full payment or even to support the contracting process.

3. BIs submit to TDO's the purchase order (PO) within 3 days after signature of the agreement, which is helpful info about possible future CF.

4. Invoices (submitted by suppliers at the same time when goods/services are delivered) have to be presented to TDO when they are actually received (not after BIs had compiled a number of them- batch) and to be matched automatically with approved PO amount.

Treasury Control & Payments

- Controls on non-payroll expenditure are primarily ex-ante voucher checking. There is very little internal audit functionality at the ex-post stage as required by international best practices. Other financial controls follow international practice and are generally complied with.

- As the budget is being implemented, Treasury monitors the staffing levels with respect to a ceiling of authorized positions. The financial resources and controls in place are based on this ceiling and not on the actual number of staff employed. Inevitable staffing lags result in an underutilized salary budget.

- All government expenditure, central as well as local, is executed through the Treasury Single Account system (TSA). The system rejects any spending for which there are inadequate allocations. Controls are exercised by budget program, institution, and economic classification regarding the yearly budget allocations. TDO records and performs an additional ex-ante control before payment. Treasury keeps a strong central control on budget execution.

Treasury Control & Payments

- Cash overspending cannot occur because each transaction is checked against the appropriations/allocations. If not sufficient cash resources are allocated to the account, the transaction has to be rejected by the Treasury District Office's expenses specialist. The Treasury executes payment when cash is available, but generally within one month.

- The right to make expenditures within the limit of approved funds expires on the last day of the budget year. There is a very strict carry-over regime. All spending is limited to the calendar year unless explicitly allowed by the Parliament in the annual budget law. Borrowing against future appropriations is prohibited. The only exception is that line ministries have the right to carry over the unused funds of multiyear investment contracts, but no longer than three years, provided ex-ante approval by the Assembly.

- The Treasury plans generally provide a transparent and reliable framework within which the local governments LG can execute their budget. However, when the government revise downwards the budget ceilings due to over-optimistic projections the LG budget execution is affected because the local governments own revenue is included in the common cash pool – the TSA. This lack of control over the use of their own revenue in the LG is reported to be a source of frustration.

Cash Flow Forecast

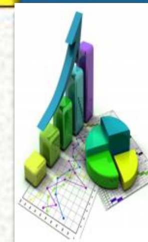
Cash planning is based on the appropriations, the allocations by Ministry of Finance and the cash flow plans from the budget institutions in accordance with provisions in the Budget System Management's Law. Issues:

- ❑ What is the difference between the short term plan and long term plans?
- ❑ What is the difference between the budget plan and cash-flow plan?
- ❑ What is the difference in the cash-flow plan of a financial insitution and the Treasury?
- ❑ How can we get realistic cash-flow plans from the Bis?
- ❑ Which institutions to concentrate on ?
- ❑ How often should you ask for data ?

Requirements

- Requirements to the updateing
- Roll-over plan
- Responsibilites on preparation and control
- Responsibilites on analysis

Liquidity Management Process



Data consistency and accuracy

The higher the quality of the information

- The lower the costs
- The smaller the risk

Do we want to have absolutely correct data each minute for cash forecast purposes?

Liquidity management short term and long term objectives:

Short term

- Ensure liqudity
- Hedge risk and mitigate risk

Long term

- Mitigate risks
- Avoid cyclical peaks

Liquidity Management Risk

- **Risk management** is the identification, assessment, and prioritization of risks followed by coordinated and economical application of resources to minimize, monitor and control the risks.
- Basel principles
  - Market risk
  - Operational risk
  - Liquidity risk (or funding risk)

Tasks concerning the development of a risk management framework

- Identification, assessment and prioritization of risks
  - identification of risk categories
  - risk analysis related responsibilities
  - definition of triggers (when action is to be done)

Liquidity Management Risk (RM)

RESERVES

As protection tools

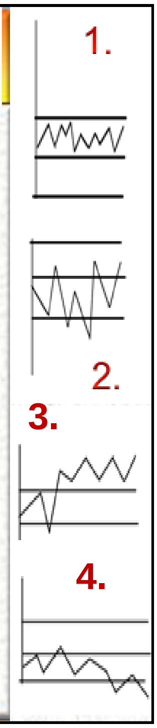
As indicators for risk management purposes (Basel)

The **volume** of the necessary reserves depends mainly on:

- the volume of the assets to be protected
- the volatility of the markets and market behaviour and specialities
- the reliability of the forecasts
- the time necessary from the recognition to the decision making and for the implementation of actions
- tools available for the implementation of actions
- time needed from the activation of the corrective actions to exercise their impact.

