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BUDGETING IN ALBANIA -- DRAFT

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This draft is for discussion at the CESEE SBO meeting.

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BUDGETING IN ALBANIA

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DRAFT, 11 June 2013

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Abbreviations and Acronyms

ALL	Albanian Lek
AMoFTS	Albania Ministry of Finance Treasury System
AO	Authorizing Officer
BMM	Budget Management and Monitoring Directorate
BAPPD	Budget Analysis, Policy and Programming Directorate
BoA	Bank of Albania
CoM	Council of Ministers
DoPA	Department of Public Administration
EU	European Union
EFP	Economic and Fiscal Program
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IFC	International Finance Corporation
IFRD	Intergovernmental Fiscal Relations Division
IPA	Instrument for Pre-Accession Assistance
IPS	Integrated Planning System
LGUs	Local Government Units
MBMD	Management and Budget Monitoring Division
MFPD	Macroeconomic and Fiscal Policy Department
MBS	Management of Budget Systems Law
MoF	Ministry of Finance
MEI	Ministry of European Integration
MTBP	Medium Term Budget Program
MTEFP	Medium Term Economic and Fiscal Program
NSDI	National Strategy for Development and Integration
OECD	Organization for Economic Cooperation and Development
PEFA	Public Expenditure and Financial Accountability Assessment
PEIP	Program Expenditure Investment Planning
PEM	Public Expenditure Management
PFS	Public Finance Strategy
PIMD	Public Investment Management Directorate
PMT	Program Management Team
PPPs	Public Private Partnerships
PPR	Program Policy Review
RMBEF	Report on Macroeconomic and Budgetary Assessment and Forecast
SAI	Supreme Audit Institution
SIGMA	Support for Improvement in Governance and Management
SAA	Stabilization and Association Agreement
SMG	Strategic Management Group
SPC	Strategic Planning Committee
TSA	Treasury Single Account

PREFACE

This review of the budget process of the Republic of Albania was carried out as part of the work programme of the OECD Working Party of Senior Budget Officials. In 2004, the working party established the Network of Senior Budget Officials of Central, Eastern and South-Eastern European countries (CESEE). Budget reviews serve as a basis for the examination of a country's budget institutions by the network in its annual meetings, and enable the participants to discuss the budget procedures of a country in depth.

A team of the OECD Secretariat consisting of Mr. Knut Klepshvik (lead) and Mr. Brian Finn, supported by Mr. Richard P. Emery Jr. (independent consultant) and Ms. Regina Bernhard (consultant from the German International Co-operation, GIZ), undertook a mission to Tirana from 29 October to 2 November 2012 to prepare the review. During the mission, the team met with Mr. Dorian Teliti, General Secretary, Ms. Mimoza Dhembli, General Budget Director, Mr. Endrit Lami, Director of Macroeconomic Directorate, Ms. Mimoza Peco, Director of Treasury Operations, Ms. Anila Cili, Director of Central Harmonization Unit of Financial Management and Control, Mr. Igli Stambolla, General Director of Central Harmonization Unit of Internal Audit and other officials of the Ministry of Finance.

The OECD team met also with: Mr. Bujar Leskaj, Chairman of High State Control, and other officials of the Supreme Audit Institution, Mr. Edmond Spaho, Chairman of Parliamentary Commission of Economic and Finance, Mr. Mimi Kodheli, Deputy Chairman of Parliamentary Commission of Economic and Finance, and other Members of Parliament as well as senior officials from other ministries, the Office of Council of Ministers, the Public Procurement Agency, the Social Insurance Institute and the Municipality of Tirana. The OECD team is grateful to all of these officials for the information they provided and for their willingness to explain the Albanian procedures and practices.

The team would like to thank in particular, Ms. Gelardina Prodani, Director of Budget Management and Monitoring in the Ministry of Finance, for the excellent organisation of the meetings, her help with the collection of documents, and her practical support during the team's stay in Tirana.

SUMMARY OF RECOMMENDATIONS

Budget formulation

Budget formulation procedures in Albania are more effective than those of many countries. The process is organized to ensure that participants in the budget process have constructive roles. Decisions are based on programmatic information, tied to policy goals and integrated into program planning. The form of the processes for the most part should be continued. Issues that remain are primarily to improve the quality of the budget analysis.

Albania should develop a policy neutral baseline. Albania should continue to strengthen the accuracy and reliability of its economic forecasts. One specific improvement that should be considered would be to develop a policy neutral baseline and to incorporate the results of the baseline in the Economic and Fiscal Program. Policy proposals and structural reforms should be treated separately from economic and technical factors.

Program objectives should be refined to more clearly represent the basic nature of programs and performance indicators should be better focused to reflect the critical policy sensitive nature of programs. Changes needed are improvements in the quality of review, not in the nature of the procedures undertaken. Continuing improvement to program budget measures will require additional use of MTBP procedures within ministries and in the local communities. These efforts can get feedback through the decision process, but could be facilitated by training within the ministries and / or localities, by informing the public on the results, and by translating the budget decisions into program implementation.

The budget schedule should be reviewed periodically to confirm that the sequential review adds value to the decision making process. The budget schedule defined by the BMS law requires repetitive procedures that consume a substantial effort from the budget office, and ministry authorizing and executive officers. At a minimum, the National Assembly should have more time to review budget policy and a greater opportunity to affect budget allocation choice.

Budget documents should be reviewed on an on-going basis to ensure that the budget is transparent to the decision makers and the public. It should not require a budget expert to understand the policy presented in the budget. Comparisons overtime (two prior years, the budget year, and two succeeding years) are particularly effective in conveying an understanding of changing budget policies. The solution is frequently not more information, but information presented in easily understood tables, graphs and displays. Budget writing should also be simplified and made more direct.

Responsibility and accountability for budget formulation and management should be delegated to budget institutions and spending units. Program budgeting is based on an assumption that budget responsibility is delegated to the extent possible. The MBS authority creating authorizing officers may need to be clarified to ensure that lines of authority are clear and do not conflict with the broader goal of delegating program accountability.

The MoF should take an active role in reviewing any PPP proposal. Many countries have found that public interest is frequently not served by these arrangements. The OECD guidelines should be considered in developing PPP oversight and governance arrangements.

Budget approval

The Parliamentary budget process in Albania is regulated by a comprehensive legal framework. Most crucial Parliamentary rights are granted by the organic budget law. Amending the organic budget law to reflect the parliamentary practice of exercising amendment powers would eliminate doubts about the Assembly's rights and assure that minority requests are responded to in a regulated procedure.

The schedule and procedures of budget approval in the Assembly should be revised to provide the Assembly with more time for considering the budget. While the Assembly theoretically has two months to discuss the budget, it takes usually no more than four to five weeks, limiting the possibilities for in-depth discussions in the relevant committees. The Assembly could put more effort into the approval process under the existing timeframe and revise its procedures to expand the budget hearings and budget debate to increase its impact on budget deliberations. Considering the importance of the MTBP document, the Assembly should be granted the right to review and approve the medium-term financial strategy during the budget process, e.g. together with the annual budget.

The Albanian Assembly should reconsider establishing a non-partisan budget office in order to address the lack of independent analytical capacity for MPs. Increasing the non-partisan analytical capacity in the Assembly and its availability for the Committee on Economy and Finance for all MPs, including the minority MPs, would strengthen the quality of the parliamentary budget discussions.

The Assembly, and especially the Committee on Economy and Finance, should assure that the majority of hearing sessions are open to the public and that information on the sessions is adequately published. Concerns about the publicity of Parliamentary hearings (including those of the Committee on Economy and Finance) should be taken seriously. While the Albanian regulatory framework for the budget process entails all necessary provisions to guarantee full transparency of the content of the Assembly's session, in practice, publicity of the hearings is contested.

The role of the Committee on Economy and Finance could be significantly enhanced regarding budget oversight, with a more prominent role for the opposition. Since the tasks of budget approval and budget oversight are both carried out by the Committee on Economy and Finance, the minority raised concerns about their role in controlling budget execution. As a means to minimize changes to the existing system, the German or the British model would be suitable for the Albanian Assembly. While the German Budget Committee also exerts both functions of budget approval and oversight, a sub-committee on public accounts usually led by the minority has been established. In Great Britain, the oversight committee on public accounts is led by the minority.

Budget execution

Broadly, the government has established sound systems and procedures for budget execution, generally in line with practice in OECD countries, though there is still some way to go before all elements are fully implemented. The Treasury system is according to international best practice. The proper implementation still needs to be addressed.

The government should establish better commitment control where spending units are required to register commitments in the Treasury system when a contract is signed (before an invoice arrives). The MoF is on the right track when they plan to introduce the commitment module as of 2013, primarily for investment contracts. However, the government should establish a more comprehensive commitment control integrated with the Treasury system.

The MoF should consider an electronic link between the budget institutions financial system and the treasury system in order to facilitate efficient payment execution and commitment control. This could

increase efficiency of the budget execution and help the spending units to plan better use of allocated resources and it would give the Treasury better basis for cash planning. Access to the treasury system for all budget institutions would also help reconciliation and planning at the spending unit level.

Over time, the government might consider allowing small carry-overs to the next budget year, in combination of a compensation strategy for next year's budget, in order to secure efficient use of resources over the year-end and to allow budget institutions to reallocate smaller amounts between programmes.

The government should consider reducing the Reserve Fund in order to increase budget discipline. Though, at this stage of development it seems to be well suited for Albania to continue its limited right to exercise reallocations through a centralised procedure.

The MoF should emphasis monitoring of actual expenditure against budget and actual outputs against targets but have less focus on direct links to unit costs in the budget formulation and monitoring. The Albanian performance budgeting system represented by the MTBP and the budget monitoring process is broadly in line with practices in some OECD countries. However, recent international research indicates that it is difficult to use non-financial performance as a direct tool for budgeting.

Line ministries should take a stronger responsibility of their own budget execution and use the MTBP pro-actively in management and as a basis for internal management and control. This will create better understanding of the interaction between inputs and outputs, and create better ownership of the results and better reports to the MoF. The management culture should be changed by structural reform and training, and the civil service law should be amended to shift to a performance structure from position based personnel controls.

The government should continue to pursue professionalism, depoliticisation, meritocracy, transparency and accountability and secure implementation of approved legislative and institutional frameworks. The roles concerning design of civil service wages policy and performance elements in wages should be reconsidered in order to allow MoF a better opportunity to coordinate wages policy with fiscal policy.

The government should continue to refine the legislative and institutional framework of public procurement and secure training and cross-the-board implementation to secure successful implementation of the modern ICT system for electronic procurement processing. Defence procurement outside the Public Procurement procedures is a potential major loophole in procurement procedures.

Accountability, Control and Audit

The adoption of full accrual system of accounting is less important than controlling arrears and recording commitments. Getting complete information on commitments so that arrears are stopped should be a higher priority than the adoption of full accruals in an administration that does not have the capacity to use the information a full accrual system provides.

More emphasis should be placed on practical improvements to the system of financial control and audit. While positive steps have been taken in these disciplines over the past few years, many of the steps have been in the field of legislation and regulation. This provides a basis for these disciplines but is not sufficient in itself to ensure successful implementation.

The Albanian authorities should aim to raise the level of understanding throughout the administration as to what financial management and control and managerial accountability actually mean. Despite a reasonable legal framework for the introduction of FMC and despite the efforts of the CHU/FMC in promoting the new FMC law, there is a poor understanding in Albania of what FMC and managerial

accountability mean in practice. Responsibility for decision making is mainly centred on the head of the budget institution with very little delegation of tasks. This is an issue which will take time to improve as the traditional administrative arrangements cannot be changed overnight.

One step towards developing more delegation would be that the official responsible for the overall financial management and control of the finances of the spending unit ought to be positioned at the highest levels of management and report directly to the authorising officer. This is what the FMC Law of 2010 requires, but it does not happen in practice. The solution to this problem may be a redefinition of the role of the executing officer.

There should also be emphasis on achieving performance targets within budget limits in the budget institutions. This does not happen currently since the focus of reporting is mainly financial and does not contain information about management performance. Despite the work that has been invested in improving the Treasury system over the past decade, it continues to exist as an accounting system for transaction control, cash-flow management, and formal accounting and budget reporting purposes.

In the field of internal audit, the internal audit units need more practical guidance to do their work more effectively. Therefore, the relatively recent formal cooperation agreement between the Minister of Finance and the HSC and the strategy for the training and certification of internal auditors are both positive developments. The CHU/IA could ensure that the implications of internal audit for financial management and control policy are reflected in the training of internal auditors as this is not being done already.

The law should be amended to clarify the role of the Directorate of Public Financial Inspection and also the Minister of Finance with regard to financial inspections. Managers should be aware as to the difference between an internal audit unit providing top management with advice about corrective actions and the top management taking responsibility for ensuring that the necessary corrective action is implemented.

The HSC should move beyond a concentration on regularity/compliance audit. The HSC recognises this, and is taking steps to improve its capacity for performance audit but it eventually will need to save resources on compliance audit by reducing the audit procedures and by applying professional audit sampling techniques.

Finally, an independent body to audit the accounts of HSC should be appointed by the Parliament as foreseen in the Law on HSC.

1. INTRODUCTION

1.1 Basic information on Albania

General characteristics

The Republic of Albania was established as a unitary parliamentary republic in 1991 after 46 years of Communist rule. Albania has enjoyed a status as an independent country since 1912 after the dissolution of the Ottoman Empire, but the country suffered an Italian occupation from 1939 and later a German occupation during the Second World War.

The country is situated¹ in South-eastern Europe, bordering the Adriatic Sea and Ionian Sea, between Greece in the south, Macedonia in the east and Montenegro and Kosovo to the north. Across the Strait of Otranto Albania is about 70 km from the coast of Italy. The country consists of mostly mountains and hills with small plains along the coast.

Albania has a population of 2.8 million (2011 census) of which about half live in urban areas. 537 000 people live in the capital, Tirana. About 20% of the population is below 15 years, almost 70% is 15-64 years and some 10% is 65 years or above. The population is rather homogenous with only smaller ethnic minority groups. The majority are Muslim with sizeable contingents of Orthodox and Roman Catholics.²



*Political situation*³

The Albanian Parliament is a unicameral Assembly with 140 deputies elected for a 4-year term under a closed-list regional proportional representation system.

The parliamentary work has been seriously hampered for some time due to the political standoff between the ruling majority and the opposition, lack of constructive political dialogue and the mutual suspicion characteristic of Albanian politics. In November 2011 the situation eased somewhat when the ruling parties and the opposition reached a political agreement of co-operation. The political climate has improved since then with a temporary set-back in connection with the presidential election. The political agreement allowed progress in a number of areas like amendments of laws requiring three-fourth majority vote, appointment of an Ombudsman and approval of the presidential nomination of a judge to the High Court.

The centre-right Democratic Party (DP) and the centre-left Socialist Movement for Integration (SMI) combined to form a coalition government after the 2009 general elections, the first coalition government in Albania's history. After the general elections in 2009 the distribution of seats by party is: DP 68, SP 65, SMI 4 and other 3. The Socialist Party (SP) contested the results of the 2009 parliamentary elections and the 2011 local elections.

Election of the Albanian president requires a three-fifths vote of the Parliament. The President is elected for a five-year term and is eligible to be elected for a second term. The President of the Republic

Bujar NISHANI took office on 24 July 2012. The prime minister is appointed by the president and the Council of Ministers is proposed by the prime minister, nominated by the president, and approved by the Parliament. The Prime Minister Sali BERISHA has served since 10 September 2005.

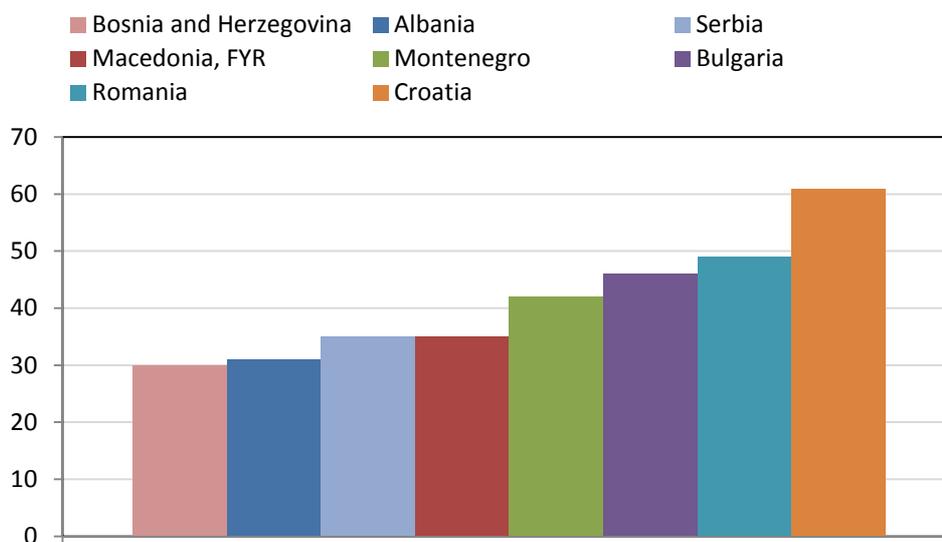
*Judiciary*⁴

Judicial power is exercised by the High Court and courts of first and second instance. According to the European Commission Albania needs to further accelerate the implementation of the judicial reform strategy in order to ensure the independence, efficiency and accountability of its judicial institutions. Reform of the laws on the High Court and the Constitutional Court are pending.

*Economy*⁵

Although Albania's economy continues to grow, the country is still one of the poorest in Europe. The informal economy is large and the energy and transportation infrastructure is not yet of modern standard and presents a long-standing barrier to sustained economic growth. Compared to the neighbouring EU candidate countries (Macedonia, Montenegro and Serbia), the potential candidate country (Bosnia and Herzegovina), the two most recent EU member countries (Bulgaria and Romania) and the prevailing EU accession country – Croatia, the GDP per capita in Purchasing Power Standards (PPS) is among the lowest (about 30% of the EU average).

Figure 1. GDP per capita in Purchasing Power Standards (PPS) in 2011⁶ (index EU27=100)

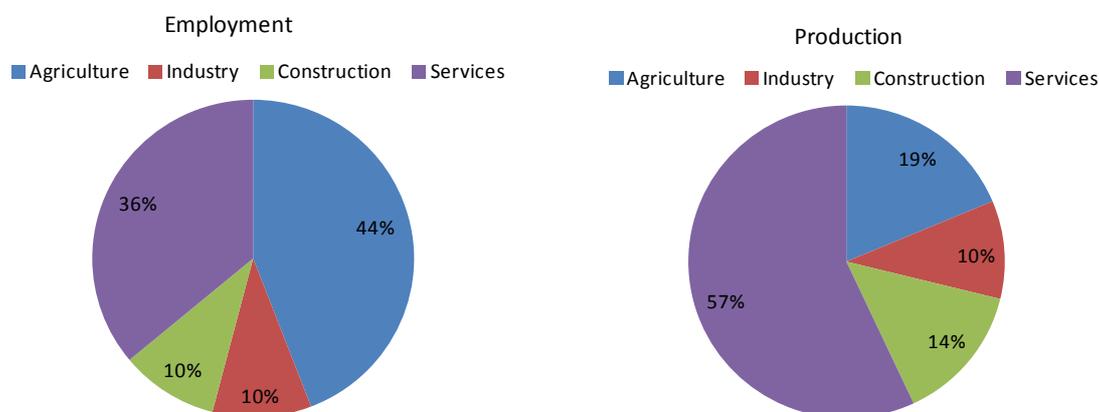


Source: Eurostat database

Services are the main contributor to Albania’s gross domestic product (GDP) at nearly 60% in 2009, with trade, hotels and restaurants accounting for the bulk of this sector. Agriculture’s share in GDP was about 20% and construction about 14%. The industry sector (10% of GDP) is dominated by manufacturing and extractive industries. Agriculture remains the largest employer with 44% of total employment in 2009 (figure 2).

Albania’s manufacturing base remains concentrated around three main sub-sectors which accounted for some 83% of total exports of goods in 2011 and which are either dominated by low value-added products or vulnerable to fluctuations in global commodity prices: textiles and footwear (32%), minerals, fuel and electricity (30%) and building materials (21%). The largest foreign trade partner is Italy that receives about 45% of Albania’s export.

