

Albania:**Public Expenditure and Financial Accountability
(PEFA) Public Financial Management Assessment¹****July 2006****Government of Albania and the World Bank**

¹ This Assessment is prepared as a part of Country Fiduciary Assessment Update (CFA) and Public Expenditure and Institutional Review (PEIR)

**Albania - Public Expenditure and Financial Accountability (PEFA) Public
Financial Management Assessment**

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Foreword

There is wide agreement that effective institutions and systems of public financial management (PFM) have a critical role to play in supporting implementation of policies of national development and poverty reduction. The PEFA PFM Performance Measurement Framework has been developed as a contribution to the collective efforts of government, donors and other stakeholders to assess and develop essential PFM systems by providing a shared information pool for measurement and monitoring of PFM performance and a common platform for dialogue.

The PFM Performance Measurement Framework is an integrated monitoring framework that allows measurement of country PFM performance over time. It has been developed through concerted international effort by PEFA partners in collaboration with the OECD/DAC Joint Venture on PFM.² The framework incorporates a set of high level indicators which draw on HIPC expenditure tracking benchmarks, the IMF Fiscal Transparency Code and other international standards, and a PFM Performance Report that provides information on PFM performance as measured by the indicators. The Performance Measurement Framework identifies the critical dimensions of performance of an open and orderly PFM system for all countries based on a set of high-level indicators which measure the operational performance of key aspects of PFM systems, processes and institutions. It uses the indicator analysis to develop an integrated assessment of the PFM system against the critical dimensions of PFM performance and evaluates the likely impact of PFM weaknesses on the three levels of budgetary outcomes: aggregate fiscal discipline, strategic allocation of resources, and efficiency of service delivery.

The PFM Performance Report recognises efforts by government to reform its PFM system by describing recent and on-going reform measures which may or may not yet have impacted on PFM performance. The report does not, however, include any recommendations for reforms or any assumptions about the likely impact of on-going reforms on PFM performance.

The focus of the PFM indicator set is on PFM performance at central government level, including the related central institutions of oversight. The framework does not measure factors impacting on performance (such as capacity of institutions or the legal framework) nor does it involve fiscal or expenditure policy analysis. This would require

² PEFA (Public Expenditure and Financial Accountability) is a multi-agency partnership programme sponsored by the World Bank, the International Monetary Fund, the European Commission, The UK's Department for International Development, the French Ministry of Foreign Affairs, the Royal Norwegian Ministry of Foreign Affairs, the Swiss State Secretariat for Economic Affairs, and the SPA Strategic Partnership for Africa.

detailed country-specific data analysis. Instead, the framework focuses on the extent to which the PFM system is an enabling factor for the achievement of policy outcomes.

Finally, this report is prepared as a part of Country Fiduciary Assessment (CFA) and Public Expenditure and Institutional Review (PEIR) from the period of June 2005 and June 2006. The World Bank team consists of Junghun Cho, Johannes Stenbaek Madsen, Olav Christensen, Devesh Chandra Mishra, Alia Moubayed, Belita Manka, and Elona Gjika. The team worked closely with the Ministry of Finance including key departments such as the Treasury, Budget, Accounting, and General Directorate of Internal Audit (GDAI). The team also cooperated closely with the Supreme State Audit (SSA). Meetings were held with the DFID team that are supporting the further development of the MTBP and the EU team supporting the internal control and internal audit as well as the team that supported the SSA. When possible the meetings with the government counterparts were held with the participation of the PEIR team and often both FM and Procurement held joint meetings with the government representatives.

Objectives

The overall objective of the PFM assessment is to develop an up-to-date picture of the quality of the PFM system in Albania and to establish a baseline for monitoring the progress of PFM reforms in future. While standard coverage of PEFA assessment is expenditures incurred at the central government, this assessment also include local government expenditures as they are captured by the treasury system includes also the local government.

The assessment will also provide the basis for fiduciary risk analysis of the World Bank in preparation of budget support programs. It will also facilitate forthcoming discussions between the Government and its development partners on PFM reform.