Albanian current reserves:

- Budget related contingencies and reserves
- Stand-by facility for liquidity management purposes kept at BoA



Gap analysis

Gap - the difference between the expected revenues and expenditures.

Principal long term RM **tools** available in case of long term liquidity shortage:

1- Increase of deficit.

2- Increase of revenues (new taxes, increase of tax, custom etc.).

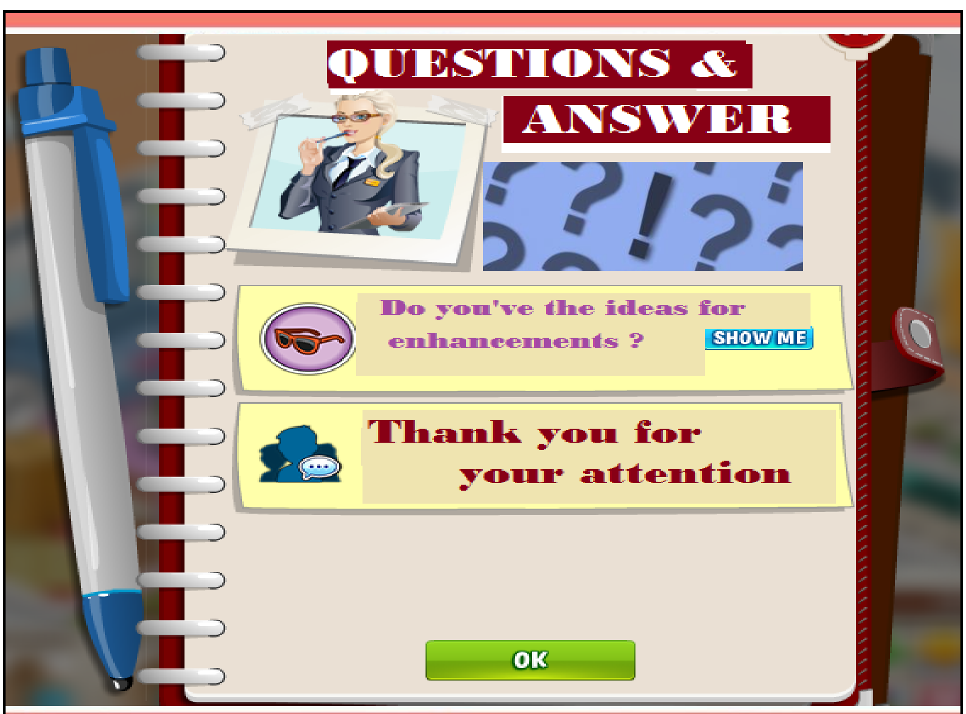
3- Budget cut-building in systematic reserves (budget modification).

4- Allocate only a certain percentage (90%) of the total budget at the beginning of the year, which can be revised without budget modification during the year. This raises the need of law modification in this respect.

5- Decrease of budget allocation-only practical tool available for the Treasury for handling long term liquidity shortages on a proper way.

Item/period	0-30	31-60	61-90	91-180	180-365
+Income					
-Exp					
Gap					
CUMULATIVE Gap					
Min. reserve requirements (RR)					
Max. RR					
Gap - min.RR					
Gap– max. RR					


ANALYSIS
GOAL


QUESTIONS &
ANSWER
Do you've the ideas for enhancements ?
SHOW ME
Thank you for your attention
OK


IT'S TIME FOR A COFFEE
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