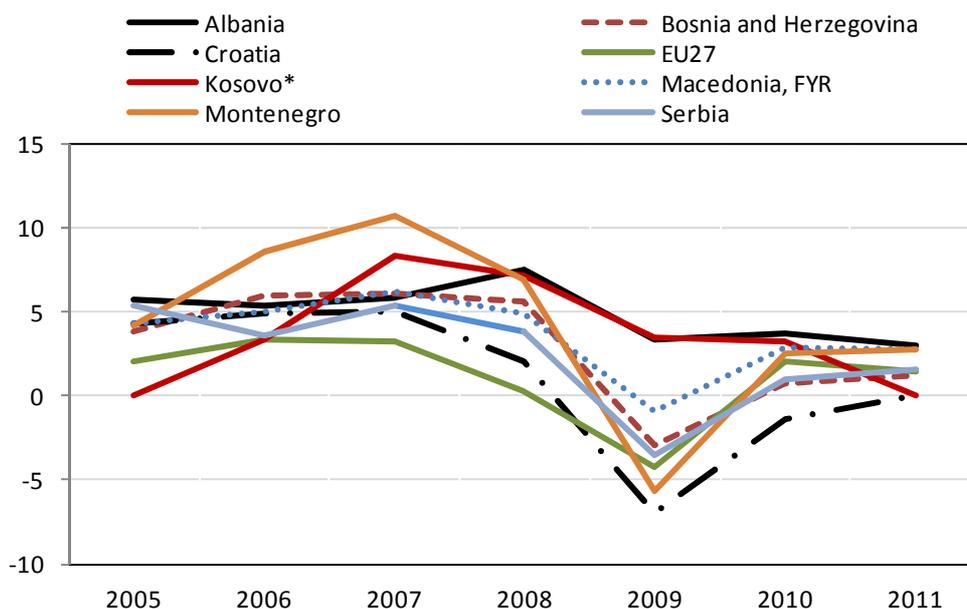
Figure 2. Employment and production by sector (2009)



Source: INSTAT (production data extracted on 20.11.2012) and Albania Progress Report 2012, European Commission (employment)

The Albanian economy has performed on a persistent high growth rate (averaged around 6% between 2004-08), higher than the EU average and most of the neighbours. The growth rate outperformed these (except Kosovo*) especially during the global financial crisis and continued to grow in 2011 (on average lingering on 3-4%), driven by domestic demand (figure 3).

Figure 3. Real GDP growth rate

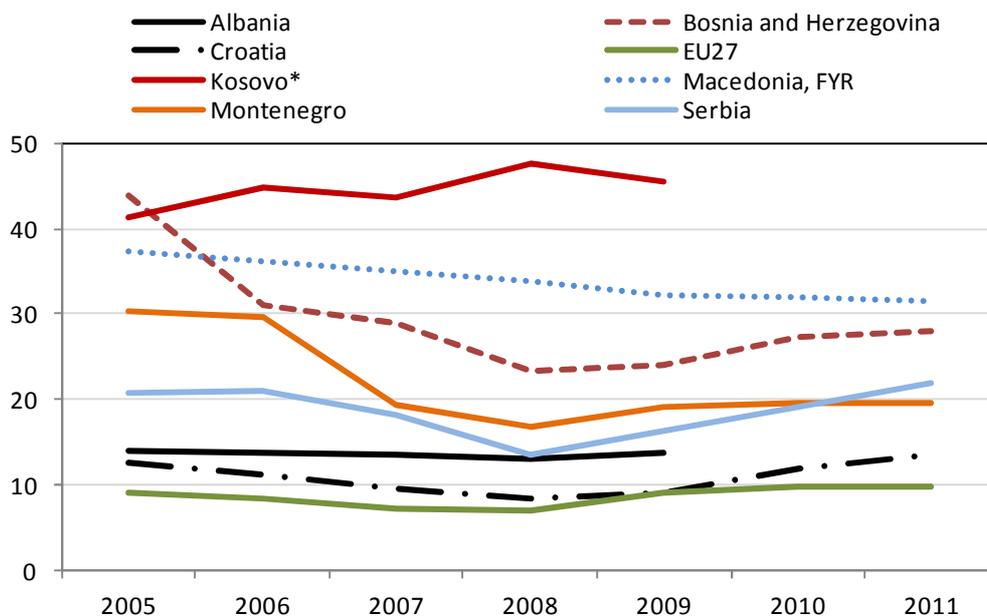


Source: Eurostat database

Note: *) under United Nations Security Council Resolution 1244/99

Although relatively high growth rate, Albania has experienced an unemployment rate substantially above the EU level and also higher than Croatia but considerably lower than most of the neighbouring countries (figure 4).

Figure 4. Unemployment rate: share of labour force that is unemployed (%)



Source: Eurostat database

Note: *) under United Nations Security Council Resolution 1244/99

International relations and foreign aid⁷

In 2009, Albania submitted its formal application for EU membership. Three years later, in October 2012, the European Commission recommended that Albania be granted EU candidate status, subject to completion of key measures in the areas of judicial and public administration reform and revision of the parliamentary rules of procedures.

Pre-accession financial assistance to Albania is provided by EU under the Instrument for Pre-Accession Assistance (IPA). Through IPA National Programmes, the EU allocated a total of EUR 83.2 million in 2010 and EUR 82.0 million for 2011.

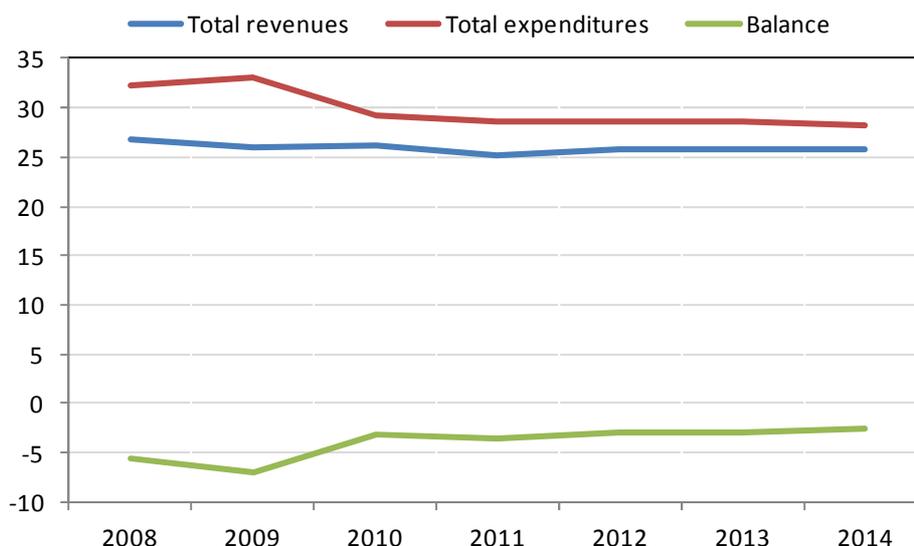
Albania completed a three-year arrangement with the IMF in 2009 and the government plans to finance its prevailing debt and future investments by commercial loans.

1.2 Overview of fiscal and monetary policy

Fiscal position and public debt⁸

The fiscal policy of Albania has become more prudent in the last two-three years. The budget deficit shrank to 2.9% and 3.5% of GDP respectively in 2010 and 2011 (from 7% in 2009), following a sharp reduction in capital expenditure that followed the government's push before the 2009 election to finish large public investment projects (figure 5). The expansionary fiscal policy of 2009, mainly through higher capital expenditures, helped Albania to avoid a recession in 2009 that its neighbours experienced. Notwithstanding, the government has failed to meet its revenue targets over the past several years. This has affected its deficit targets as well, and has necessitated mid-year spending cuts to restore the fiscal balance projected in the budget. These cuts have the potential to delay payments, potentially build up arrears and adversely affect the private sector operators, who have the greatest potential to contribute to job creation and increased economic growth.

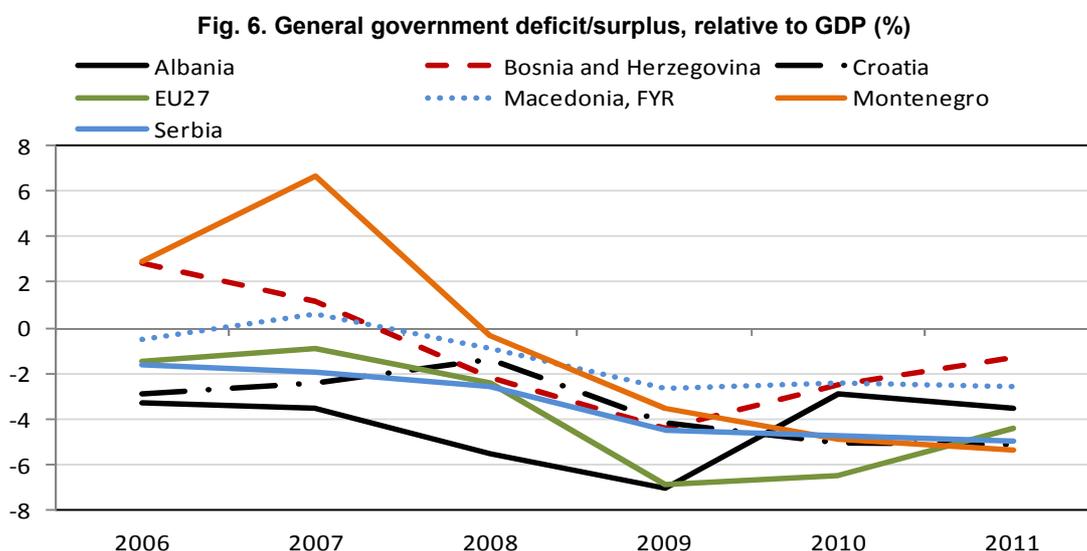
Figure 5. Expenditure, revenues and balance of general government¹ (per cent of GDP)



1: Data for 2012-14 are the government's forecasts.

Source: Economic and Fiscal Programme 2012-14, Ministry of Finance, Albania.

The track record of fiscal deficits of Albania prior to the global financial crisis is worse than that of neighbouring countries and EU27. Albania has weathered the financial crisis better than most other regional and European economies so far and has managed to limit its deficit two of the last three years. Only FYR Macedonia and Bosnia and Herzegovina have a lower deficit in 2010-11 (figure 6).

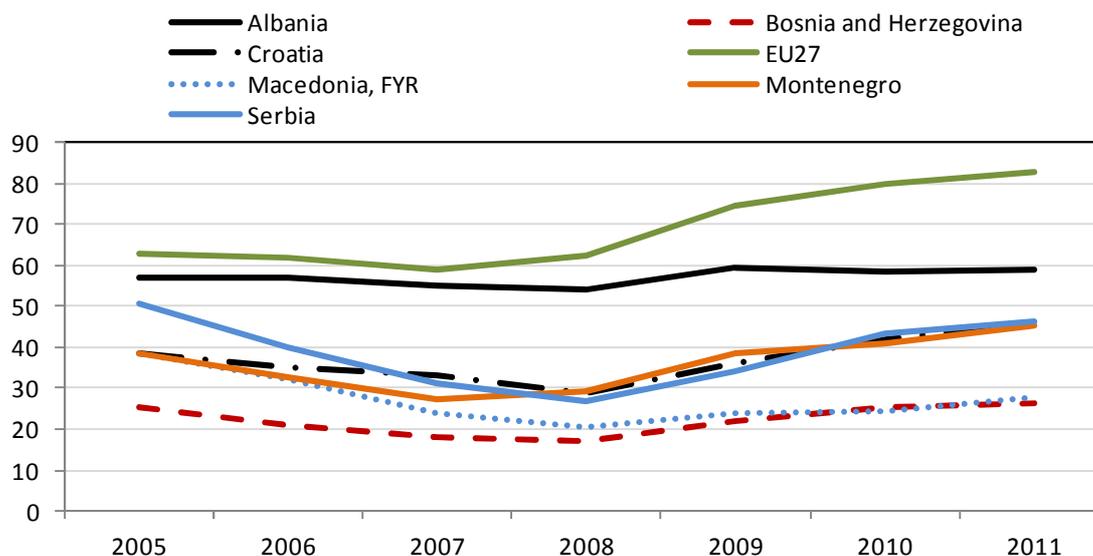


Source: Eurostat database

Compared to the unsustainable debt level of EU, Albania is better situated but its high public debt may create hindrances for further developments in the country. The public debt is approaching the EU limit of 60% of GDP (figure 7). Strong trade, remittance from migrant workers, and banking sector ties with Greece and Italy make Albania vulnerable to spillover effects of the global financial crisis. Foreign-denominated loans stood at 68% of the total credit outstanding in 2011, of which more than half consist of un-hedged loans, while foreign currency-denominated deposits account for 50%.

The government successfully placed its first ever Eurobond in October 2010, and its policy is to continue to rely on commercial loans to finance its external and fiscal deficits. However, there is a risk that Albania may need to turn to the IMF for assistance if demand for merchandise exports and migrant workers remains depressed beyond the modest recession expected in the euro zone in 2012, and if the national currency (ALL) depreciates more sharply than in 2011-12.

The current account deficit widened to 12.2% of GDP in 2011, up from 11.3% a year earlier, primarily reflecting a higher trade gap and a lower services account surplus. Foreign Direct Investment (FDI) inflows are estimated by the European Commission to have increased by about 17% in 2010 (9.5% of GDP), mostly in the hydrocarbons sector, and declined in 2011 by 10%. FDI inflows covered some 65% of the current account imbalance, down from 78% in the previous year. Notwithstanding, the accumulated stock of FDI is among the lowest in the region.

Figure 7. General government debt relative to GDP (%)

Source: Eurostat database

Monetary policy⁹

The Bank of Albania's (BoA, the central bank) is owned by the state and is accountable to the Parliament. The Bank is managed by the Supervisory Council, composed of 9 members, appointed by the Parliament for a term of seven years, eligible for reappointment. The main target is achievement and maintaining of price stability. Though BoA enjoys the attributes of a modern central bank and pursues a sound monetary policy the Law on the National Bank is still not adopted and there are some cautions on independence of Council members and accountability of the bank (EC, 2012).

The annual inflation rate in Albania averaged 3.6% in 2010 and 3.4% in 2011, the highest level in ten years, and remained within the Bank of Albania's target range of 2-4%. The main contributors to inflation in 2011 were international prices for food and fuel.

After raising its key repo rate by 25 basis points in March 2011, to 5.25%, as inflation exceeded its target band of 2-4%, the Bank has cut the rate on five separate occasions by a total of 125 basis points, bringing it down to a historical low of 4% in July 2012. This followed a sharp disinflationary trend in the second half of 2011; inflation in February 2012 (0.6%) was the lowest in 12 years. (EIU 2012)

Albania pursues a free-floating foreign exchange rate system. The ALL, which has depreciated sharply since 2009, was more stable in 2011, depreciating by some 2% against the euro. During the first eight months of 2012, the Albanian currency appreciated marginally reaching 1.8% year on year in August. (EC 2012)

In general, the Albanian banking system remains capitalised and liquid. The banking sector, which accounts for 85% of GDP and comprises 16 commercial banks, are all privately owned. The share of foreign ownership stands at some 90% of total assets. Non-performing loans continued to rise during 2011 and stood at 21% of total loans in June 2012 which is a cause for concern. (EC 2012)

2. BUDGET FORMULATION

The concepts and procedures for budget formulation in Albania are well developed and comprehensive. Some structural reforms are fully mature, others are in the process of being developed, and some need to be developed further. This section reviews the formulation of the budget in seven sub-sections: the budget legal framework, the structure and classification of the budget, fiscal rules, the annual budget cycle, a review of elements of budget formulation, documents and transparency, and the organization of the Ministry of Finance. Conclusions and recommendations for further actions are provided at the end of the section.

2.1 Legal framework

The Albanian budget system is defined in law, most of which has been enacted over the past few years. Albania began its shift from communism to a democratic state in 1992, enacting its Constitution in 1998, its first organic budget law in 2000, and the current organic budget law, the Law on Management of the Budgetary System of the Republic of Albania in 2008. Albania has enacted a broad spectrum of related public financial management legislation: the Law on Organization and Functioning of Local Governments of 2000, the Debt Policy Law of 2006, the Public Procurement Law of 2007, the Internal Audit Law of 2007, Law on Public Financial Inspection of 2010, and the Law on Financial Management and Control of 2010.

The Albanian Constitution of 1998 established a parliamentary republic, based on free elections and a governance system reflecting the classical separation of powers between the legislative, executive and judiciary. Executive power is vested in the Council of Ministers. Part Thirteen of the Constitution establishes provisions for public finances. It establishes a budgetary system composed of state budgets and local budgets. It provides for the Prime Minister to present a budget to the National Assembly and authorizes the Assembly to make changes in the budget.

The Management of Budgetary System (MBS) Law, enacted in 2008 provided legislative specifications for program budgeting, set out the budget preparation and monitoring calendar more clearly, clarified budgetary roles and responsibilities, and established "Authorizing Officers" (AO) for each budgetary institution, the senior civil servant with authority for public expenditure management (PEM). The MBS establishes "Executive Officers" who are high level civil servants named by authorizing officers to implement financial management rules, keep accounts, and prepare financial statements. The 2008 Act establishes requirements for budget classification and specifies provisions for establishing special funds. It also improves the framework for PEM at local levels, requiring balanced budgets, common classification systems, and accounting standards to be determined by the Ministry of Finance. Authorizing officers are also authorized for localities. Scheduling requirements for budget preparation instructions require information on the sharing of functions between central and local governments and the methods of calculating unconditional and conditional transfers to localities by February, eleven months before the beginning of the budget year.

Albania began the Stabilization and Association Process (SAP) with the European Union (EU) in 2000. The SAP has both provided a catalyst for PEM reforms and contributed significantly to Albania's legal framework for financial management, as Albania has moved toward the *Acquis Communautaire* expressed in Treaties and secondary legislation and policies of the EU.¹⁰ Albania's public finance laws are clearly written for the most part, and generally reflect best practice in budget procedures and financial management generally.

Authorizing officers created under the MBS law report to the First Authorizing Officer (FAO), the General Secretary of the Minister of Finance. This reporting arrangement makes them accountable to the FAO of the MoF for public finance. It potentially creates a managerial conflict between the FAO of the Ministry of Finance and the minister of their ministry. This could undermine the allocation of managerial accountability that the program budget tries to establish. The MBS attempts to clarify roles and responsibilities for budget and public finance. It may need to be clarified to avoid unintended conflicts.

2.2 Structure and classification of the budget

The budget of Albania is composed of the State Budget, Local Budget, and Special Funds: social insurance, health insurance, and ex-owners compensation. Revenues, expenditures and balance for each component are presented separately in the annual budget. Total government spending in 2012 was projected to be 28.6% of GDP, revenues 25.6% of GDP. The Table below shows general government operations and identifies the major categories of government spending and revenues. Personnel expenditures account for just over one fifth of current government spending. Social insurance expenditures account for approximately 25% of total spending or one-third of current expenditures. Local government expenditures are a little over 10% of current expenditures. Capital expenditures account for one-fifth of expenditures. Interest and operations and maintenance expenditures account for the remaining 25% of spending. The VAT is the largest source of revenue followed by social insurance contributions (table 1).

Table 1: General Government Operations in Albania, 2011 – 2013 (% of GDP)

	2011	2012	2013
Revenues and grants:			
VAT	9.2	8.8	9.1
Profit tax	1.5	1.2	1.3
Excise tax	3.1	2.7	3.0
Personal income tax	2.2	2.1	2.1
Other taxes	3.3	3.9	4.3
Social insurance contributions	4.4	4.3	4.3
Non-tax revenues	1.8	1.7	1.5
Grants	0.3	0.3	0.9
Total revenue and grants	25.5	24.7	25.6
Expenditures:			
Personnel	5.2	5.1	5.1
Interest	3.2	3.1	3.6
Operations and maintenance	2.5	2.3	2.3
Social insurance outlays	8.8	9.0	9.1
Local government expenditures	2.2	2.0	2.1
Other expenditures	1.7	1.8	1.7
Total current expenditure	23.6	23.3	23.9
Capital expenditure	5.4	4.8	5.0
Reserves and contingency funds	0.0	0.3	0.2
Total spending	29.0	28.4	29.1
Overall balance	-3.5	-3.7	-3.5
GDP - ALL in billions	1,297.7	1,346.2	1,407.0

Source: Government of Albania, Fiscal Table

Budget classification requirements are established by Article 11 of the MBS law. Budget classifications are specified by the Minister of Finance in compliance with international standards. At a minimum budget classifications cover an administrative classification, an economic classification, a functional classification, a program based classification and a classification of the source of financing. Table 2 below presents this classification graphically. Budget decisions are made on a program basis. Allocations are approved by administrative unit, program, and by major economic categories: current and capital, personnel, interest, operations and maintenance, and subsidies. All general governments are subject to the same classification requirements.