Framework of Assessment

The Performance Measurement Framework identifies six critical dimensions of performance of an open and orderly PFM system which are as follows³:

- i. **Credibility of the budget** - The budget is realistic and is implemented as intended.
- ii. **Comprehensiveness and transparency** - The budget and fiscal risk oversight are comprehensive and fiscal and budget information is accessible to the public.
- iii. **Policy-based budgeting** - The budget is prepared with due regard to government policy.
- iv. **Predictability and control in budget execution** - The budget is implemented in an orderly and predictable manner and there are arrangements for the exercise of control and stewardship in the use of public funds.

³ These core dimensions have been determined on the basis of what is both desirable and feasible to measure and define the nature and quality of the key elements of a PFM system captured by the set of high-level indicators.

- v. **Accounting, recording and reporting** – Adequate records and information are produced, maintained and disseminated to meet decision-making control, management and reporting purposes.
- vi. **External scrutiny and audit** - Arrangements for scrutiny of public finances and follow up by the executive are operating.

The six critical dimensions of performance (or pillars) cover the following indicators: (I) Credibility of the budget (Indicators 1-4); (II) Comprehensiveness and transparency (Indicators 5-10); (III) Policy-based budgeting (Indicators 11-12); (IV) Predictability and control in budget execution (Indicators 13-21); (V) Accounting, recording and reporting (Indicators 22-25); (VI) External scrutiny and audit (Indicators 26-28).

However, this report does not provide assessment on indicator 13, 14, and 15, which are related to revenue administration as the Team did not have sufficient information to assess these areas.

Summary Assessment

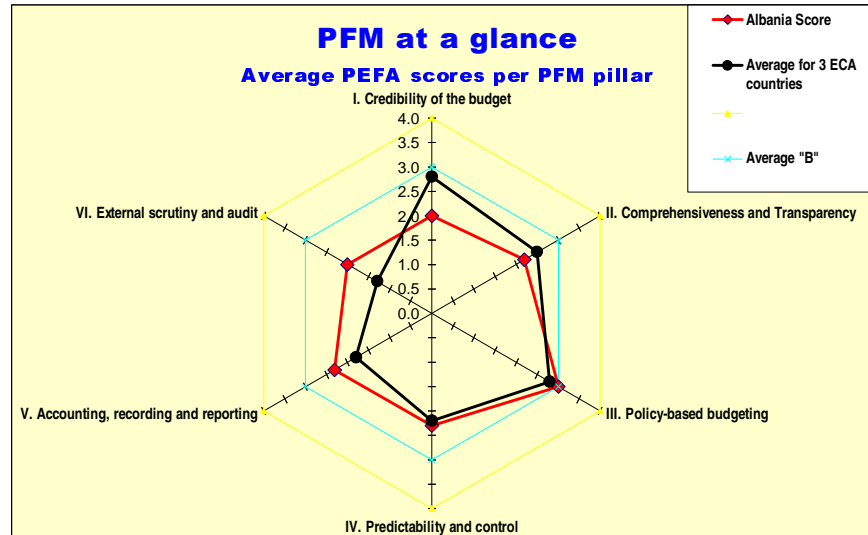
	INDICATOR	2005/6
Budget Credibility		
1	Aggregate Expenditure Outturn compared to approved budget	B
2	Composition of expend. outturn compared to approved budget	D
3	Aggregate revenue outturn compared to approved budget	B
4	Stock and monitoring of expenditure payment arrears	D
Transparency and Comprehensiveness		
5	Classification of the budget	A
6	Comprehensiveness of information in budget documentation	C
7	Extent of unreported government operations incl. donor funds	D+
8	Transparency of Intergovernmental Fiscal Relations	C+
9	Oversight of aggregate fiscal risk	C+
10	Public access to key fiscal information	B
Policy-based Budgeting		
11	Orderliness and participation in the annual budget process	A
12	Multi-year perspective in fiscal policy, planning, & budgeting	C
Predictability and Control in Budget execution		
13	Transparency of taxpayer obligations and liabilities	N/A
14	Effectiveness of taxpayer registration and tax assessment	N/A
15	Effectiveness in collection of tax payments	N/A
16	Effectiveness of cash flow planning, mgt. & monitoring.	C+
17	Recording & management of cash balances, debt and guarantees	B
18	Effectiveness of payroll controls	B+
19	Competition, value for money and controls in procurement	D+
20	Effectiveness of internal controls.	B
21	Effectiveness of internal audit	C+
Accounting, Recording and Reporting		
22	Timeliness and regularity of accounts reconciliation	B (provisional)