Table 2: Structure of budget allocations for spending units

Dimensions	Classification	Specification
Administrative	Central government (44)	Line ministries (14) Independent central government institutions (30)
	Special funds (3)	Social insurance fund (compulsory and supplementary) Health insurance fund Ex-owners compensation fund
	Regional government (12)	Districts (36)
	Local government (373)	Municipalities (65) Communes (308)
Functional (COFOG)	General public services Defence Public order and security Economic affairs Environmental protection Housing and community amenities Health Recreation, culture and religion Education Social protection	
Programme	1-10 programmes per budget institutions (on average 6 per line ministry)	Outputs
Economical (expenditures)	Current	Wages Social insurance contribution Goods and services Subventions Other internal current transfers Foreign current transfer Transfer for families and individuals
	Capital	Tangible capital expenditure Intangible capital expenditure
Economical (revenues)	Grants	
	Taxes	
	Non-tax revenues	
Financing	Own non-budget revenue Annual budget External financing	

Source: Annual Budget Law 2011

2.3 Fiscal rules

Albania has recently modified its single fiscal rule, a limitation on public debt. Article 58 of the MBS Law originally restricted total public debt, including guarantees, to not exceed 60% of GDP. In 2013, this specific numerical limitation was replaced by language limiting borrowing to financing of capital expenditures. The revised rule described as a "golden rule" prohibits borrowing for current expenditures; these expenditures are to be covered by revenues. Borrowing is only to be used to finance capital investment. Local budgets have similar requirements; they are required to be balanced, except in cases where borrowing is to finance investment projects. All borrowing is subject to review by the Ministry of Finance. Limitations on total State Debt and total loan guarantees are established in the annual budget law.

In recent years, public debt has been just below 60% of GDP. Budget revenue projections have been too optimistic requiring mid-year reductions in expenditures to keep borrowing below 60% of GDP. Difficulties in operating the budget within this constraint, may have led to the change in the MBS. The shift from a fixed debt limit to a "golden rule" may provide more flexibility, but may also be a less effective constraint. Spending pressure may result in attempts to expand definitions of capital expenditure to cover more government operations.

With candidate status for the EU, additional standards may have to be met: possibly requiring more enforceable fiscal rules. Fiscal rules may be incorporated in the National Strategy for Development and Integration (NDSI) for 2013-2020. An alternative would be to enact fiscal rules in law, comparable to the debt rule. The IMF has recommended establishing a fiscal rule limiting expenditures, explicitly tied to debt reduction. Such a rule would keep the size of the public sector in check.¹¹

Box 1. Fiscal rules in OECD countries

According to the definition of a fiscal rule proposed by Kopits and Symansky (1998, p. 2), a fiscal rule is a permanent constraint on fiscal policy expressed in terms of a summary indicator of fiscal performance. A fiscal rule has two fundamental characteristics. First, it presents a constraint that binds political decisions made by the legislature and by the executive. And second, it serves as a concrete indicator of the executive's fiscal management.

There is no one-size-fits-all fiscal rule. Four broad yet distinctive categories of rules exist, namely: expenditure, balance, surplus or deficit (hereafter "balance"), debt, and revenue rules.

- **Expenditure rules:** limit the amount of government spending and can be expressed in nominal or real terms as limits on spending levels or expenditure growth, or as an expenditure-to-GDP ratio.
- **Balance (i.e. deficit or surplus) rules:** limit nominal or cyclically adjusted government spending *vis-à-vis* revenues, and can be expressed in nominal terms or as percentage of GDP.
- **Debt rules:** limit the amount of government debt and can be expressed in nominal terms, as a debt-to-GDP ratio, or as an explicit reduction of the debt-to-GDP ratio.
- **Revenue rules:** impose constraints on the tax-to-GDP ratio and place restrictions on government revenues raised in excess of projected amounts.

Anderson and Minarik (2006) argue that an expenditure rule that governs discretionary spending and tax expenditures (but exclude automatic stabilizers) is a superior alternative to deficit rules because they:

- Are more transparent for monitoring purposes and reduce opportunities for creative accounting;
- Are inherently counter-cyclical and allow automatic stabilizers to function properly;
- Provide firm guidance to policy makers regardless of economic conditions;
- Increase the predictability of resources, most notably for annual appropriations related to core government functions and public investments; and
- Reduce the risk of adding to tax burdens (when combined with expenditure ceilings).

The introduction of an expenditure rule or an expenditure framework anchored in a structural balance rule is a common tendency in many OECD countries. For example in the EU member states, following the tightening of the *Stability and Growth Pact* in 2011, a new expenditure rule requires that the expenditure growth (adjusted for interest payments) may not exceed medium-term potential growth in order to assess compliance with a medium-term budgetary objective of a structural deficit ceiling of no more than 1 % of GDP.

A structural balance rule puts a constraint on the budget balance over the economic cycle in order to guarantee debt sustainability in the long term. This may require gradual debt reduction if public debt is currently unsustainable (with interest payments growing at a higher rate than GDP), or it may require temporary debt reduction in the coming decades to allow for some growth of public debt during a foreseeable period of demographic imbalance (in the case of an ageing population). For structural balance rules to work, however, governments need to identify where in the economic cycle their economies currently are. This has proven to be inherently difficult and subject to optimism bias.

For example Sweden uses a structural surplus rule, requiring that the budget is at least 1% in surplus over the economic cycle. Even though the financial crisis has pushed some countries off this path in the last few years (for instance, the Netherlands aimed at a structural surplus in the past and its current target is to restore balance by 2015), a surplus rule remains necessary to achieve long-term sustainability for countries with high debts and ageing populations.

Source: OECD

2.4 Annual budget formulation cycle

Budget calendar

The annual budget cycle of Albania is set out in detail in the BMS law. The process is centred on the development of a program oriented Medium-Term Budget Program (MTBP). It is somewhat unique compared to other OECD countries in providing for two complete rounds of budget formulation each year. The annual budget calendar is approved by government decree in December, one year before the budget year begins. The Finance Minister proposes to the Council of Ministers (CoM) the detailed deadlines for the public expenditure management process as an element of the strategic planning calendar. The calendar takes effect on January 1, the first day of the fiscal year. The major steps in the budget formulation calendar are shown in the box below.

Macroeconomic and budgetary forecast

The first step in the process is for the MoF to prepare the Macroeconomic Fiscal Framework (MFF). The framework reviews the last two years, the budget year, and the following three budget years. It includes assumptions and methods used in making the forecast, comparisons to recent forecasts, estimates of general government revenue and expenditure under both existing policies and proposals for new or amended policies, proposals for expenditure ceilings, and detailed information on domestic and foreign debt stock. The MFF is completed in January and presented first to the Committee on Strategic Planning and then to the CoM for revision and approval no later than mid-January.

The forecasts are developed within the MoF. The report is prepared by the Macroeconomic and Fiscal Policy Department (MFPD) of the MoF, with input from the Budget Policy Analysis and Programming Directorate (BPAPD) and the Budget Management and Monitoring Directorate (BMMD). The Tax Office provides input on revenue forecasts. Tax and revenue targets are used for revenue estimates for the budget. Inflation is tied to Central Bank assumptions. The Central Bank does not, however, project economic growth. The Statistics Office provides data, but does not develop forecasts. The IMF published economic assumptions are used as a point of comparison. Comparisons also focus on principle trading partners: Italy, Greece, and Kosovo. The forecast developed in January is updated at mid-year, in July. The revised forecast serves as an input for revisions to the MTBP. Recent forecasts have been too optimistic.

The MBS law provides for projections based on both existing policies and new proposals. The estimates are combined, not presented separately in the MFF report. The failure to distinguish between current law estimates and policy estimates fails to highlight the impact of budget policy. This will be addressed under the baseline section below.

Box 2. Budget Formulation Calendar

Prepare detailed calendar for coming year	December
Preparation of macroeconomic and fiscal framework	January
Program expenditure ceilings approved by CoM	February
Budget Preparation Instructions	February
Line ministries draft MTBP	March / April
Requests submitted to MoF	May
MoF analyzes requests, holds hearings	May / June
Draft MTBP presented to SPC and CoM	June
Revised macroeconomic and fiscal framework	July
Ministries prepare revised MTBP	July - August
MoF analyzes revised budget, second round of hearings	September
MTBP and Annual Budget Law presented to SPC and CoM	October
Budget presented to Parliament	Oct. 31 - 1st days of Nov.
Parliamentary Commissions hold hearings on budget with MoF and other ministers	November
Budget approved	1st week of December
Budget takes force	January 1st
3rd round of MTBP produced, incorporating changes made by CoM and Parliament	January

Macroeconomic and budgetary forecast

During February the MoF issues budget preparation instructions to all authorizing officers. The instructions include expenditure ceilings for the MTBP, unconditional transfers for local government units, methods of calculating conditional and unconditional transfers to local governments, and regulations for sharing functions between central and local governments. Authorizing officers are required to submit MTBP in compliance with the requirements and deadlines specified in the instructions.

Medium term budget program

Line ministries and other budgetary institutions and spending units (secondary level) develop their initial MTBP during March and April, consistent with the expenditure ceilings and budget guidance. The MTBP presents programs, subprograms and projects according to objectives of the government units. The draft MTBP is reviewed and assessed by the MoF. Each ministry's recommendations, output targets, performance on previous years budgets, and questions of fact are discussed in the MoF and in a series of hearings with ministry budget officials according to a pre-established calendar. The conclusions of the hearings are consolidated into a draft MTBP document which is then presented to the Strategic Planning Committee (SPC) and the CoM for approval by the end of June. The MoF submission includes MoF proposals for revised expenditure ceilings and adjustments to the draft MTBP and any additional requests. The CoM revises and approves the draft MTBP by July 10. The MoF then prepares revised instructions and expenditure ceilings by government unit. The government units are required to incorporate changes into the MTBP by the 1st of September. The MoF reviews the revised submissions, raises questions and holds hearings as necessary. Once issues have been resolved, the principle authorizing officer (the general secretary of the MoF) prepares the draft annual budget, including the MTBP.

Box 3. Medium-term expenditure frameworks in OECD countries

An expenditure framework is a normative instrument capturing policy objectives of the government and imposing limits on spending over the medium term. The design of expenditure frameworks differs across countries. The frameworks can be either flexible (annually updated each year in light of the previous year's outcomes, new estimates of the consequences of current policies and new political priorities) or fixed (when the figures remain unaltered from year to year once they have been set).

The major advantage of a flexible framework in comparison to no framework is that, at the time of budget formulation, the multi-annual consequences of all policy changes have to be traded off against each other and against the adjustment of medium-term targets. This guarantees that the consequences of new spending initiatives in future years (which may be larger than in the first year, so-called "camel noses") are accounted for. Similarly, it allows for due consideration of savings measures which phase in slowly – which is the case with most major measures since they require changes to the law or reorganisation of administrative units.

A few countries (notably Austria, the Netherlands, Sweden and the United Kingdom) have fixed expenditure frameworks. The major advantage of a fixed expenditure framework over a flexible framework is that it is (more) effective in realising multi-year expenditure targets. Precisely because the overall ceiling cannot be changed from year to year, the target is automatically realised as long as the framework is maintained. In addition, a fixed framework contributes to automatic stabilisation because autonomous fluctuations in tax revenues are not allowed to affect the expenditure level. Although only a few OECD countries work with a fixed expenditure framework, many others seek to keep their expenditure framework as stable as possible from year to year (without formally committing to a fixed framework).

An expenditure framework can be rolling like in Austria and Sweden, or it can be periodical like in France and the United Kingdom. In a rolling framework, an additional year is added at the end of the framework period when the first year (or budget year) expires. In a periodical framework, a new sequence of ceilings is drawn up at periodic intervals, for instance at the beginning of every new cabinet period.

Expenditure frameworks can be distinguished along several other dimensions, notably the number of future budget years covered, the number of ceilings they establish, and their comprehensiveness (the share of expenditures subject to the ceiling). In terms of future budget years covered, many frameworks cover a three-year period (France, Sweden) or a four-year period (Finland, the Netherlands). In 2010, the United Kingdom moved from a three-year to a five-year forward framework. In terms of the number of sub-ceilings, some frameworks establish only a single aggregate ceiling on expenditures (Sweden), while others contain a number of binding sub-ceilings at the ministerial level (Netherlands, United Kingdom) or at the policy area level (France). In terms of comprehensiveness, some governments have exempted particularly volatile items or items determined by entitlements from the ceilings (for instance, the United Kingdom has exempted interest payments and social security expenditure).

Source: OECD

Budget formulation within the line ministries

Ministries receive instructions and ceilings by the beginning of March. The authorizing officer, General Secretary, establishes a "Strategic Management Group" (SMG) consisting of the executive officers and main program officers to oversee budget development. "Program Management Teams" (PMT) are organized for each program to review the program policy, discuss objectives, measurable indicators and overall strategy, detail activity trees, and coordinate budget needs for each program within approved ceilings. The PMTs then discuss their proposals with the SMG. Each PMT then revises the proposal as appropriate and identifies additional requirements. Proposals for additional requirements are then discussed with the SMG and the General Secretary. Following the second round of updates and feedback from the MoF, the Ministry prepares the MTBP in full format including accompanying documents. The full MTBP presents the objectives of each program, funds allocated to the program and the intended outputs.

Supporting documents allocate funds according to all budget classifications and list investment projects separately.

Submission and consideration of the annual budget law

The draft annual budget is approved by October 25th. Within 10 days after the CoM approves the budget and the revised MTBP, the principal authorizing officer informs each local government of the approved transfers from the central government. By November 1st, the Prime Minister submits the annual budget to the National Assembly on behalf of the CoM. The National Assembly must approve the budget by December 31st. Once approved, the budget law is published in the Official Gazette. After approval of the annual budget law by the National Assembly, the MTBP is revised to reflect any changes made by the CoM or the National Assembly. The MoF publishes the final MTBP by the end of February.

Interim budget

If the National Assembly does not approve the proposed budget by the day preceding the start of the budget year, the CoM shall authorize the implementation of an Interim Budget. The Interim Budget expenditures for each month and each program shall not exceed one twelfth of the actual expenses financed by the budget for the previous year. Similarly, if the councils of local government have not approved local budgets by the beginning of the fiscal year, the chairman of the local council can authorize up to one twelfth of actual expenditures of the local government in the previous year.

Supplementary budget

Authorizing officers of central government units may submit supplementary funding requests to the principal authorizing officer for expenses that were unforeseen at the time the budget was prepared and that cannot be postponed until the following year. The principal authorizing officer makes recommendations to the Minister of Finance on whether to approve the proposal. The Minister then submits a proposal to the CoM to approve funding the proposal from the reserve fund. The Minister periodically informs the Assembly of requests that have been approved. In general, supplementary budgets have corresponded with the mid-year budget revision in June.

2.5 Elements of budget formulation

Performance and results

Program budgeting began in 2001. Pilot efforts were undertaken for the next five years. In 2006, program budgeting was implemented in all ministries. In 2008, program budgeting was incorporated into the organic budget law in the MBS law and became the central legal structure for the budget. The program budget is intended to strengthen the link between government policies and the allocation of resources, while achieving value for money. It incorporates policy objectives, goals, outputs and performance indicators. According to the MBS law, local governments have been required to prepare and approve medium term budgets for the past three years. Implementation of program budgeting began at the local level in 2009. For 2012, preparation of medium term budgets at the local level was expected to be coordinated with regional and national policies and planning processes.

The MTBP process begins by Ministries preparing a Program Policy Review (PPR) for each program. Each program is expected to be based on one or more specific policies that should be clearly expressed in the National Strategy for Development and Integration (NSDI). The PPR produces a policy statement for each program, including: a mission statement, program policy goal, program policy objective, and program policy standards. The PPR should be clear, understandable and periodically revised – for example, on an annual basis. The second component of the MTBP effort is the Program Expenditure and Investment

Planning (PEIP). The PEIP is used to allocate resources among programs and builds on the PPR process. The main outputs are identified and costed for each program. As noted above, the MTBP process is an on-going iterative process beginning with the approval of expenditure ceilings, continuing through two rounds of MTBP development with ministries and reactions by the MoF, and concluding with the presentation of the annual budget. The process is a rolling budget planning process where the annual budget and medium term are reviewed and revised to reflect results and changing budget constraints.

The MTBP is more fully integrated into the budget procedures of Albania than program budgeting is in most countries. Most budget participants understand the system. Program indicators may not be useful measures in some instances. A focus of the spring review is improving the unit cost analysis for outputs. Attention going forward should continue to emphasize improving the clarity of definition of program objectives, utility of measures, and the accuracy of cost figures. Going forward it may be appropriate to reassess time consumed by having two rounds of program budget review annually. The budget schedule in many countries is too compressed to allow for such a deliberative process. The schedule in Albania restricts time available for parliamentary review to the extent that the National Assembly has limited impact on the budget.

Performance budgeting practices are widely implemented, but varied; while countries might face similar challenges and share a common need to focus on demonstrating the extent to which spending achieves policy outcomes, they need to tailor their performance-budgeting system to fit their particular circumstances. As shown in box 4 and figure 8 below, there is currently no consensus among OECD countries on the optimal way of using performance budgeting.

Box 4. Trends in Performance Budgeting

Performance budgeting is a term that focuses on how output and outcome information is used in budgeting for resource allocation. OECD has identified three broad categories of performance budgeting:

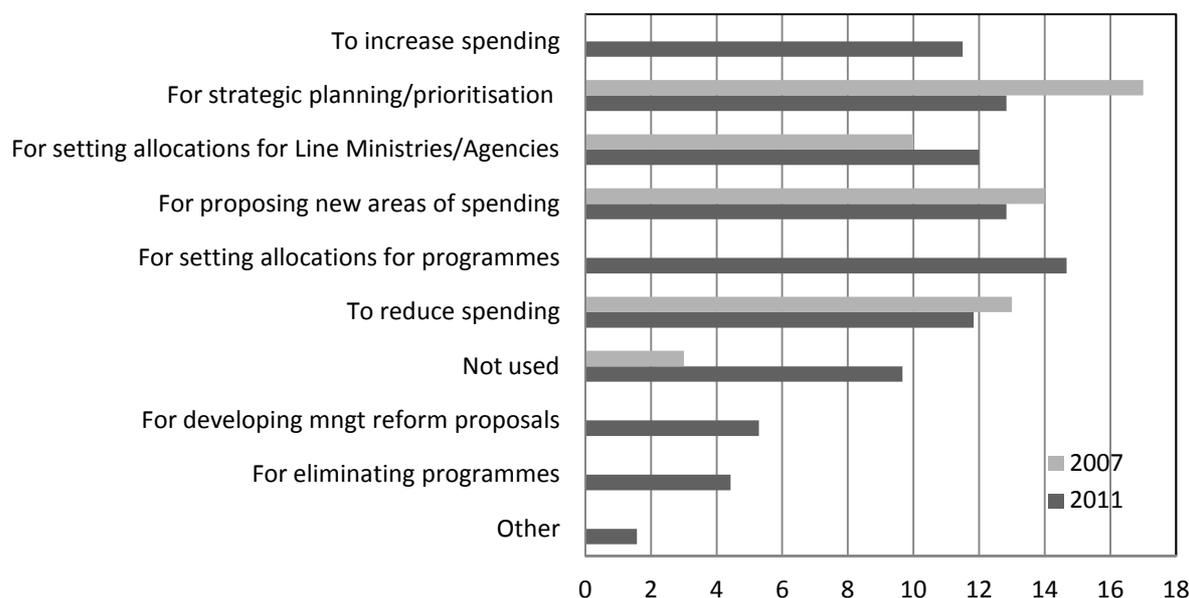
- presentational performance budgeting,
- performance-informed budgeting, and
- direct performance budgeting (formula-based budgeting).

Performance targets on output and outcome levels constitute important information about the strategic direction of programmes. The corresponding results on such targets indicate whether or to what degree the programmes are effective and efficient. The regular (annual) performance reports from programmes and government institutions as well as programme evaluations may provide important information to line ministries and the CBA when the centre of government discusses long-term policy changes to programmes.

In OECD countries experiences so far indicate that performance information adds value to the management and service delivery tasks of line ministries and executive agencies but has proven difficult to use for fund allocation as per the needs of ministries of finance. For programme managers, spending unit heads and line ministries, performance information is important both in the short run and in the long run. Performance targets on output and outcome levels constitute important information about the strategic direction of programmes. The corresponding results on such targets indicate whether or to what degree the programmes are effective and efficient. Performance information is also a vital part of an open government approach and may provide the legislature, the supreme audit institution and the civil society with essential background for assessing accountability of the government.

Source: OECD

Figure 8. How is performance information generally used by line ministries in their negotiations with CBAs?



Source: OECD

Baseline estimates

"The Economic and Fiscal Program", February, 2012, describes the baseline scenario of the macro-economic framework as being based on the actual policy mix and the implementation of planned structural policies for the medium term. The MBS law requires the RMBEF report to include estimates of general government revenues and expenditures under both existing policies and proposals for new or amended policies. However, the report does not distinguish between current policy and proposed policy.

The primary purpose of baseline estimates is to highlight the impact of policy changes on government finances. Calculation of baselines requires a rigorous analysis of revenues and expenditures under current law. Estimates are revised to reflect the economic forecast and technical factors such as pre-commitments for construction projects, rising prices for prescription drugs, or demographic changes affecting pension programs, i.e. the aging population. This function should be implemented as a technical exercise both within Ministry budget offices and the MoF. The MoF should verify the accuracy of the estimates. The result should be to show budget outcomes in the absence of new policy. Having a policy neutral baseline would strengthen the "Economic and Fiscal Program" document by highlighting the impact of new policy proposals. The difference between current law estimates for revenues and policy targets could improve revenue forecasts by making policy changes more transparent. The baseline concept used in Albania mixing actual policy and implementation of structural reforms does not provide the benefit of a policy neutral benchmark.

Box 5. Baseline estimates in OECD countries

OECD countries that work with expenditure frameworks produce and update multi-annual baseline estimates. Each programme has its own particular set of factors that will affect expenditures – for instance economic variables, demographic developments, price changes or participation rates. The baseline estimates capture the cost of current law and/or current policy over the medium term and are essential to ensure the consistency of current law or policy with the multi-annual ceilings. Best practice in OECD countries shows that baseline estimates are frequently updated to reflect any changes in the underlying variables (usually monthly or quarterly) and are prepared at a line-item level (the same level of detail as the annual budget). They should be part of the annual budget proposal submitted to parliament (OECD, 2002). The baseline estimates should also be agreed between the line ministry and the finance ministry. The baseline estimates are an essential tool for budgetary discipline not only during budget formulation, but also during budget execution. During execution, they alert at an early stage to overspending, which should immediately trigger corrective measures (not in the next budget).

Establishing the expenditure framework can be seen as a top-down process, and preparing budgetary and multi-annual estimates as a bottom-up process. In fact, the reconciliation of prescriptive targets or ceilings with descriptive line-item estimates is central to a disciplined budget process.

Source: OECD

Investment budgets

In 2007, the government of Albania introduced new Public Investment Management (PIM) procedures to set out a coherent appraisal and planning process for public investment projects based on government priorities, sectorial policies and a better allocation of domestic and external budget resources. The PIM process is designed to ensure that public investments are clearly linked to the MTBP, that investments are prioritized within a framework of a realistic assessment of available domestic and external financing, and that public investment are coordinated over the medium term time frame of the MTBP. Investments are defined as increasing assets, having a life time of over one year and costing 1 million ALL (7,031 Euros) or more. For each project, project justifications must be developed, the project fully described, alternative approaches identified, total project cost estimated, cost for the budget year, two succeeding years, and remaining cost, recurrent cost implications as a result of the investment, project revenues if any, donor funding – if any, and net budget cost. The project plan, feasibility study and other economic/financial analyses must be completed and submitted with the proposal. Project proposals are submitted to the MoF, to the Public Management Investment Directorate (PMID) in the budget office for review. Project plans are also integrated into the MTBP for the responsible ministry.

Budget formulation for investment projects in Albania is a logically designed system. In recent years, budget retrenchment to adjust for unrealized revenues, has restricted the public investment program. The PEFA report noted that “not sufficient attention is being paid to implementation capacity, expenditure targets for investment programs are being set at overly optimistic levels despite poor past performance.”¹² The PEFA report also found that investment fell short of planned levels in the Ministries of Health and Defence, but that the Ministries of Education and Science and Public Works, Transport and Telecommunications executed more or less at planned levels.¹³ As noted in Chapter 4 of this report, project arrears have a direct effect on budget formulation for investment projects in Albania. Funding for prior commitments has pre-empted funding of new projects under in some areas.

Guarantees and loans and Public Private Partnerships

The Law on State Borrowing, State Debt and State’s Guarantees in the Republic of Albania of 2006 sets the legal framework for debt transactions. It defines financing transactions broadly and ensures that

proposals to obligate the state to a future payment must be submitted to the Minister of Finance for review and approval. The MBS law subjects all local borrowing to review by the Ministry of Finance as well.

Public Private Partnerships (PPPs) and concessions are coordinated by the Ministry of Economy, Trade, and Energy in Albania. From an internet review, it appears that the US Aid for International Development and the World Bank's International Finance Corporation (IFC) are supporting PPP development in Albania. It appears further that the objective of the concession agency is to promote more private investment in Albania.

The Law on State Borrowing reflects OECD's view that transactions that obligate the state to future obligations should be subject to review by the MoF. The team did not have an opportunity to meet with the Ministry of Economy, Trade and Energy. However, experiences from our Member countries show that it can be difficult to get value for money out of PPPs, if government agencies are not equipped to manage them effectively. Moreover, PPPs can obscure real spending and make government actions non-transparent, using off-budget financing. This means PPPs are potentially risky for fiscal sustainability, possibly leading to credit rating downgrades as has happened in some OECD countries. PPPs should be recognized as potentially obligating the state to future costs and should be subject to review by the MoF. Albania is encouraged to consider the "OECD Recommendations on Principles for Public Governance of Public-Private Partnerships".

2.6 Documents and transparency

The annual budget submitted to the National Assembly consists of the "The Annual Budget Law", and annexed tables, which are enacted into law by the Assembly. The "Medium Term Budget Program" and the updated Economic and Fiscal Program are also provided to the National Assembly for its information.

The Annual Budget Law is a brief legal document. In 2011, it consisted of 20 articles, specifying budgetary levels for 2011 for revenues, expenditures and the deficit for: the aggregate budget, the State Budget, the Local Budget, and Social Insurance. The Social Insurance budget is further divided among the Scheme for Compulsory Social Insurance, the Supplementary Insurance Scheme, Health Insurance, and the Budget for Ex-Owners. The Annual Budget Law also specifies the total number of government employees, the salary of the President of the Republic, the CoM Reserve Fund, and the Judiciary Budget. It defines the formula for allocation of unconditional transfers to local government by community population. Finally, the Annual Budget Law specifies funding levels for ministries and investment project by reference to budget annexes and sets limits on state debt and guarantees.

The annexes to the Annual Budget Law, enacted by reference are:

- Employees by budgetary institution;
- State budget by Ministry and Independent budget institutions and major program – divided between current and capital expenditure;
- Unconditional transfers by region;
- Unconditional transfers by Municipalities and Communes;
- CoM Reserve Fund and Contingency allocated among 10 categories.

Requirements for the contents of the MTBP are set out in article 29 of the MBS law. For each central government unit the annual budget shall include: the mission or goals of the central government unit; a description of its programs and activities; a presentation of the programmatic policies, goals and policy objectives; an explanation of how each program's outputs contribute toward the achievement of the goals; the actual indicators for the two previous years, budgetary funds planned for the current year, and the

medium term budget program allocated to each program for the next three years; and a list of capital projects for each program; an explanation of quasi fiscal activities; and a tax expenditure forecast.

The MTBP was not available in English, but appeared to be the central focus of budget policy discussions. The Economic and Fiscal Program is a useful overview of the economy, the macroeconomic policy and fiscal condition of the country. The document presents a number of useful tables that provide information for four prior years, the budget year, and three succeeding years.

As a general matter, many countries detailed budget documents are not easily understood by parliamentarians or the general public. Significant effort is needed to limit information to what non-experts can understand and to present the information in simple enough language to clearly present relevant facts about the programs. Albania's budget documents could be made more useful by providing more budget relevant summary tables, for example historical presentations by economic classification, administrative unit, personnel, and major program. Summary tables should be reviewed and revised annually to provide information that will inform the budget debate.

2.7 Organization of the Ministry of Finance

The Ministry of Finance is organized into six departments: General Directorates for Treasury, Budget, Macroeconomic and Fiscal Policy, Public Debt Management, Internal Audit, and Public Financial Inspection. The Ministry has a number of other operational units, including its Central Harmonization Unit for Internal Audit, the unit for Prevention of Money Laundering, unit for Gambling, the Agency for Management of Seized and Confiscated Assets, and the Agency for Audit of EU funds.

The General Directorate for Budget is responsible for the management of public expenditures with effectiveness, efficiency and economically. The main functions of the General Budget Directorate are:

- Preparation and implementation of the Organic Budget Law
- Budget management and monitoring
- Public investment management
- Legal regulation of intergovernmental fiscal relations
- Classification and budgetary system
- Analyzing and budget policy development
- Preparation of legal and sub-legal acts on public financial matters
- Planning and regulation of budget processes and systems

The General Directorate for Budget is organized into four directorates and has a total of 31 staff. The directorates and their primary functions are shown below:

- Budget Analysis, Policy and Programming Directorate (BAPPD) (Allocation of a director, two unit heads and 6 specialists)
 - Analysis of budget policies to ensure fiscal stability
 - Allocation of resources to reflect government policies and priorities
 - Proposing norms and standards for budget expenditures
 - Preparing guidelines for preparation of the budget
 - Drafting the MTBP
 - Preparing the budget
 - Reviewing laws and sub-legal acts to ensure efficient and effective management of public finances
- Management and Budget Monitoring Directorate (MBMD) (Allocation of a director, two unit heads and 6 specialists)
 - Managing the implementation process of the State budget

- Monitoring Medium-Term Programming and annual budget processes
- Preparing the management, implementation and monitoring instruction for annual budget and MTBP
- Reviewing laws and sub-legal acts to ensure efficient and effective management of state budget
- Analyzing budget performance indicators to assess performance of planned activities
- Preparing the sectoral analyses in order to improve the management of the sectors when the correction actions are needed
- Analyzing the expenditure plan of all independent institutions or entities, which by law have to have their expenditure plans approved by a CoM decision
- Proposals of amendments to the state budget
- Preparing periodic monitoring reports of budget output indicators and performance of budget activities.
- Public Investment Directorate (PIMD) (Allocation of 1 director and 6 specialists - currently only 4 specialist positions are filled)
 - Ensuring that public investment projects support implementation of the NSDI
 - Managing the procedure for identifying and assessing public investment projects
 - Evaluating and improving public investment projects
 - Tracking performance of planned public investments
 - Participating in the review and negotiation of programs and projects financed by donors
 - Preparing annual summary reports on the progress of program implementation
- Intergovernmental Fiscal Relations Directorate (IFRD) (Allocation of 1 director and 3 specialists)
 - Propose criteria for distribution of transfers of the state budget to local governments
 - Preparing the Annual Fiscal Package for Local Government
 - Analysis of alternative approaches to increasing local revenue and using expenses effectively
 - Notifying local government units of the unconditional transfer of funds allocated under the formula
 - Preparing guidelines for the implementation of the budget for local government units of government.

The Macroeconomic and Fiscal Policy Directorate is responsible for developing the macroeconomic forecasts and fiscal forecast presented in the Macroeconomic and Fiscal Framework document, formulating recommendations on short, medium and long term fiscal policy, designing tax policy and periodic macroeconomic and fiscal analysis.

For the most part the organization of the MoF seemed to be well structured to carry out the functions of the Ministry. Consideration should be given to integrating the staff and functions with the BAPPD and MBMD to encourage integration on a programmatic basis rather than by economic classification of spending.

2.8 Conclusion

Budget formulation procedures in Albania are more effective than those of many countries. The process is organized to ensure that participants in the budget process have constructive roles. Decisions are based on programmatic information, tied to policy goals and integrated into program planning. The form of the processes for the most part should be continued. Issues that remain are primarily to improve the quality of the budget analysis.

Albania should develop a policy neutral baseline. Macroeconomic and fiscal forecasts are prepared in a credible manner. Few budget offices have anticipated the severity and duration of the current economic downturn. Albania should continue to strengthen the accuracy and reliability of its economic forecasts. One specific improvement that should be considered would be to develop a policy neutral baseline and to incorporate the results of the baseline in the Economic and Fiscal Program. Policy proposals and structural reforms should be treated separately from economic and technical factors.

Program objectives should be refined to more clearly represent the basic nature of programs and performance indicators should be better focused to reflect the critical policy sensitive nature of programs. Staff in the ministries needs to refine their skills to plan and budget for programs more effectively. Changes needed are improvements in the quality of review, not in the nature of the procedures undertaken. Continuing improvement to program budget measures will require additional use of MTBP procedures within ministries and in the local communities. The more the results of the reviews are recognized as influencing budget choices by government or public debate on programs, the more the practice will improve. These efforts can get feedback through the decision process, but could be facilitated by training within the ministries and / or localities, by informing the public on the results, and by translating the budget decisions into program implementation.

The budget schedule should be reviewed periodically to confirm that the sequential review adds value to the decision making process. The budget schedule defined by the BMS law requires repetitive procedures that consume a substantial effort from the budget office, and ministry authorizing and executive officers. At a minimum, the National Assembly should have more time to review budget policy and a greater opportunity to affect budget allocation choice.

Budget documents should be reviewed on an on-going basis to ensure that the budget is transparent to the decision makers and the public. It should not require a budget expert to understand the policy presented in the budget. Comparisons overtime (two prior years, the budget year, and two succeeding years) are particularly effective in conveying an understanding of changing budget policies. The solution is frequently not more information, but information presented in easily understood tables, graphs and displays. Budget writing should also be simplified and made more direct. The readers of budget documents are almost certainly not going to have expertise in the content presented in budget documents. If the material is clearer, the public will support the budget policy more strongly, have a better understanding of what their tax payments are purchasing.

Responsibility and accountability for budget formulation and management should be delegated to budget institutions and spending units. Program budgeting is based on an assumption that budget responsibility is delegated to the extent possible. The MBS authority creating authorizing officers may need to be clarified to ensure that lines of authority are clear and do not conflict with the broader goal of delegating program accountability.

The MoF should take an active role in reviewing any PPP proposal. Many countries have found that public interest is frequently not served by these arrangements. The OECD guidelines should be considered in developing PPP oversight and governance arrangements.

3. ROLE OF THE LEGISLATURE

3.1 Legal framework

The Assembly of the Republic of Albania (Kuvendi i Shqipërisë) is the sole legislative body in Albania. It is a single-chamber parliament elected for four years under a closed-list proportional representation system. It consists of 140 deputies (Article 64 of the Constitution).¹⁴ Its role in the budget process is defined in Article 158 of the Constitution. According to the Constitution, the Assembly approves the budget and makes the final decision on the budget's implementation after a hearing of the High State Control's report.

The budget system, including its structure, principles and the foundation of the budgetary process, as well as intergovernmental financial relations and responsibilities for the execution of the entire budgetary legislation are defined in the organic budget law. According to Article 13 of the organic budget law, the budget year for all government units begins on January 1st and ends on December 31st. The organic budget law also specifies the role of the Assembly (Article 14): *“The National Assembly, by a specific law, approves budgetary revenues and appropriations for the central government units, unconditional transfers for local government units and their special funds, through which it gives the right to undertake expenditures in exercising their functions, as well as the financing sources of the budget deficit.”*

The Rules of Procedure of the Assembly of the Republic of Albania (Rules of Procedure) further specify the procedures and processes of the Assembly. A chapter of the Rules of Procedure is dedicated to the budget process and the role of the Committee on Economy and Finance.¹⁵

3.2 The Committee on Economy and Finance

The Assembly has a standing Committee on Economy and Finance (the Committee). Included within its purview are: economic policy, the state budget, the supervision of its implementation, public finances, privatization and the banking system.¹⁶ The Committee leads budget discussions and the approval process according to the Parliamentary rules and the organic budget law. It is composed of 23 members: 13 are from the majority party, and 10 of the opposition party.

According to the Rules of Procedure (Article 79), a main task of the Committee is to lead the budget approval process, including budget discussions. Article 158 (V) of the Constitution mandates that after hearing the High State Control Report, the Assembly should discuss and make a final decision on the implementation of the previous year's budget. The Committee on Economy and Finance is also involved in this process since there is no separate committee for public accounts.

The Assembly does not have a budget office responsible for carrying out budget analysis. Attempts to establish a non-partisan budget office have been unsuccessful. In OECD countries, there is a trend to establish specialized units to assist with budget related research and analysis (e.g. Australia, Austria, Korea, and the UK have established Parliamentary budget offices).¹⁷ Parliamentary budget offices may have greater scope to act independently by setting their own research agendas and issuing their own reports.¹⁸ In Albania, the committee is supported by three economists and one lawyer. Individual members of the committee have the right to request help from the support staff. However, the minority party members of the committee do not believe they have equal use of the analytical capacity of technical staff. Technical expertise is provided by the Ministry of Finance at the request of the committee. The executive branch, often represented by the Minister of Finance, participates in most committee sessions in order to directly respond to committee requests.

Article 78 (I) of the Constitution stipulates that meetings of the Assembly are open. The Rules of Procedure specify that committee meetings are generally open to media, interest groups and visitors. Committees also have the right to decide to close or partially close their meetings, although in practice, committee meetings are usually open to the public.¹⁹ Open proceedings increase the likelihood of the publication of media reports on parliamentary debates and committee or member views, as well as assure transparency and accountability of the Parliament for voters. Especially in countries like Albania which face new budget constraints, it is important that the public fully understands the difficult trade-offs associated with budgetary decisions.²⁰ However, it has been suggested by the minority that information about the exact date and time of sessions is not adequately published, so that only few meetings of the committee are attended by the public or media. The majority, instead, stated the media is present at any meeting of the Committee and that the minutes of the Committee's discussions are published on regular basis on the Assembly website and are sent in electronic form to all Committee members.

3.3 Parliamentary budget procedure

Budget approval

The Constitution (Article 158 (III)) stipulates that on behalf of the Council of Ministers, the Prime Minister presents the Assembly with a draft of the budget law during the autumn session. The organic budget law further specifies November 1st as the deadline for submission of the proposed annual budget to the Assembly (Article 29).

The annual budget law approved by the Assembly contains:

- Revenues;
- annual budget funds for central government institutions;
- unconditioned transfers for local government units;
- special funds;
- sources to finance the budget deficit and authorization to borrow.

According to Article 25 of the organic budget law, in July of each year, the Minister of Finance shall provide the Assembly with a copy of the Medium Term Budget Program (MTBP) approved by the Council of Ministers and shall answer questions about it upon request of the Assembly Commission responsible for public finances. However, approval by the Assembly is not foreseen: The MTBP is attached to the annual budget for informational purposes. While the debate in the Assembly mainly focuses on the budget and pays little attention to the MTBP changes between the draft annual budget and MTBP forecasts for the upcoming year are also considered.

Once the annual budget is approved, the principal authorizing officer consolidates any changes in the MTBP (Article 31, organic budget law). The MTBP, revised and approved by the Council of Ministers, is then submitted, usually in January, by the Minister of Finance to the Assembly for information purposes.