	INDICATOR	2005/6
23	Availability of resource info received by service delivery units	D
24	Timeliness, quality and dissemination of in-year exec. reports.	C+
25	Timeliness of audited fin. statements submitted to legislature.	B+
External Scrutiny and Audit		
26	The scope, nature and follow up of external audit reports.	C+
27	Legislative scrutiny of the annual budget law	B+
28	Legislative scrutiny of external audit reports.	C+
Donors-related PFM system		
D-1	Predictability of direct budget support	D
D-2	Financial information on projects	C
D-3	Proportion of aid managed by national procedures	D

Credibility of the budget ranks fairly low in Albania. This means that the budget is not an adequate managerial tool to reflect government’s priorities and secure smooth operational performance⁴. Due to too optimistic budget forecasts, unpredictability of investment spending, and poor cash planning, the budget is not implemented as planned. Significant reallocations during budget implementation (as reflected by an average of 20,000 virements annually) result in ad-hoc spending, including in procurement. It is most important and urgent to strengthen budget credibility by improving macro and fiscal forecasting, the budget preparation process (particularly in procurement), and considerably strengthen cash flow planning before and during budget execution setting realistic and manageable cash allotment ceilings. Once cash flow planning is improved, discipline will be essential in enforcing these ceilings. Similarly, discipline in budget execution also implies committing expenditure based on available resources. To that effect, the Ministry of Finance needs to be able to track and control commitments by line ministries.

Budget comprehensiveness and transparency is deficient. To bring Albania to the next level of performance, there is a need to make more information available to the public and Parliament in connection with the presentation of the annual budget, including information on debt financing, debt stock, financial assets and on current and prior year’s outturn. Because donor funded projects are not fully reflected in the Government’s fiscal reporting, budget execution data are inconsistent and the basis for annual budget planning poor. Donor funds should therefore be included in the standard fiscal reports. Finally, it is recommended that central monitoring of public enterprises and sub-national government debt be strengthened

⁴ These issues are addressed in full in the PEIR.



While Albania is at par with the regional comparison group on the PFM dimensions related to predictability and control in budget execution, deep problems in cash management need to be addressed before an orderly and predictable budget execution can be ensured. Already mentioned above, very frequent in-year reallocations or “virements” persist. While the first objective is to reduce the need for reallocations, it is also important to introduce transparency to both Parliament and the public into the reallocation process by undertaking it in connection with a formal midyear review. More importantly, controls on budget execution are weak, increasing risks to the government’s funds. This issue will partly be addressed with the implementation of an ongoing modernization of the Treasury system leading to improvements in payroll, cash and debt management. While the internal control system is moderately satisfactory, the nascent modern internal audit system is in need of additional support to become fully operational. To strengthen internal audit, it is recommended that procedures for the systematic follow-up of internal audit recommendations be put in place. To improve financial controls in general it is also recommended that detailed written procedures be developed in line with the Government’s Public Internal Financial Control policy paper.

In a regional comparison, Albania seems to be doing relatively well on the PFM performance dimensions related to Accounting, Recording and Reporting. However, to achieve an average score on this transparency dimension, improvements are needed in the comprehensiveness and consistency of financial reporting (depending for the most part on progress in the ongoing modernization of the Treasury system). The system should allow for central capturing and reporting on commitment, resources received by basic service providers, and in the long-run, it should allow accounting for all essential government assets and liabilities.

On the External Scrutiny and Audit PFM dimension, Albania’s performance appears weak. Particularly important to strengthening accountability is the follow-up by Parliament and government on the findings by the Supreme Audit institution, the SSA. More time should be allowed for Parliament to review the annual budget law and to formalize the actions required in following up on the audit reports from the Supreme

Audit Institution, the SSA. Involvement by the government in hearings on findings by the SSA should increase.