The deadline for approval of the annual budget is 31 December according to the MBS. This allows the Assembly approximately two months for its approval process. Thus, there is only limited time allotted to the annual budget discussion in the Assembly. OECD's "Best Practices for Budget Transparency" recommend that Parliament be provided at least three months for review of the budget. However, the Assembly usually takes no more than four or five weeks to approve the budget. The Constitution provides guidelines for budget execution in case the annual budget is not approved until the beginning of the next financial year. However, this has yet to occur. The article by article discussions take place based on a schedule by the committee. Hearings usually take place in the month of November so that the timeframe for Parliamentary budget approval is not fully utilized. The annual budget is usually approved by the beginning of December.

The process of budget approval in the Assembly is fully elaborated in the Rules of Procedure (Article 78-85). Once the annual budget has been submitted, the Speaker of the Assembly announces it immediately. The draft budget is then debated according to a specific approved calendar in the standing parliamentary commissions and the Assembly's plenary sessions. The first plenary review is primarily a political discussion about the macroeconomic and fiscal aspects of the fiscal framework, and generally takes place within a single day.²¹ Next, the budget is approved in principle, meaning that it votes on the total amount of expenditure, adopting policies and priorities that the government aims to realise across the economy branches and sectors for the budget year. Within two days of the budget's submission to the Assembly, the Speaker convenes a meeting of the chairpersons of all standing committees in which the Minister of Finance introduces the budget and related financial bills.²² Finally, a schedule of in-depth committee hearings and plenary sittings is planned and presented to the plenary.

Each standing committee holds hearings on matters within its jurisdiction and has the right to invite institutions, civil society or private sector representatives, as well as other relevant bodies within the scope of its authority. Ministers may be required to report to the Assembly on specific issues. Furthermore, committees may organize public hearings in order to gather opinions and comments from institutions, persons or interested groups.²³ Based on these hearings, the standing committees formulate recommendations or amendment proposals to the Committee of Economy and Finance. A consolidated report is then prepared and submitted to the plenary for a second reading and final vote.²⁴ The Rules of Procedure specify the required content of this report.²⁵

While the process of hearings is generally well regulated and organized, doubts about the quality of the debate have been raised by the minority. Concerns have been expressed that individual debate sessions in the Committee on Economy and Finance are too short to allow for in-depth discussion. Analytical support from the committee's support structure may not be as fully available to the minority as to the majority, leading to a lack of understanding of the budget's implications thus, influencing the quality of debate.

The regulatory framework does not explicitly foresee amendment powers of the Assembly at the budget approval stage. The former organic budget law²⁶ stipulated in Article 22 (IV) states that the Assembly may make changes to the proposed state budget under specific conditions defined in the law, e.g. when the main indicators of revenues change, when expenditures are above a certain limit, and when the deficit or other financial conditions change. However, this law has been abrogated by Article 75 of the Law on Management of Budgetary System in the Republic of Albania. The current organic budget law does not entail a comparable provision for the approval stage of the budget. However, a common practice in accordance with legal provisions is for the Assembly to request amendments to the Council of Ministers during the approval phase of the budget. The requested amendment must entail a proposition on how to balance the additional costs. The Committee on Economy and Finance reports having proposed changes to programs and line ministries' spending each year without changing the total spending. However, it was the team's impression that changes are being made only on a small scale and that minority's requests are not being responded to systematically.

Throughout the financial year, according to Article 160 of the Constitution, the Assembly is fully empowered to make changes to the budget based on the defined procedures for drafting and approving it. The Assembly must submit the requests for changes to the annual budget law to the Council of Ministers with an accompanying explanation as to why the requested changes could not have been forecasted in the proposed budget (see Article 46 of the organic budget law). If the Council of Ministers decides to change the annual budget law, approval by the Assembly is necessary.

The annual budget law provides appropriation totals for expenditures, revenues and deficit, specified on state and local governments and special funds (social insurance, health insurance and ex-owners

contribution). The budget law also provides some appropriation specifications, namely the composition of state revenues (grants, taxes and non-tax revenues) and composition of state expenditures (current, capital and special fund expenditures). The state's current and capital expenditures are furthermore specified for line ministries and other central government budget institutions and their programmes. Employment ceilings are specified for all central government budget institutions. The state's unconditional transfers to local and regional governments are also detailed in the law. In addition, the total expenditures (state, local and special funds) are specified in a table showing COFOG functions and economical classifications.

Budget monitoring

The Assembly monitors the budget's execution during the fiscal year through quarterly and yearly reports presented by the Ministry of Finance. Budget execution and monitoring reports are prepared by the authorizing officer of general government units no fewer than four times per year (Article 65, organic budget law). Within one month after completion of the reporting period, the Minister of Finance presents the budget monitoring and implementation reports to the Council of Ministers and the Assembly. These reports are performance-based and consist of:

- the financial performance of each program
- the products produced by each program
- objectives achieved by each program

Based on these reports, the Assembly has the right to examine the budget's implementation. Individual MPs can request hearings with government representatives and call for debates in the standing committees or the plenary. MPs also have the right to ask for hearings with the Prime Minister, with or without a debate, regarding issues of budget implementation. Changes to the budget law must be approved by Parliament (see above: budget approval). The committee reported that it receives quarterly reports in a timely and adequate manner. However, debate seems to be limited to the discussion of the consolidated budget implementation report. A lack of capacity for analyzing these reports in the Assembly seems to be a major obstacle to the exertion of the monitoring rights.

Supplementary budget requests under the state budget reserve fund may be approved by the Council of Ministers and require no consultation with the Assembly. However, the Minister of Finance shall periodically inform the Assembly, in writing, of supplementary budget requests and if requested, provide answers to related questions by the Committee on Economy and Finance (Article 45, organic budget law).

Article 63 of the organic budget law foresees the submission of a consolidated budget implementation report by the Council of Ministers to the Assembly for approval in the month of June.²⁷ This report is discussed by the Committee on Economy and Finance together with the High State Control report. Usually, the Minister of Finance and the head of the High State Control participate in the meeting. MPs have the right to contact the institutions directly for more information; however, in practice, this right is not extensively exercised.

Budget control

As mentioned before, the Committee on Economy and Finance also fulfils the task of legislative scrutiny by discussing and making a final decision on the implementation of the previous year's budget based on the High State Control report.

Article 164 of the Constitution stipulates that the High State Control presents to the Assembly:

- the report on the implementation of the state budget

- an opinion on the report of the Council of Ministers for the expenses of the previous financial year, before it is approved by the Assembly
- upon request, information about audit results and reviews

While the Constitution mandates the Assembly to make the final decision on the budget’s implementation, it does not establish deadlines for review of the audit reports. However, parliamentary examination of the audit reports generally takes one to two months.²⁸

The approval process for the High State Control’s report follows the same procedure as budget approval, but with fewer opportunities for input from the public. While parliamentary groups have the right to call for sessions with the government including the Prime Minister, ministers are unlikely to participate in the hearings unless there is a political issue.²⁹ Since the committee in charge of budget approval and budget oversight is chaired by an MP of the majority party, the minority does not have much influence on budget oversight. In the Great Britain, a separate public accounts committee, chaired by the opposition leader, is responsible for holding the government to account for its use of public resources. This model aims at assuring that party membership does not impede Parliamentary control.

The Committee on Economy and Finance formulates its recommendations based on findings of the High State Control report. These recommendations, once approved by the plenary, are legally binding.

Table 3. Parliamentary budget calendar

1st January	Beginning of fiscal year.
June	Submission of a consolidated budget implementation report by the Council of Ministers to the Assembly.
July	Minister of Finance presents MTBP to assembly.
1 November	Submission of budget to Parliament. Revised Medium Term Budget Programme (MTBP) approved by the Council of Ministers is submitted to the Assembly for information by the Minister of Finance.
31st December	Deadline for the approval of the annual budget and end of fiscal year.
January of following year	Revised Medium Term Budget Program (MTBP) approved by the Council of Ministers is submitted to the Assembly for information by the Minister of Finance.

3.4 Conclusion

The Parliamentary budget process in Albania is regulated by a comprehensive legal framework. Most crucial Parliamentary rights are granted by the organic budget law. Although current organic budget law does not explicitly foresee amendment powers at the budget approval stage; in practice, the Assembly regularly exercises this right. However, the mission had the impression that the Assembly generally makes limited amendments and that the minority’s requests are not taken up systematically. Amending the organic budget law to reflect this practice would eliminate doubts about the Assembly’s rights and assure that minority requests are responded to in a regulated procedure.

The schedule and procedures of budget approval in the Assembly should be revised to provide the Assembly with more time for considering the budget. While the legislative framework foresees an active role of the Assembly, the Committee of Finance and Economy in practice does not make extensive use of it. While the Assembly theoretically has two months to discuss the budget, it takes usually no more than four to five weeks, limiting the possibilities for in-depth discussions in the relevant committees. The Assembly could put more effort into the approval process under the existing timeframe and revise its

procedures to expand the budget hearings and budget debate to increase its impact on budget deliberations. The three-year MTBPs are the major strategic policy documents on which the government bases its annual budget. The MTBP is submitted to the Assembly every June for informational purposes. Considering the importance of the MTBP document, the Assembly should be granted the right to review and approve the medium-term financial strategy during the budget process, e.g. together with the annual budget.

The Albanian Assembly should reconsider establishing a non-partisan budget office in order to address the lack of independent analytical capacity for MPs. A major obstacle to the quality of the parliamentary budget discussions is the lack of non-partisan analytical capacity in the Assembly. The committee is supported by a limited number of technical experts. However, the minority raised concerns about the availability of existing support staff for the Committee on Economy and Finance for all MPs, including the minority MPs.

The Assembly, and especially the Committee on Economy and Finance, should assure that the majority of hearing sessions are open to the public and that information on the sessions is adequately published. Concerns about the publicity of Parliamentary hearings (including those of the Committee on Economy and Finance) should be taken seriously. While the Albanian regulatory framework for the budget process entails all necessary provisions to guarantee full transparency of the content of the Assembly's session, in practice, publicity of the hearings is contested.

With regard to budget oversight, the role of the Committee on Economy and Finance could be significantly enhanced with a more prominent role for the opposition. Since the tasks of budget approval and budget oversight are both carried out by the Committee on Economy and Finance, the minority raised concerns about their role in controlling budget execution. As a means to minimize changes to the existing system, the German or the British model would be suitable for the Albanian Assembly. While the German Budget Committee also exerts both functions of budget approval and oversight, a sub-committee on public accounts usually led by the minority has been established. In Great Britain, the oversight committee on public accounts is led by the minority. A corresponding model could be established in Albania, thus providing a major role for the minority in the (sub-)committee.

4. BUDGET EXECUTION

The systems and procedures for budget execution in Albania have developed substantially over the last two decades as an outcome of a series of structural reforms. The Organic Budget Law, chapter V, set out the main legal framework for budget execution. This section reviews the implementation of the budget in eight sub-sections: overview of budget execution, cash and debt management, reallocations and carry-overs, budget monitoring, the structure of service delivery, the public enterprise sector, fiscal relations across levels of governments, public employment and the civil service, and public procurement. Conclusions of the assessment and recommendations for further actions are provided at the end of the section.

4.1 Basis for budget execution

This sub-section provides a short overview of the basis for the annual budget execution, like the structure of budget allocations and the control regime. Details are discussed in the following sub-sections.

The approved funds in the annual budget law are the upper limits of expenditure within which the Council of Ministers is authorised to undertake commitments and make expenditures. The government has the authority to cut spending once the budget has been approved by the Parliament up to 10% of appropriated funds. The Council of Ministers exercises the authority to make expenditure through the finance minister.

In January the Ministry of Finance consolidates any changes in the annual budget and in the MTBP (3rd round of MTBP) stemming from the Parliamentary budget adoption, and publishes both documents. Following the budget adoption in the Parliament the MoF issues budget implementation instructions comprising budget execution procedures and specific deadlines. At the same time, the MoF allocates a budget to each central and local government institution within the total appropriations in the budget law. MoF's budget allocations for each general government unit are split by programme and economical classification, in line with OBL article 42 and the structure documented in table x in chapter 2.

In recent years (since 2005) changes to the financial control system have been adopted in line with the principles of the EU Public Internal Financial Control system, legislated in the Organic Budget Law. The managers in budget units are now responsible for maintaining effective internal controls, with internal auditors advising how to improve the controls. This change of internal control environment still requires a cultural change before the controls are fully implemented (see chapter 5).

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.

Budget institutions receive invoices from suppliers and prepare expenditure documents and perform ex-ante controls. As many budget institutions don't have access to the treasury system they send expenditure documents to the relevant Treasury district office that records and performs an additional ex ante control before payment. If complete documents are not available, the district office sends them back to the budget institution. Final documents are also sent back to the budget institutions for archive. By this practice the Ministry of Finance keeps a strong central control on budget execution, unlike many OECD countries. In a number of OECD countries the responsibility for spending in compliance with the approved budget is to a large degree transferred to the line ministries. However, such an arrangement is dependent on strong financial management of the spending units, clearly defined and accepted roles, rights and obligations of the budget institutions, and politically supported arrangements on violations of the rules of budgetary discipline.

4.2 Cash and debt management

Box 6. The Treasury Department

The Treasury Department administers a set of rules and procedures for budget implementation, handles the Treasury Single Account (TSA) system, takes care of the management of liquidities and keeps the accounts and financial reporting of the general government. The Treasury Department consists of the Central Treasury in Ministry of Finance and 36 treasury district offices. The Treasury deals with the line ministries and some 41 individual institutions of which 30 central government institutions (see table x). There are about 2000 spending units, including local governments, special funds and sub-units.

The Central treasury consists of one general director and two departments:

- Operational Department has one director and four sections. The Operational Department has 30 staff in four sections: Cash forecasts, financial reporting (expenditure and revenue), electronic payments, and TSA management and foreign financing. In addition the 36 District Treasury offices around the country serve the general government (central government, local governments and special funds). Altogether there are 220 staffs in the department and the district offices.
- Government **Financial Information System Administration Department** has one director and 7 specialists.

Cash Management

The system

Treasury maintains central control over cash. In 2011 the new cash management system (Oracle) was implemented provided by an Instrument for Pre-Assessment Assistance (IPA) grant and Austrian support (the SETS project). There are a gradually expanding number of users of the Treasury system. Cash planning is based on the appropriations, the allocations by MoF and the cash flow plans from the budget institutions in accordance with provisions in the Organic Budget Law.

The TSA system covers all general government entities, managed by the Treasury Directorate, including all expenditures and revenues of the general government. These include ministries, departments and agencies, regional and local government units and special funds. State Owned Enterprises are outside general government and exclusively utilise commercial banks for their financial operations. TSA is kept in ALL and two foreign currencies: EUR and USD.

The Treasury accounts are maintained at the Central Bank that has established a sub-account ledger that includes a revenue account and an expenditure account for each budget institutions. Fifteen commercial banks (36 bank district offices) are involved in collecting tax/customs revenue of which

revenue balances are transferred to the Central Bank on a daily basis. The daily report from the Central Bank summarizes the activity in each ledger account to allow Treasury to know the source of financial transactions. The balances of these sub-accounts are swept daily into the TSA by the Central Bank.

A limited number of bank accounts are maintained outside the TSA mechanism, most notably some project accounts that have external funding. These project bank accounts are maintained in the Central Bank outside the Treasury's control. However, the project accounts are recorded in the General Leger. The bank reconciliations are performed by the Central Bank and its monthly financial summaries are sent to the MoF General Account Directorate for incorporation into the monthly financial accounts.

The process

The spending units submit a breakdown of the budget allocation to the MoF (cash flow plans with a monthly payment schedule) in accordance with the MoF's instructions. In practice these cash flow plans distribute the allocated ceilings on months without a strict planning of payments' due date. The MoF approves and records the annual budget allocation in the Treasury System. The Ministry of Finance may hold back a portion of the funds appropriated by the Parliament. Controls by the Treasury are based on the limit set by the total annual budget allocation and not by month.

In practice the Treasury bases the cash management on the actual cash level and its own aggregate forecasts based on three years historical cash flow pattern. The MoF (principal authorizing officer) revises the cash flow plans during the budget year with or without a proposal from the budget institutions, based on continuous monitoring of the execution of the cash flow plan and cash management policies. Two problem areas are important for future improvements. First, the over-optimistic revenue forecasts influence cash planning and has forced the Ministry of Finance to revise the annual budget in recent years and to strongly prioritise payments. Second, the budget institutions' monthly cash flow schedules have a poor quality for cash management and are not recorded in the Treasury system. Because of frequent need of changes in the Treasury's cash flow plans, the Debt Department's auction schedule is disturbed and changed as well as temporary cash surpluses arise, hampering the cash managements' purpose of maintaining a relatively constant cash balance over time.

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. For important multi-year contracts, the right to make expenditures continue beyond the end of the budget year, but not more than three years in addition to the budget year, subject to specific approval by contracts and deadlines in the annual budget law.

The Parliament receives the Treasury performance information (fiscal table) on yearly basis which is approved as a part of the next year draft budget.

Arrears

There is an acknowledged "arrears" problem in the construction sectors (primarily roads and water supply, less dominant for school and health buildings) but the size of the arrears is disputed. The Ministry of Transport explained this practice by asserting that contractors continue building on multi-year projects from their own expense above the limit of the annual budget, which creates claims on the following budgets (but no contractual rights and formally not an arrear). Multi-year commitments are not regulated in the Organic Budget Law and the practice of making informal commitments arise from a technical issue

related to the costs of discontinuing the projects; a political issue from pressure to expand development; and a procedural issue as contractors cannot apply for new projects unless they have finished 70 % of old project contracts. As a result of these unauthorized commitments or “arrears” the Ministry of Transport’s budget of 2012 and 2013 encompasses only ongoing investment projects, and the 2013 budget for Ministry of Education had no space for new projects, only for existing commitments.

The Treasury has launched an initiative to close the “arrears” problem by documenting pending contracted payments. The Treasury system has the capacity to register contractual payment dates for future payments at the time of registration of the contract. Treasury is collecting old contracts to ensure that all commitments are recorded by 2013. No spending will be allowed unless commitments have been recorded in the system and the system will not allow a payment to a contractor on a new contract before the old ones are paid. Historical data will look back three years. Through this effort the Treasury expects to be able to document any unknown arrears.

From 2013 the Treasury will register the invoice due date in the Treasury system. Up to now there has been an uncertainty whether the budget institutions withheld invoices when the limit of the budget allocation approaches. According to the interlocutors the government does not spend much on interest on overdue payments which may indicate that there are no substantial arrears. On the other hand, since spending units are required to submit contract commitments to the Treasury for registration already, the continuing problem with arrears suggests that the obligation to submit contract commitments is not being met in many cases. The due date registration will be a partial solution to eliminate arrears – stronger commitment control could eliminate the problem. Therefore the government should establish better commitment control where spending units are effectively submitting commitments to the Treasury system when a contract is signed (before an invoice arrives).

Debt Management

The core legislation for the debt-related activities is the *Law on State Borrowing, State Debt and Guarantees of the Republic of Albania* (number 9665/2006) covering state borrowing activities, complemented by the *Law on Local Borrowing* (number 9869/2008) for municipalities, only a few of which have incurred debt. The Minister of Finance has an exclusive authority to contract loans and issue guarantees as defined by the Law on State Borrowing.³⁰ The Directorate of Debt Management in MoF follows an annual debt strategy that is approved by the Council of Ministers, working through the Central Bank of Albania as its fiscal agent for treasury bills and government bonds.

The Directorate employs its Debt Management Financial Analysis System for all external debt and uses stand-alone Excel spreadsheets for managing domestic debt and guarantees. Reconciliations of domestic debt are performed on a monthly basis, while external debt can take up to two months to be reconciled. The delay of an additional month for some external debt reflects the fact that some line ministries bypass the General Directorate and deal directly with "direct payment" applications from World Bank loans or other IFI credits. As a result, information on disbursements can take up to two months to reach the department and to be recorded in their system.

Quarterly and annual debt bulletins contain domestic and foreign borrowing of all general government and government guarantees. They are posted on the MoF website. External debt is broken down by maturity (long-term or short-term), currency, types of creditors, and interest rates. Domestic debt is broken down by maturity, types of interest rates, and by holders of debt. For guarantees, only aggregate external and domestic stocks are outlined. The Minister of Finance’s annual report on the state budget presents the performance of the government’s debt management activities.

The debt office updates data and notifies Treasury after auctions that take place twice a week (3, 6 and 12 month bonds). Treasury purchases Euros by auctions; 8 auctions were held in 2012.

4.3 Reallocations and Carry-overs

Reallocations

The legal arrangement for reallocation of funds during the budget year is as follows:

- Up to 10% among programmes, if approved by Council of Ministers
- Between economic articles within a programme and an expenditure category (current expenditure and capital expenditure), if approved by the principal authorising officer in the MoF
- Between spending units within a programme and a current expenditure item, if approved by the authorising officer of the central government unit superior to the spending units
- No reallocations can take place after November 15
- No shifts between investment and current expenditures

When assessing the justification for reallocations the MoF (BDMM) focuses on why the need for reallocation was not foreseen in the original budget and why the line ministry found free funds. Reallocations are formally done through the supplementary budgets, first in the Supplementary Budget tabled in Parliament in mid-year (when deemed necessary) and then in the "Normative budget" tabled in Parliament at year-end.

Reallocation between the accounts within a budget program occurs formally twice a month.

Supplementary budgets

In recent years the macro assumptions and revenue forecasts have been overoptimistic and the Council of Ministers has cut expenditures (not personnel) in the middle of the budget year, mostly budgeted capital spending, which dropped from 8.8 percent of GDP in 2009 to 5.8 percent of GDP in 2010, administration and less priority sectors. By mid-year substantial budget revisions in 2010 and 2011 the government has succeeded keeping the public debt below the previous legislative limit of 60% of GDP.

Following the bi-annual revision of the macro-economic assumptions and revenue forecasts the Council of Ministers assess the need for a supplementary budget (normally in June). Since the present government took office in 2005 there have been supplementary budgets almost every year (except 2012).

Reserve fund and contingency fund

According to the organic budget law, the budget includes a reserve fund and a contingency fund, of up to 3% of the total budget funds. The reserve fund can be used for unforeseen events, unlike some other countries, while the contingency fund may be used if the performance of revenues is less than planned.

For having additional funds from the reserve funds the general government unit may apply to the MoF with a justification why the expenditures were not foreseen in the annual budget, how the planned outputs contribute to policy objectives and why it could not be financed within the allocated funds. The Minister of Finance recommends and the Council of Minister approves the use of the reserve fund. The Minister of Finance informs the Assembly periodically on the use of the reserve fund.

Carry-overs

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.

Table 4 below shows that most OECD countries allow carry-over under certain conditions, in general in order to: avoid hasty and inefficient spending in the last month of the year, avoid building up stocks of unspent resources, and ensure budgetary discipline by compensation requirements in the next budget year.

Table 4. Can ministries carry-over unused funds from one year to another?

	Operating expenditure	Investment expenditure	Transfers and subsidies
Approval not required	8	12	8
Executive approval	17	16	16
Legislative approval	10	9	8
Not permitted	5	3	7

Source: OECD, GOV/PGC/SBO(2011)11

4.4 Budget monitoring

In accordance with the organic budget law and the Budget Monitoring Instruction, since 2006 when Albania introduced performance budgeting, all central government units submit quarterly Budget Execution and Monitoring Reports³¹ to the MoF. The reports document units of output achieved, expenditure incurred and unit costs in comparisons with planned outputs, planned expenditures and planned cost/unit for each programme as specified in the first year of the final MTBP document. For example the Ministry of Education submits quarterly reports (50 pages) to MoF, based on hard copy reports from the regional offices and data from the Treasury. The reports are used within the line ministry to update the Minister on implementation of the budget. Government-wide there are around 700 performance targets, most of those linked to a specific amount of expenditure at product level.

Evaluation of monitoring reports is a *shared responsibility* (See box 7 below). Budget institutions monitor and report on the physical delivery of outputs and they have a responsibility to use that information pro-actively. If delivery of an output is off-track or over budget, it is the responsibility of the spending unit's Group of Management and Strategy (through the Programme Management Team) to determine the reasons behind the gap in performance, in order to take remedial action and decide on reallocation of resources within the budget institution.

Based on the quarterly reports of the line ministries and other central budget institutions, Ministry of Finance (the Budget Directorate, BDMM) prepares reports with comments on reallocations vs. original budget, performance of outputs vs. plan, deviations from Treasury financial figures, and recommendations for follow-up issues. BDMM also checks the line ministries' break down of the appropriations of the annual budget law. MoF focuses on deviations – i.e. those outputs that are substantially off-track, expenditures over-budget or with unusual data on actual unit cost, the reasons for deviations and the corrective actions. The DBMM undertakes more in depth analyses where there are *exceptions* from budget or planned output:

- Ensure the Budget Department's Budget Management Team (BMT) is informed of potential problems that might (or are beginning to) emerge during budget execution and that may result in

unplanned fiscal pressures building up and/or requests for budget transfers from budget institutions;

- Provide the MoF's Department for Budget Policy and Analysis with information on potential weaknesses in the planning process within budget institutions so that this information can be used in part in the expenditure analysis process and in part in preparing appropriately for budget hearings with line ministries; and
- Provide an "early warning" to the Strategic Planning Committee (via the BMT) where key outputs that are linked to major and high profile government policies are beginning to go off-track.

Two specialists in the Capital Investment Department focus on budget monitoring. The general perception (e.g. IMF, 2011) is that the MoF does very little review of investment project plans or cost benefit. They have little capacity to verify the accuracy of the assumptions. They monitor output only.

Budget monitoring uses historical patterns as a benchmark for analysis of the budget – 15 years of historical data. The Minister of Finance submits the budget implementation and monitoring reports for information to the Council of Ministers as well as to the Parliament for information, one month after the reporting date. The annual report 2011 had 86 pages. Officially the parliament receives the monitoring reports once a year through the annual budget reports which accompany the budget law. All monitoring reports prepared by line ministries are available on their respective website and all the monitoring reports prepared by the Ministry of Finance are available on its website.

There is recognition in the Ministry of Finance of the need to strengthen budget monitoring to build a stronger foundation for the budget formulation and execution. The quality of the line ministries' reports has improved over the years but there is still a need for further improvements. Line ministries have viewed the monitoring reports as a MoF product and therefore the quality of reporting has not advanced sufficiently. According to the Central Harmonisation Unit for Financial Management and Control the internal reporting is mainly of financial nature and does not contain information necessary for performance management (CHU/FMC, 2012). One reason for this may be methodological deficiencies in developing performance indicators and unit cost calculations suited for the operational management. This is a common international problem and is reflected by a recent shift in use of performance budgeting techniques in OECD countries (See discussion in chapter 2).

There is no electronic support system for development and monitoring of performance and products, only for expenditures. A new IT system is underway, approved by a trust fund. Better system facilities may help to foster increased quality of reporting. Better system support (the Oracle system) to register total investment project cost and remaining (out year) expenditure requirements would also help monitoring the capital projects. The analytical capacity of MoF is not adequate to challenge budget planning assumptions for capital projects, or to review project management.

Evaluations are not frequently and systematically used in Albania though it happens that the staffs conduct an evaluation report upon request from a minister. In depth evaluations and analysis of performance deviations may also help the monitoring process.

Box 7. Government units involved in budget monitoring

The process of monitoring the delivery of outputs is formally the responsibility of **the budget institutions**. While the various tasks associated with monitoring are delegated to Heads of programme Management Teams within budget institutions, monitoring is the responsibility of Group of Management and Strategy (GSM).

The **Department for Budget Monitoring and Management (DBMM)** in the Ministry of Finance has a principal responsibility *for the monitoring process* – i.e. to review the monitoring reports prepared by budget institutions. DBMM is organized into two sectors composed by the head of sector and three specialists each (total 9 employees). The main functions of the department are: managing the implementation process of the budget; monitoring the medium-term programming and the annual budget process by analyzing budget performance indicators in order to monitor achievement of outputs and performance of planned activities; and preparation of laws and regulations and monitoring their process of implementation.

The **Directorate of Public Investment Management** in the Ministry of Finance follows the actual implementation of capital programs and projects by sectors aiming the improvement of programming process and project cycle management. It has presently four experts while the position of head of department is vacant, but the organization is due for reconsideration.

The **Department for Strategy and Donor Coordination (DSDC)** at the prime Minister's Office has a duty to warn the Council of Ministers if outputs to which the Council attaches great importance are at risk of non-delivery, delayed delivery or poor quality. The Department for Strategy and Donor Coordination monitors progress of programme policy objectives and high priority outputs and those outputs that are listed in the Ministry Integrated Plans. The Department for Strategy and Donor Coordination discharges this responsibility by receiving the same reports on progress from line ministries as the Ministry of Finance as well as Ministry Annual Reports.

The **Ministry of European Integration (MEI)** monitors EU Integration related objectives and outputs to the achievement of the European Partnership Action Plan (EPAP). MEI advises the Council of Ministers and also reports to the European Commission on progress in implementing the European Partnership Action Plan. The Ministry for European Integration discharges this responsibility by receiving the same reports on progress from line ministries as Ministry of Finance and the Department for Strategy and Donor Coordination.

Through the MTBP hearings the DBMM in conjunction with DSDC and MEI assess in what circumstances it can take action as a result of monitoring information and what those actions could be.

4.5 The structure of public administration and service delivery

The Albanian central government has 14 line ministries³², subordinate agencies and some independent institutions (table 5). For instance, the ministry of Transport has subordinate agencies to implement road and water supply policies. The ministry involves at policy level, monitor and follow up on reports from the agency head. Head of programmes are from the ministry while the deputy heads are from the agencies. Some programmes are administered directly from the ministry, e.g. road safety. The Ministry of Education and Science is the largest ministry with 39,000 employees, followed by the Ministry of Internal Affairs (13,400 employees) and the Ministry of Defence (11,700 employees). The Health Care Insurance Fund, the Social Insurance Fund and the Ex-owners Compensation Fund are special funds according to current legislation – operating as independent institutions.

Table 5: Structure of the public sector

Level of government		Number of budgetary institutions	Number of spending units	Employment
Central government	Ministries	14		84 558
	Central agencies sub-ordinate to line ministries and Independent agencies	30		4 802
	Special funds	3		na
	Total central government	47		89 360
Region	Counties/regions	12	31	720
Local	Municipalities	65	214	6 251
	Communes	308	309	6 100
General government	Total	432	Ca 1 500	102 431

Source: Budget Law 2011 and Ministry of Finance, Albania

Service delivery is shared by the central and local level governments. The delivery of collective services such as defence, police, penitentiary services, road construction, forest administration, tax administration, higher education and research, inspectorates etc are all the main functionalities of the respective line ministries and they are all financed from the state budget. The central government also involves in shared functions by providing funds and personnel.

Local government has a threefold responsibility: a) exclusive functions, such as water supply, public transportation, public lighting and garbage collection; b) shared functions, such as pre-school and pre-university education, priority health services and protection of public health, and social affair; and c) delegated functions (mandatory and non-mandatory functions). The delegated mandatory functions are: social protection, social assistance and poverty alleviation, civil office services, agricultural land administration, the National Registration Center and the National Licensing Center.

The Albanian public sector is rather centralised. There is an ongoing decentralisation process but it proceeds slowly. Local budget expenditures in 2012 are estimated at ALL 29.5 billion (2.1% of GDP) which come to 7.4% of total consolidated general government expenditure (MoF, 2012, p.25). The public sector is small compared to other countries in the region, with public primary spending about 28% of GDP.

Outsourcing is not forbidden by law but rarely used in practice. Outsourcing may be allowed if justified needs, mostly within legal and administrative services. PPPs are debated but not yet applied.

4.6 Public enterprises

The Albanian Public Enterprise sector is small due to the privatisation process during the two latest decades. The central government has remained present in public enterprises on the railroad, ports, energy and water supply, associations of treatment of students, etc. In recent years some energy providers, the telecom company and a gas corporation have been (partly) privatised. The Albanian Post Service a.s is a self-financed public enterprise. The employment in the public enterprise sector has fallen from about 60,000 in 2000 to just below 37,000 in 2011 (INSTAT). The budget of the public enterprises is financed through subventions of the water company, railroads and food providers. Based on the difficulties of the

Electricity Corporate's financial situation the government budget issues the guaranties for this company in order to finance the energy import. In the annual budget law 2011, table 4, there is specified subventions of ALL 1.7 billion (0.4% of total expenditures). The budget (\$18) also specifies the annual increase of state guarantees to be ALL 7.4 billion.

The present government has an ongoing privatisation program of some strategic companies such as Albanian Petrol Company, some state hydropower company and some military properties. The government budget does not include revenues received from these privatisations. For example the Law no. 119/112 article 9 declares that this privatisation receipt has to be used through the Council of Minister's order for increase of capital expenditures and decrease the borrowing. Quasi-fiscal activities in the enterprise sector are not clear. Any contingent liabilities stemming from this sector are also not documented.

4.7 Fiscal relations across levels of governments

Local government is divided into 373 directly elected units made up of 65 municipalities in urban areas and 308 communes. Indirectly elected mayors and representatives of municipalities and communes govern 12 regions (counties) through regional councils. According to the legislation, the council of a region, as the second level of local government, mainly deals with the harmonization of local development policies with regional and national ones in various fields and sectors.

Prefects of 12 administrative districts are appointed by central Government to oversee the legality, efficacy and efficiency of the operations of local governments but have no role in actual service delivery. Each prefecture has three or four districts under its jurisdiction, in total 36 districts. Also at the regional level there are different de-concentrated agencies which deal exclusively with the implementation of policies of ministries and central institutions.

Local government follow the same budget calendar as the central government, according to the Organic Budget Law. Local governments submit a two-page summary of local budgets to MoF summarizing local budgets, economic growth, inflation, allocation of formula transfers, income, revenue and expenditure for the locality. The unconditional grant to each local government is shown in an annex to the annual budget law. Local budgets are required to be balanced. However, local governments can borrow from the financial markets within the country and / or abroad to cover its short-term or long-term needs to finance investments. Any local government borrowing shall be approved by the local council and is subject to preliminary approval by the minister of finance. The total local government debt is 0.03% of GDP (ministry of Finance).

Local governments are highly dependent on the central government, as local revenues are low and infrastructure development depends on central government investments. Small local government units are in many cases not economically sustainable. The structure of revenues of local budget significantly changed from 2003. In 2012, 40 % of local government functions are financed by the own revenues, 41% from unconditional transfers and 19% from competitive grants. See tables 6 and 7 below.

Table 6: Major categories of local government expenditures and revenues (Percentage of GDP)

	2010	2011	2012
Revenues and grants			
Local shared taxes	0.0	0.1	0.1
Property tax	0.2	0.1	0.2
Small business tax	0.2	0.2	0.2
Other local taxes	0.6	0.5	0.4
<i>Total local revenue</i>	1.0	0.9	0.8
Unconditional grants	0.9	0.9	0.9
Competitive grants	0.7	0.4	0.4
<i>Total grants</i>	1.6	1.3	1.2
Total revenue and grants	2.5	2.2	2.1
Expenditures			
Personnel (600)	0.7	0.7	0.7
Operations and maintenance	0.8	0.6	0.7
Social insurance outlays(601)	0.1	0.1	0.1
Interest	0.0	0.0	0.0
<i>Total current expenditure</i>	1.6	1.5	1.5
Capital expenditure	0.9	0.7	0.5
Total spending	2.5	2.2	2.0
Overall balance	0.03	0.01	0.05
<i>Nominal GDP (million, national currency)</i>	1,222,462	1,297,710	1,346,169

Sources: Ministry of Finance, Albania

Table 7: Local government expenditures by programme (Percentage of GDP)

	2010	2011	2012
Education	0.2	0.2	0.1
Transportation	0.7	0.6	0.4
Water supply and sanitation programs	0.1	0.1	0.1
Public services programs	1.4	1.2	1.1
Cultural and sports programs	0.1	0.1	0.1
Other programmes/ functions	0.1	0.1	0.2
Total local expenditure	2.5	2.2	2.0

Sources: Ministry of Finance, Albania

The local governments are entitled to levy local taxes and to determine the level of them within limits defined by local tax laws. Local taxes include the small business tax and the property tax. Some taxes are

collected on a shared tax basis: the vehicle registration tax is shared with 18% of the revenue to the local government and 25% of the mining rent tax goes to the relevant local government.

The Central Government provides financial resources to the local governments (commune /municipality and council of region) through unconditional and conditional grants, prescribed in the Law no. 8652 dated 30.07.2000 "For organization and functioning of local government" that is administered by MoF (the Directorate of Public Investment Management). The local governments take part in financing the regional governments by transferring grants.

The unconditional grants (about 65% of total grants) have been a formula distribution since 2002, administered by the Ministry of Finance. The grant to municipalities and communes is based on population and the relative geographical size of the communes. The formula for regions is based on an equal share for all regions, population, geographical Indicators of counties (field, hilly and mountainous), and length of rural roads. The total grant is tied to growth of the economy. Through a relative complex mechanism, funds are reallocated between local governments according to fiscal capacity. Local governments at the receiving end are guaranteed a minimum transfer.

The remaining 35% of transfers are conditional grants that comprises of competitive grants and earmarked grants. The competitive grants were from 2010 collected into one pool, the Regional Development Fund that can finance: local infrastructure, basic education, health, cultural facilities, water and sanitation facilities, building agro-food markets, irrigation and drainage, and forestation. Coordination of the competitive grants has been moved to the Council of Ministers. Local governments apply to line ministries for their programs. Line ministers send their proposed allocations to Council of Ministers which then coordinates funding for all ministries to localities.

Shared functions funded in part through conditional grants are education (salaries are central), health care, and social welfare. Generally, local governments maintain buildings; central government provides investments and staff.

The PEFA report suggest that despite the formal allocation criteria, the actual allocation of the competitive grants under the Regional Development Fund has been criticised as a rather politicized process, tending to favour regions run by the majority party.

The budget notes presented to the Parliament provide explanation of the formula and the itemized allocation. The criteria are formally decided by the Parliament, but Parliament has not made any changes on proposed criteria up to now.

The Treasury plans generally provide a transparent and reliable framework within which the local governments can execute their budget. However, when the Government revise downwards the budget ceilings due to over-optimistic projections the local government 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 local governments is reported to be a source of frustration.

The interlocutors at the municipal level, the Deputy Mayor for Tirana and Authorizing Officer for the Municipality, advocated that local governments need more flexibility in the planning and execution of their budgets, especially concerning approval of investment projects and reallocations. The local governments report both to the Municipal Councils and to Treasury.

4.8 Public employment and the civil service

Positions in ministries, from the Secretary General of the Council of Ministers and the highest level of civil servant (Secretary General in ministries) to specialists in ministries and local self government (lowest

level) are considered civil servants. The management of these categories of employees is based on the provisions of the Law on the Status of Civil Servants. Other public employees, such as teachers, doctors, nurses, as well as support staff in central and local administration, are considered to be public employees, and their management (human resources) is based on the provisions of Labour Code. The Department of Public Administration (DoPA) under the Ministry of Internal Affairs administers the legislative and institutional frameworks for public administration and the civil service.

About 89,400 public employees are civil servants (2011). In addition there are some 22,800 army and police personnel (Sigma, 2003, p.49). In the third quarter of 2012, there were 164,400 employees in the public sector in Albania out of a total employment of 922,475 (INSTAT, Labour Market, QIII/2012). 17.8% public employment is slightly above the OECD average of around 15% but below other countries in the region. About 22% of public employment belongs to non-budgetary positions (public enterprises).

According to the World Bank's Worldwide Governance Indicators the government effectiveness³³ in Albania has improved substantially in recent years, with scores from 32.7 out of 100 in 2002 to 48.3 in 2011, though still among the weakest scores in the region (the average of Europe and Central Asia was 67.2).

There is a common comprehension that the legislative and institutional framework for public administration needs to be addressed with a view to strengthening professionalism, depoliticisation, meritocracy, transparency and accountability. The extensive use of temporary contracts to circumvent selection procedures should be avoided. The recently drafted amendments to the Civil Service Law of 1999 – approved by the Council of Ministers, but not adopted by the Parliament – intends to prevent politicisation and to ensure equal opportunities, and stipulates open competition and a merit-based system for recruitment and career development. The implementation of the government's action plan in Public Administration reform for preparation to EU accession has however proceeded slowly.

Salaries for state bodies are set by the Department of Public Administration in conjunction with the MoF. Unions are invited to provide comments, but do not have a direct role. Under government policies, teacher and health care workers salaries were to be doubled from 2005 levels. That change is close to being achieved. MoF sets amount available for salaries. DoPA and MoF negotiate the mix of salaries.

The performance appraisal system is not effective. As a measure of the weakness of the performance appraisal system, 90% of employees were rated as outstanding. Under prior scheme outstanding employees were to be given 3 months' salary as a bonus, category 2 employees – 2 months, and category 1 employees a 1 month bonus. In 2008, bonuses were reduced to 1 month, 0.7 months and 0.5 months respectively.

There are applicants for all vacant government positions. One reason for this may be that the average monthly salary for public employees exceeds the average salary for all employees in Albania, following a real public wage increase over ten years (2001-11) by 122% (INSTAT, Earnings and Wages 2011). The criteria for hiring are according to by-laws education for specialists and experience for others. There is mass recruitment for vacant civil servant positions (according to the Civil Service Law), except teachers. The Department of Public Administration recommends the three best candidates to the line ministry that is free to select one of those. Pension schemes for civil service are regulated by the Social Insurance Fund.

Present systems involved in the determination and management of payroll are manual, stand-alone systems. Extensive manual reconciliations are therefore required. The government is taking gradual steps to implement a modern human resource management information system (HRMIS) to replace the current manual systems in each ministry but is yet not fully operational, supported by several donors such as

World Bank, EU and IPS trust Fund. Its first pilot phase, for making the salary module functional, was successfully concluded in five institutions in April 2012.

4.9 Public procurement

The government, assisted by donor partners and a twinning project with Poland and Romania, has created a modern public procurement framework in line with international norms. Competition is the dominant method of procurement, supported by the mandatory use of centralised electronic procurement by the 1700 contracting authorities.

Prior to 2006 procurement was a major problem. The Law on Public Procurement, passed in 2006 and amended annually until 2010³⁴, is closer to EU requirements and provides an appropriate legal basis. Since 2007 most procurement requirements have been published on a central website fostering transparency. Since 2009 most contracts are being competed through E-procurement (goods, services and work). All procurements greater than 16,000 € must be competitively tendered; procedures below 3,000 € are exempt from pre-publishing. All procurements between these two limits must be pre-published on the website and attract a minimum of five bidders. Defence is outside the procurement procedures.

The Public Procurement Agency (PPA), under the Prime Minister's Office, has been restructured and administers the legislative and institutional framework for public procurement. It has 20 staff.

A Public Procurement Commission (PPC), appointed by the Council of Ministers and reporting to the Parliament, deals exclusively with the complaints of economic operators for procurement, concessions, and public auctions procedures. It is a collegial review body composed of 5 members. The Commission issues decisions which are administratively final, and may be appealed to the court. Before 2010 the complaints were subject to a fee, now complaints are for free. Most cases concern evaluation of criteria for entering into a contract. Approximately half of the complaints are upheld by the Public Procurement Commission. The PPC has 18 staff.

A Procurement Advocate reports to the Prime Minister. The Procurement Advocate may initiate and conduct its own investigation.

In 2010, 85 per cent of all procurements were conducted using competitive procedures. Transparency in operations is a key attribute. The PPA website reports all procurement opportunities, makes available all standard bidding documents, requires e-filing of all bids and reports on the results of all procurement decisions. However, some 20% of the contracting authorities do not notify the PPA of their procurement plans and hence the PPA is not able to publish them.

The Albanian e-procurement system has been strongly endorsed by donors as a good practice example. Further improvements are anticipated, including the provision of enhanced security of access to the system and greater safeguards against collusion among suppliers. There is also some need for improvements in the legislative framework and a clearer division of roles between the PPC, the PPA and the Public Procurement Advocate (PPAd) in order to secure their administrative capacity and independence.

Box 8. Public Procurement Procedures

Open procedures are those procedures whereby any interested economic operator may submit a tender.

Restricted procedures are those procedures in which any economic operator may request to participate and whereby only those economic operators selected by the contract authority may submit a tender.

Negotiated procedures are those procedures whereby the contract authority consult the economic operators of its choice and negotiate the contract terms with one or more of these.

Request for proposals is a procedure without prior public notice, whereby the contract authority may seek offers from a limited number of economic operators of its choice and compare them according to the criterion of price.

Source: Law on Public Procurement (10 309/2010)/PEFA (2012)

4.10 Conclusion

Broadly, the government has established sound systems and procedures for budget execution, generally in line with practice in OECD countries, though there is still some way to go before all elements are fully implemented.

The Treasury system is according to international best practice. The proper implementation still needs to be addressed.

The government should establish better commitment control where spending units are required to register commitments in the Treasury system when a contract is signed (before an invoice arrives). There is an issue with invoices not being submitted to the Treasury when there are budget shortages, creating unrecorded arrears. The MoF is on the right track when they plan to introduce the commitment module as of 2013. This applies primarily to investment contract. In addition, the plan to register invoice due date may help to analyse if the budget institutions keep invoices out of the control of the Treasury when there is shortage of budget allocation. However, the government should establish a more comprehensive commitment control integrated with the Treasury system.

The MoF should consider an electronic link between the budget institutions financial system and the treasury system in order to facilitate efficient payment execution and commitment control. This could increase efficiency of the budget execution and help the spending units to plan better use of allocated resources and it would give the Treasury better basis for cash planning. Access to the treasury system for all budget institutions would also help reconciliation and planning at the spending unit level. However, full system integration would not be recommended. The more sophisticated the systems are the more opportunities there are for a failure.

Over time, the government might consider allowing small carry-overs to the next budget year, in combination of a compensation strategy for next year's budget, in order to secure efficient use of resources over the year-end and to allow budget institutions to reallocate smaller amounts between programmes.

The government should consider reducing the Reserve Fund in order to increase budget discipline. Though, at this stage of development it seems to be well suited for Albania to continue its limited right to exercise reallocations through a centralised procedure.

The MoF should emphasis monitoring of actual expenditure against budget and actual outputs against targets but have less focus on direct links to unit costs in the budget formulation and monitoring. Such an emphasis of performance budgeting will be in line with international best practice. The Albanian performance budgeting system represented by the MTBP and the budget monitoring process is broadly in line with practices in some OECD countries. However, recent international research described in chapter 2 indicates that it is difficult to use non-financial performance as a direct tool for budgeting.

Line ministries should take a stronger responsibility of their own budget execution and use the MTBP pro-actively in management and as a basis for internal management and control. This will create better understanding of the interaction between inputs and outputs, and create better ownership of the results and better reports to the MoF. The management culture should be changed by structural reform and training, and the civil service law should be amended to shift to a performance structure from position based personnel controls.

The government should continue to pursue professionalism, depoliticisation, meritocracy, transparency and accountability and secure implementation of approved legislative and institutional frameworks. The roles concerning design of civil service wages policy and performance elements in wages should be reconsidered in order to allow MoF a better opportunity to coordinate wages policy with fiscal policy. Public administration reform is one of the key measures that Albania has to encompass before the EU candidate status is finally granted.

The government should continue to refine the legislative and institutional framework of public procurement and secure training and cross-the-board implementation to secure successful implementation of the modern ICT system for electronic procurement processing. Defence procurement outside the Public Procurement procedures is a potential major loophole in procurement procedures. In the present work on legislation for PPP and concessions, MoF should be secured a decisive role to secure value for money while using such instruments.

5. ACCOUNTABILITY, CONTROL AND AUDIT

In recent years, many steps have been taken in Albania to improve accounting and audit. The organic budget law, *the Law on the Management of the Budget System in the Republic of Albania 2008* (MBS), came into effect in 2009 and, among other things, provided for the basic organisational structures for a budget institution. These structures were then developed in more detail by the *Law on Financial Management and Control 2010*. 2010 also saw the introduction of the *Law on Public Financial Inspection*, which provided for the establishment of a financial inspection service. Also in 2010, the *Law on Internal Audit* was amended to separate inspection from internal audit and clarify the role of internal audit. As a result, the legal basis is in place for a well-functioning internal financial control system that supports managerial accountability. While putting the principles into practice is a more challenging task, good progress has been made although much remains to be done. The implementation of these steps is considered in this chapter.

5.1 Accounting basis and procedures

Cash is the accounting basis for the government accounts although the Treasury system is based on a unified accounting and budgeting classification system that observes GFS 2001 and COFOG classification standards and work is ongoing for adopting aspects of ESA 95. The consolidated report for the executed budget which is submitted to Parliament by the Treasury General Directorate of the Ministry of Finance is on a cash basis only.

Throughout the administration, the focus on financial control is one of cash. The MBS makes no provision for any element of accrual at the State level and it provides for the exercise of controls with reference to the cash position. Budgetary control is exerted on the basis of the availability of cash with the Treasury checking the availability of allocations within agreed budget cash limits. This has allowed significant arrears to build up even though in recent years attempts have been made to record commitments in the Treasury as well. The matter of arrears is discussed in more detail in Chapter 4.

Steps are being taken to control the build-up in arrears by ensuring that all commitments are recorded in the Treasury system by end-2013 and by ensuring that in future commitments will be recorded in the Treasury system at the initial contract stage. This is being done with the support of an EU-funded project *Support and Expansion of the Treasury System – Albania (SETS)*. It remains to be seen how successful this will be in addressing the arrears problem.

However, the MBS provides for modified accrual at the level of the individual budget institutions which are required to keep their own financial records, in accordance with standards set by the Ministry of Finance, and to report them to the Treasury for the purposes of reconciliation. These reports are on a modified accrual basis with expenditures being recorded at the time that the invoice is received as opposed to when the payment is made and revenues being recorded only when they are actually received. The individual reports of the budget institutions are considered to be less accurate than the consolidated report for the executed budget produced by the Treasury.

Albania plans to change the accounting basis to accruals. In 2009, the Government approved a policy paper for the gradual adoption of IPSAS over the period 2009-2014. To this end, a pilot project involving five institutions is currently on-going and it is planned to include 40 budget institutions by end-2014. However, the implementation of a full accrual system will require an extension to the Treasury system of recording all transactions on an accrual basis as well as cash. It is unclear as to how this can be achieved. Furthermore, there is little evidence to show that even modified accruals information is being used by management in budget institutions to inform decision making. Therefore it would be better to concentrate

first on eliminating the problem of arrears before progressing to the introduction of full accruals, which is a challenging and complex system. Getting complete information on commitments so that arrears are stopped is a higher priority than the adoption of full accrual in an administration which does not have the capacity to use the information a full accrual system provides.

5.2 Reporting

The Treasury is responsible for keeping the state accounts and for the preparation of periodic and annual budget execution reports through the Government Financial Information System (GFIS). Reporting tends to focus on budget accounting, which remains on a cash basis. The compilation methodology underlying the data for the consolidated budget is broadly consistent with the analytical framework of GFS 2001 but the presentation and classification of data are not in the GFS 2001 format.

The MBS provides that the annual consolidated budget execution report, as approved by the Parliament, will be published in the *Official Gazette* before the end of October each year. The law also provides that the report will contain information on the achievement of objectives, and the status of internal financial management control and internal audit. The law further requires for a copy of the report to be sent to the supreme audit institution, the High State Control, which audits the annual consolidated report between February and July.

The Treasury also provides a monthly Consolidated Fiscal Indicators report and a quarterly *General Government Fiscal Statistics Bulletin*. Monthly and annual data on the consolidated budget are published in the quarterly *General Government Fiscal Statistics Bulletin*. Data cover the general government sector. The data are disseminated on the website of the Ministry of Finance.

The MBS also stipulates that in June each year the Minister of Finance will provide the Government with a mid-year report which analyses the implementation of the State Budget. The analysis includes:

- an assessment of the macroeconomic situation and forecasts,
- a comparison between actual budget outturns and budget projections, with explanations on differences,
- if necessary, proposals for Government decisions,
- if necessary, a proposal for a change in the original Budget, along with the rationale as to why the requested changes could not be forecasted in the proposed budget.

However, this report is for the information of the government only and is not published unless the Government decides to change the original Budget. The production of the report is good practice but the fact that is not automatically published is not in compliance with the OECD's "Best Practices for Budget Transparency" even though some of the information is published in the monthly "Fiscal Report" for end-June.

The Treasury sends monthly budget execution reports to the budget institutions by the end of the first week after the end of the month. The actual budget utilisation is presented largely in the same format as the budget, using the budgeting classification system. General government monthly reports are submitted to the Parliament and published preliminary five days after the month and finally 20 days after.

Although the Treasury system records monthly data for all budget institutions and local governments, it does not yet fulfil a management accounting role and thus provide deeper analysis for managerial purposes in the budget institutions. Budget institutions are still producing their own management accounting records on a largely manual basis, assisted by spreadsheet systems. The pilot project for

adoption of accruals does not make provision for a full financial management information system, which includes supporting management accounting and costing information systems.

5.3 Public internal financial control

The legal framework for the introduction of Public Internal Financial Control (PIFC) is set out in the MBS, the *Law on Internal Audit 2007* and the *Law on Financial Management and Control 2010*. These laws provide an adequate legal framework for the implementation of the three pillars of PIFC, namely Financial Management and Control (FMC), a functionally independent Internal Audit (IA) and a Central Harmonisation Unit (CHU) for developing methodologies and standards for FMC and IA. The key role and responsibility for the development and implementation of PIFC rests with the Ministry of Finance, which fulfils its role through the operations of the Central Harmonization Unit of Financial Management and Control (CHU/FMC), the Central Harmonization Unit of Internal Audit (CHU/IA) and the Financial Inspection Service in co-operation with units in the budget institutions.

Financial management and control

The CHU/FMC is separated from CHU/IA. The CHU/FMC is a Directorate consisting of a director and five specialists. It cooperates with the Treasury Department and the Budget department. It has prepared standards for budget preparation, budget execution, risk management, management of assets, and audit trails on public procurement. Its main functions are to:

- Establish and coordinate laws, strategies and methodological guidelines for financial management and control (including accounting),
- Provide training, and
- Monitor financial management and control in public sector bodies, as part of which it annually reviews the instructions for FMC.

The CHU/FMC has worked to develop a better understanding of the legislation and the principles of internal control throughout the administration. For instance, training in risk management was provided through a Twinning Project of 2008-2010. Despite this work, however, CHU/FMC has identified many weaknesses in its Annual Report for 2011 on "Functioning of Internal Public Financial Control System at General Governance Units".

That report highlights the fact that there is only a narrow understanding in many institutions of the full implications of the introduction of FMC and the concept of managerial accountability. This narrow understanding reflects the traditional administrative arrangements in Albania where there has been little evidence of downward delegation of responsibility and authority. This narrow understanding impacts on the implementation of the internal control arrangements. For instance, the MBS provides for the appointment of an executing officer to whom the head of the budget unit delegates responsibility for the implementation of the financial management rules, for keeping the accounts and for the preparation of financial statements. However, in practice the decision-making responsibility remains largely with the head of the budget (authorising officer) user.

Furthermore, there is no finance director role as such in Albania and the responsibilities of that role can be divided among several officials. The official responsible for the co-ordination of budget formulation and the executing officer are two different functions. Executing officers are usually only responsible for one part of a budget institution's activities and there is no overall executing officer responsible for the overall financial management and control of the whole organisation (*i.e.* covering both first and second-level spending units). This is despite Article 20 of the MBS, which states that "the executing officer shall

be designated by the authorizing officer for the implementation of the financial management rules, keeping the accounts and for preparation of financial statements".

The focus of financial control is to ensure that spending does not exceed budgetary limits (and with those limits monthly cash-flow limits agreed with the Treasury) rather than to achieve performance targets within the budget limits. Internal reporting is mainly financial and does not contain information about management performance.

The arrangements for control and accountability that should apply between first and second-level spending units, regardless of the size of the second-level body, are not defined in the MBS or the FMC Law. The *State Administration Law 2012* seeks to put a reporting structure in place for the administration but does not provide a satisfactory structure for FMC and managerial accountability between the first and second-level budget institutions. Moreover, the MBS provides that the authorising officer in a municipality should be the mayor. It would be normal for the authorising officer in a municipality to be the most senior appointed official rather than the elected mayor – at least in the larger municipalities.

Internal audit

Central Harmonisation Unit/Internal Audit

The CHU/IA is a General Directorate consisting of two Directorates, one responsible for monitoring quality of auditing in all budget institutions and the other responsible for professional development and certification of qualifying auditors. The total number of staff is twelve, with the directorates consisting of one director and six specialists and one director and four specialists respectively.

CHU/IA organizes training and certifies auditors, as well as drafting instructions, manuals and methodologies for the budget institutions. For example, in 2010 it produced, with the assistance of an EU project, the 183-page *Manual of Internal Audit*. This manual has helped to improve the quality of internal audit. For example, it explains the importance of annual audit planning and explains that it should be based on risk so that the internal audit unit focuses its efforts on systems or areas where the greatest potential exists for things to go wrong. It explains that risk assessment is carried out during the entire audit. It also emphasises that the responsibility for setting the plan rests with the internal auditors. Nevertheless, the quality of IA still needs further improvement. The *Manual* has helped with regard to the methodological framework but it is still a general manual and IA units require practical guidance.

It is responsible for ensuring the quality of the budget institutions' internal audit function. After each monitoring assignment, it delivers a report which identifies issues that are needed to improve the quality of the work in that unit. CHU/IA prepares a consolidated annual report for all IA activity in the public sector and submits it to the nine-member Internal Audit Committee appointed by the Minister for Finance, which then submits it to the Minister who in turn submits it to Government. CHU/IA recognises that the external quality assessments which it carries out need to be brought into line with international professional standards and it is working to achieve this.

The Law on Internal Audit requires cooperation between internal audit and external audit so that duplication of responsibility is avoided. The law provides that CHU/IA will collaborate and maintain continuous contact with the HSC with the objective of exchanging all relevant information relating to audit through Annual Reports and annual plans, and joint training for internal and external auditors. In order to increase the effectiveness of this cooperation, a formal agreement between the Minister of Finance and the HSC became effective in May 2012.

Internal Audit in the budget institutions

Any budget institution with three or more spending units is required by the law to have an internal audit function. Whether a second level user has an internal audit function is based on a Government decision. Although each ministry should have an internal audit function, small ministries – as well as independent organizations – may contract with larger ministries for audit services. For example, the Ministry of Integration has only 50 staff and contracts with the Ministry of Finance for internal audit. In the case of entities contracting for internal audit, there is a legal requirement that each entity should be audited at least once every two years.

Internal audit units are expected to provide management with quarterly and annual summarised information, including explanations about audit assignments that have been completed in accordance with their annual plan. They should present conclusions on the internal control system with recommendations for improvement, as well as information about actions taken by management to implement previous recommendations, including the reasons why any recommendations were not implemented.

The internal audit area has benefitted from technical assistance training in recent years. 1,200 internal auditors have been certified with 300 more in the process of certification. Not all, however, are practicing as internal auditors. There are 406 internal auditors in 124 internal audit units, including 13 of the 14 ministries. A new strategy for the training and certification of internal auditors is being developed by CHU/IA with the support of SIGMA. This new strategy is expected to improve the system of certification and the training programme.

In accordance with the Law on Internal Audit, internal audit is an independent activity that is separate from the management role. Accordingly, it should be clear that the head of an IA unit should report directly to top management and should not be part of the management team. Also in accordance with the Law, internal auditors in ministries or municipalities report directly to Ministers or Mayors respectively. In a second level budget institution, the internal auditor reports to the top-level official of that body, with a copy of the report being sent also to the management of the responsible first level user.

2010 amendments to the Law and the new *Law on Financial Inspection 2010*, separating inspection from internal audit, have helped to clarify the role of internal audit as a support to management. There is more awareness among top officials of the purpose of internal audit. Although ministers and mayors are still asking IA units to carry out financial inspection-type activities, despite the establishment of a specific financial inspection function in the Ministry of Finance, as awareness is raised it seems that these instances are declining.

Financial Inspection

The Directorate of Public Financial Inspection was established under the provisions of the *Law on Public Financial Inspection 2010*. The focus of the Directorate is on anti-corruption in all the budget institutions. Under the Law, the Directorate is limited to a small co-ordinating team with the power to "call on" selected officials from other ministries on an *ad hoc* basis. It consists of a Director and five staff. There are 125 inspectors throughout the administration who submit reports to the Directorate, which is responsible for ensuring the quality of their work.

Inspections are usually carried out after a request from the authorising officer of a first-level budget institution in response to concerns about fraud, corruption or bad management. They can also be carried out on foot of information from a member of the public or a whistle-blower though anonymous requests are not acted upon. All budget institutions can be subject to inspection and donor funds can also be inspected. Overall, the Directorate has received about 150 requests for investigations since its

establishment. It has considered 29 cases, completing eight inspections and with five investigations still on-going. It has taken no action in 16 cases. It has proposed 33 disciplinary measures and it has proposed 24 corrective actions to be taken.

The Directorate produces an annual report which is not officially published but is made available on request. Results are reported to the Supreme Audit Institution, the High State Control.

The Directorate has two main problems with which to contend. The first is that the powers of the Directorate under the Law on Financial Inspection are unclear, which hinders its ability to give guidance to the inspectors and to comment on reports. The second relates to the powers of the Minister of Finance as set out in the Law. It is unclear whether the Minister is limited to only providing "advice" on the results of an inspection or whether he can make "decisions" as well. In order for the Directorate to become more effective, clarifications in these areas are needed.

5.4 External audit

Legal Framework

The legal framework for external audit is provided through Articles 162-165 of the Constitution and the *Law on the High State Control 2000* which set out the legal basis for the mandate and organisation of the supreme audit institution, the High State Control (HSC). Under Article 164 of the Constitution, the HSC reports to the national Parliament. The legal basis is generally sufficient to guarantee the independence of the HSC, which as well as auditing the consolidated report for the executed budget, may audit all public sector institutions without limit and carry out all types of audits. For instance, during 2011 the HSC carried out audits in the Ministry of Defence, the Ministry of the Interior and in the General Directorate of the State Police. In recent years, there has been suggestions that the *Law on the High State Control* be amended to allow for dismissal of a chairman before his or her term of office ends. Although this has not yet been submitted formally to the parliament for consideration, even the suggestion potentially could affect the independence of the Chairman, and the HSC in general.

The Law on the High State Control requires audited institutions to take necessary measures following HSC recommendations. Furthermore, an order of the Prime Minister from 2006 requires the budget institutions to implement HSC recommendations as soon as possible and in the event of non-compliance it directs that there shall be administrative sanctions.

Role of the National Parliament

The HSC reports to the national Parliament through the Parliamentary Committee on Economy and Finance. It submits two main reports:

- An annual report of its own activities, which is submitted within three months of year end; and
- The Report on the Implementation of the State Budget, which is submitted within nine months of year end.

The Report on the State Budget is presented along with two associated reports, one containing the HSC opinions on the Government's report for expenditures of the previous year and the other a report on FMC and IA. The Chairman of the HSC and the Minister of Finance appear before the Parliamentary committee in October to discuss these reports. The Committee has the power to do the following:

- It can produce a draft Parliamentary Resolution on the HSC's annual report on its own activities that is debated and approved in plenary session;

- It can scrutinise the HSC Report on the execution of the State Budget before the Government submits to Parliament the draft law for the upcoming annual State Budget; and
- It can consider particular audit reports on specific request from a member of Parliament or the Prime Minister.

However, the HSC's relations with the Parliamentary Committee on Economy and Finance are limited to the discussion on the annual activity report of HSC and the annual report on the budget execution. The committee does not deal with individual audit reports, and ideas to establish a separate body or subcommittee to deal with those reports have not materialised. Furthermore, despite requests to do so from the Chairman of the HSC, neither the committee nor the Parliament have appointed an independent body to audit the accounts of HSC, as foreseen in the Law on the High State Control. Instead, HSC's own internal auditors audit the accounts, which is not an appropriate situation.

Structure of the HSC

The HSC currently has 156 staff, of which 110 are auditors. It has recently intensified its requests for additional funding in order to fill existing vacancies. In the past year the development of the HSC has been more intense than the previous few years when the pace of development was slow. During that time, it proved to be a challenge to maintain the level of quality achieved after the twinning project 2007-2008, and even more to further develop audit quality and audit impact.

In 2012, the HSC has reorganised itself in order to better comply with INTOSAI standards. It has established a Performance Department, a Department of Research, Development and IT and a Directorate of Audit of State Budget and of Public Financial Management. In order to carry out its mandate more effectively, it is trying to improve the quality of its auditors' work by way of internal training programmes and training offered by peer organisations and specialised training centres both within Albania and also abroad. A comparison for the first nine months of 2012 shows that there was a seven times increase in training days for the same period in 2011. The HSC has benefited from support of SIGMA as well the United Kingdom National Audit Office and the Courts of Audit in Slovenia, Poland and the Netherlands.

Audits carried out by HSC

HSC carries out all main types of audit as defined in the INTOSAI standards, but the vast majority of its audits deal with the financial inspection type of regularity/compliance issues. This is shown by table 8 below, which shows details of audits carried out between 2010 and mid-2012.

Table 8: HSC Audits by type

	2010	2011	01.01 to 30.06 2012
Performance Audit	3	1	2
Financial Audit	17	10	10
Compliance/Regularity Audit	128	132	73
Other	5	9	6
Total	153	152	91

Reports on compliance audits list non-compliance issues with all of the necessary details for the management of the entities to follow up on recommendations from HSC. The impact of audit reports therefore depends on the reaction of the auditees. The percentage of the compliance-related

recommendations implemented by auditees has increased over the years, demonstrating both a growing acceptance by auditees of the recommendations and the HSC's increased ability to provide them.

However, performance audit-related recommendations, which could increase the impact of the HSC, are still too low. Indeed, the development of performance auditing has stagnated in recent years. Performance audit was developed during a 2007-2008 Twinning project, when the number of performance audits carried out annually reached seven. The HSC recognises that further development of performance auditing is needed. However, despite a number of pilot performance audits being carried out in recent years there is a lack of information that would enable performance audits to be carried out to required international standards. It is intended to conduct a pilot performance audit of the National Statistics Office that will comply with required standards and will develop a methodology that can be used more widely. The HSC wants to follow the process used in Slovenia where 60% of 80 performance audits were IT audits. With procurement being 100% IT based and with the Treasury system being IT centred, this is important and HSC has been trying to develop skills in this area with support of SIGMA who has provided training on IT auditing.

In the area of financial audit, the audit activity has been limited since it is unclear as to whether the HSC can issue an opinion following the audit. The Constitution allows the HSC to give opinions as part of financial audits but the Law on HSC does not. The HSC is hoping that the law will be amended in early 2013 to provide such a power as it has auditors qualified to issue opinions and they have already been working on a pilot basis with some institutions in this field.

Since all public institutions and local governments, including all public enterprises or companies in which the state holds a majority interest, are subject to audit by the HSC, financial and compliance audits cannot be carried out on all subjects on an annual basis. Approximately 50% of all potential auditees are covered annually, representing around 70% of the public budget. The selection of auditees takes place on the basis of criteria covering volume of budget, number of employees, risk, and results of previous audits, with the principle of covering each bigger entity at least every two years. The most recent audit on the Execution of the State Budget used data from about 80 institutions out of 153. Furthermore, about 60 audits of local governments are done each year out of 65 municipalities and 308 communes. This approach is appropriate given the resources available to the HSC at the present time.

5.5 Conclusion

The adoption of full accrual system of accounting is less important than controlling arrears and recording commitments. Getting complete information on commitments so that arrears are stopped should be a higher priority than the adoption of full accruals in an administration that does not have the capacity to use the information a full accrual system provides.

More emphasis should be placed on practical improvements to the system of financial control and audit. While positive steps have been taken in these disciplines over the past few years, many of the steps have been in the field of legislation and regulation. This provides a basis for these disciplines but is not sufficient in itself to ensure successful implementation.

The Albanian authorities should aim to raise the level of understanding throughout the administration as to what financial management and control and managerial accountability actually mean. Despite a reasonable legal framework for the introduction of FMC and despite the efforts of the CHU/FMC in promoting the new FMC law, there is a poor understanding in Albania of what FMC and managerial accountability mean in practice. Responsibility for decision making is mainly centred on the head of the budget institution with very little delegation of tasks. This is an issue which will take time to improve as the traditional administrative arrangements cannot be changed overnight.

One step towards developing more delegation would be that the official responsible for the overall financial management and control of the finances of the spending unit ought to be positioned at the highest levels of management and report directly to the authorising officer. This is what the FMC Law of 2010 requires, but it does not happen in practice. The solution to this problem may be a redefinition of the role of the executing officer.

There should also be emphasis on achieving performance targets within budget limits in the budget institutions. This does not happen currently since the focus of reporting is mainly financial and does not contain information about management performance. Despite the work that has been invested in improving the Treasury system over the past decade, it continues to exist as an accounting system for transaction control, cash-flow management, and formal accounting and budget reporting purposes.

In the field of internal audit, the internal audit units need more practical guidance to do their work more effectively. Therefore, the relatively recent formal cooperation agreement between the Minister of Finance and the HSC, which became effective in May 2012, and the strategy for the training and certification of internal auditors that is currently being developed by CHU/IA with the support of SIGMA are both positive developments. However, these are both at the early stage and it is too early to say how effective they will be. Furthermore, the CHU/IA could ensure that the implications of internal audit for financial management and control policy are reflected in the training of internal auditors as this is not being done already.

The Law should be amended to clarify the role of the Directorate of Public Financial Inspection and also the Minister of Finance with regard to financial inspections. Despite the likelihood that the establishment of the Directorate should see a reduction in the cases of internal audit units being asked to carry out financial inspection type activities (especially as it become more well-known), there are still cases where this is happening. This should be investigated and the Directorate and the CHU/IA if necessary should put an emphasis on training top management of public institutions such as ministers, general secretaries and their deputies, directors of agencies, heads of directorates and heads of departments, in the objectives of internal audit. Managers should be aware as to the difference between an internal audit unit providing top management with advice about corrective actions and the top management taking responsibility for ensuring that the necessary corrective action is implemented.

The HSC should move beyond a concentration on regularity/compliance audit. The HSC recognises this, and is taking steps to improve its capacity for performance audit but it eventually will need to save resources on compliance audit by reducing the audit procedures and by applying professional audit sampling techniques.

Finally, an independent body to audit the accounts of HSC should be appointed by the Parliament as foreseen in the Law on HSC.

APPENDIX: SUMMARY OF RECENT REVIEWS OF ALBANIA

Debt Management Performance Assessment (DeMPA), Albania, June 2011.

A World Bank team conducted an assessment of Albania's debt management performance in November 2010. It found in summary that "Albania stands out as one of the few (countries) which has sound debt management practices in the largest number of areas defined by the DeMPA methodology." Debt management is particularly strong in the areas of governance, strategy development, coordination with fiscal and monetary policy and domestic market borrowing. Areas for improvement are external borrowing and some parts of operational risk management framework. There is no systematic tracking of foreign holding of the government securities issued in the domestic market.

Albania 2012 Progress Report, European Commission Staff Working Paper, Brussels, 12.10.2012.

In October of 2010 the European Commission adopted a progress report on enlargement of the EU. The EC recommended that Albania be granted EU candidate status subject to completion of key measures in the areas of judicial and public administration reforms and the revision of parliamentary rules of procedure. The report further found that Albania needed to develop tools to fight against tax evasion and fraud. Overall it viewed Albania's financial and budgetary provisions to be at an early stage.

Public Expenditure and Financial Accountability Assessment (PEFA) 2011, Allan Gustafsson, Andy Macdonald and Antonin Braho, January 2012.

The PEFA report is the second PEFA assessment of Albania's public finances; the first was done in 2006. The assessment found that "The Government of Albania had made significant progress across a wide range of the performance indicators since the 2006 assessment." Highlights of the findings include:

- *Credibility of the budget* – GDP and revenue forecasts have been consistently over-optimistic. Differences between budgeted and actual expenditures were rated as "A"; differences between budgeted and actual revenue as "D". Revenue estimates were not credible, anecdotal evidence of arrearages .
- *Comprehensiveness and transparency* – Budget information is not sequenced well to support Parliament.
- *Policy based budget* – Government has made considerable effort to integrate planning and budget processes; undermined by external shocks and Government's response to the shocks. Expenditure targets for investment programs have been set at overly optimistic levels despite past poor performance.
- *Predictability and control in budget execution* – Substantial improvements in revenue collection, controls on non-payroll expenditures are primarily ex-ante voucher checking with little internal audit, procurement has been fundamentally altered since the 2006 assessment. Internal control and internal audit require time and patience to improve.

2011 Article IV Consultation, Albania – IMF Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Albania.

The August 2011 IMF staff report found that Albania required more realistic budgeting and recommended an expenditure-based fiscal rule tied to public debt reduction over the medium term.

Improving and Integrating Cash and Debt Management, IMF, Fiscal Affairs Department, Albania, December 2012.

Albania has taken several steps to improve its cash and debt management. The credibility of the annual budget is particularly hampered by an optimistic bias in the revenue assumptions. Commitments that are not covered by appropriations lead to arrears that distort cash management. At present, no effective cash plans are produced by Treasury to assist in cash management. Revenue agencies must be encouraged to provide realistic cash plans. The Ministry of Finance should ensure that line-ministries develop reliable baseline estimates and present consistent baseline estimates in the medium term budget documents.

Support for Improvement in Governance and Management: OECD SIGMA Assessment, March 2012.

The basic administrative legal framework and civil service system are in place, but have many shortcomings, among them:

- *The organization of the central administration is too fragmented.* The current civil service law does not promote a merit system.
- *The Integrated Planning System at the heart of the public expenditure management is complex, but in practice inefficient.* The planning system leads to a lot of paperwork and may overtax the limited staff available.
- *The difference between baselines and ceilings is not understood.* Baselines should be empirical estimates of the future costs of current policy and ceilings should be normative constraints on future expenditures. There is a lack of control of baseline estimates both inside line ministries and in the Ministry of Finance.
- *A legal framework for Public Internal Financial Control is in place.* Internal audit is separated from financial inspection, but ministers and mayors still request confuse the two functions.

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NOTES

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- ¹ The source of the map is the World Factbook (CIA 2012).
- ² The percentages are estimates made by the World Factbook (CIA 2012); there are no available current statistics on religious affiliation; all mosques and churches were closed in 1967 and religious observances prohibited; in November 1990, Albania began allowing private religious practice.
- ³ Based on The World Factbook (CIA 2012) and Country report on Albania (The Economist Intelligence Unit, 4Q 2012).
- ⁴ Based on the Albania 2012 Progress report by the European Commission, Staff working document, Brussels, October 2012.
- ⁵ Based on the Economic and Fiscal Programme 2012-14 (Ministry of Finance, Albania, February 2012); the Albania 2012 Progress Report, European Commission, October 2012; and the Public Expenditure and Financial Accountability Assessment (PEFA) 2011 (Gustafsson, Macdoba and Braho, January 2012).
- ⁶ The volume index of GDP per capita in Purchasing Power Standards (PPS) is expressed in relation to the European Union (EU-27) average set to equal 100. Basic figures are expressed in PPS, i.e. a common currency that eliminates the differences in price levels between countries allowing meaningful volume comparisons of GDP between countries (Eurostat).
- ⁷ Based on the Albania 2012 Progress Report, European Commission, October 2012.
- ⁸ This section is based on the Economist Intelligence Unit's country report 4Q 2012, the PEFA report 2011 and the Albania 2012 Progress report, European Commission, October 2012.
- ⁹ Based on the Albania 2012 Progress report, European Commission, October 2012 and the Economist Intelligence Unit's country report 4Q 2012.
- ¹⁰ Commission Staff Working Document: Albania 2012 Progress Report, European Commission, 10.10.2012. The EU acquis is the accumulated legislation, legal acts, and court decisions that constitute the body of European Union Law.
- ¹¹ IMF Article IV Consultation, October 2011. See "Box. 3. Public Finance Sustainability and Options for Fiscal Rules in Albania".
- ¹² Albania – Public Expenditure and Financial Accountability Assessment (PEFA) 2011, see page 9.
- ¹³ Ibid. Page 30.
- ¹⁴ <http://www.osce.org/albania/41888>, 1998 Constitution of the Republic of Albania, text approved by referendum on November 22, 1998 and amended on January 13, 2007; translated under the auspices of OSCE –Albania.
- ¹⁵ Chapter III, "Consideration of Budget Bill and Financial Law".
- ¹⁶ Article 19, Rules of Procedure of the Republic of Albania.
- ¹⁷ Von Trapp/Jason: Background notes on Committee Structures for Budget Approval and Oversight/Interim Financial Reporting (OECD), p. 5. [http://search.oecd.org/officialdocuments/displaydocumentpdf/?cote=GOV/PGC/SBO\(2011\)6&doclanguage=en](http://search.oecd.org/officialdocuments/displaydocumentpdf/?cote=GOV/PGC/SBO(2011)6&doclanguage=en)
- ¹⁸ Schick, The Legislature's Budget Role – No longer fully dependent, not yet independent <http://www.oecd.org/gov/budgetingandpublicexpenditures/42464324.pdf>
- ¹⁹ Article 35, Rules of Procedure.
- ²⁰ Von Trapp/Jason: Background notes on Committee Structures for Budget Approval and Oversight/Interim Financial Reporting (OECD), p. 9.
- ²¹ See: Albania, Public Expenditure and Financial Accountability Assessment (PEFA) 2011, p. 109, 110.
- ²² According to Article 29 of the organic budget law, the Minister of Finance shall provide a statement to the Assembly, including a list of spending units according to the general government units to which they depend;

respecting and implementing correctly the principles described in article 4 of this law by the annual budget and the medium term budget programme; harmonization of debt stock and forecasts with the objective of fiscal stability; fiscal risks and measures of protection; contingent liabilities of the general government and the probability of becoming liabilities in the following budget year.

²³ Article 80, Rules of Procedure.

²⁴ Albania, Public Expenditure and Financial Accountability Assessment (PEFA) 2011, p. 110.

²⁵ Article 81 (IV), Rules of Procedure says that the report must contain a complete evaluation of the entire structure of the bill like the macroeconomic indicators, the main indicators, the incomes and planned expenses, financing and their accomplishment according to the program of the Council of Ministers.

²⁶ Organic Budget Law, No. 8379 Date 29 July 1998 on the Preparation and Execution of the State Budget of the Republic of Albania; <http://www1.worldbank.org/publicsector/pe/BudgetLaws/AlbaniaOrganicBudget1998.pdf>

²⁷ It contains:

- annual consolidated accounts for state financial transactions;
- a report on the implementation of the annual budget according to approved funds;
- a report on public debt and its composition;
- a report on the use of the reserve and contingency funds;
- information on achievement of objectives, status of financial management and internal control, as well as an internal audit.

²⁸ Albania, Public Expenditure and Financial Accountability Assessment (PEFA) 2011, p. 112.

²⁹ Albania, Public Expenditure and Financial Accountability Assessment (PEFA) 2011, p. 112.

³⁰ Law on State Borrowing, State Debt and State's Loan Guarantees in the Republic of Albania (9665/2006) and On the Management of Foreign Financing in the Republic Of Albania, (775/2010).

³¹ The Monitoring Reports includes 5 different tables:

- Factual programme expenditures reported by line items
- Outputs factual materialisation
- Factual expenditures of products
- Budget investments (projects) factual expenditures
- Foreign investments (projects) factual expenditures
- Total factual expenditures by programs

³² Line ministries in Albania: Agriculture & food; Defence; Economy, trade & energy; Education & science; Environment & water; European integration; Finance; Foreign affairs; Health; Internal affairs; Justice; Labour & equal opportunities; Public works, transport & telecommunications; Tourism, culture, youth & sport.

³³ The Government effectiveness indicator captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies. The Worldwide Governance Indicators (WGI) are a research dataset summarizing the views on the quality of governance provided by a large number of enterprise, citizen and expert survey respondents in industrial and developing countries.

³⁴ The legal foundation for public procurement in Albania is the Law on Public Procurement (LPP) No. 9643 of 2006, with two amendments in 2007, one in 2009, culminating with amendment no.10309 of July, 2010.