Assessment of the PFM system

This section provides an assessment of the key elements of the PFM system, as captured by the indicators, and to report on progress made in improving those.

1. Budget Credibility

Indicator 1: Aggregate Expenditure Outturn compared to original approved budget

The ability to implement the budget as originally approved is an important factor in supporting the Government's ability to deliver public services for the year as expressed in the programmes and work plans. This performance indicator compares originally approved total expenditure of the budget with actual expenditure for the last 3 fiscal years (2002, 2003, 2004). The indicator excludes from its definition of expenditure (i) debt service payments, and (ii) donor funded project expenditure, since these two categories may change for reasons beyond the control of government. According to the Ministry of Finance, the difference between budgeted and actual expenditures (excluding debt service payments and foreign financed expenditure) was as follows: 2002 - +7.38%, 2003 - +6.0.8%, 2004 - +1.27%. It is believed that MTBP, which has been in place since 2000, has contributed to maintain fiscal sustainability. According to the guidance, these figures would produce a score of **(B)** for this indicator.

	2002 Approved Budget	2002 Actual Expenditure	2003 Approved Budget	2003 Actual Expenditure	2004 Approved Budget	2004 Actual Expenditure
A. Total Expenditure	212,283	192,517	223,420	201,153	240,360	222,715
Of which interest	25,085	24,762	27,050	29,823	31,082	28,423
Of which externally financed project expenditure	26,500	18,921	27,961	13,167	23,591	10,967
B. Total Expenditure less interest and externally financed expenditure	160,698	148,834	168,409	158,163	185,687	183,325
C. Difference (approved vs actual)	-11,864		-10,246		-2362	
Difference (%)	-7.38%		-6.08%		-1.27%	

(WB calculated from Albanian budgets and annual reports, 2002-2004)

Indicator	Brief Explanation	Rating
1. Aggregate Expenditure Outturn compared to original approved budget	Aggregate deviation has declined since 2002, from 7.3% to 1.27%.	B

Indicator 2: Composition of expenditure outturn compared to original approved budget

When the composition of expenditure varies considerably from the original budget, the budget will not be a useful statement of policy intent, As an administrative level of expenditure composition is preferred by PEFA guidance and is available in Albania, the assessment is based on administrative composition.

Expenditure deviation across the 52 budgetary heads shows that the absolute value of the deviations as a percentage of total primary expenditure was as follows: 17.9% in 2002, 17.2% in 2003, and 9.8% in 2004. Deducting these percentages from the overall primary expenditure deviation for each year (shown in indicator 1), as required by the PEFA methodology, provides the following absolute measures by which variances in expenditure composition exceeded overall expenditure variance: 2002 – 10.5%, 2003 – 11.1%, 2004 – 8.5%..⁵ The degree of deviation, as is the case with aggregate deviation, has declined over the time.

Table 5 - Results Matrix			
	for PI-1		for PI-2
year	total exp. deviation	total exp. variance	variance in excess of total deviation

⁵ Information and calculations supplied by Ministry of Finance

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2001/02	7.4%	17.9%	-10.5%
2002/03	6.1%	17.2%	-11.1%
2003/04	1.3%	9.8%	-8.5%

Indicator	Brief Explanation	Rating
2.Composition of expenditure outturn compared to original approved budget	The variance in expenditure composition by administrative basis exceeded the overall deviation in primary expenditure by more than 10 percentage points in two out of the last three fiscal years.	D

Indicator 3: Aggregate revenue outturn compared to original approved budget

Accurate forecasting of domestic revenue is a critical factor in determining budget performance, since budget expenditure allocations based upon this forecast. A comparison of budgeted and actual revenue provides an overall indication of the quality of revenue forecasting. Total revenue collection as a percentage of the original approved revenue budget was as follows for each of the last three fiscal years: 94.4% in 2002, 93.7% in 2003, and 95.1% in 2004

	Budget 2002	2002 (actual)	Budget 2003	2003 (actual)	Budget 2004	2004 (actual)
Total Revenue	159,425	154,595	180,410	167,225	198,052	184,581
Of which foreign revenue	0	4,119	4,644	2,617	6,622	2,616
Total Domestic Revenue	159,425	150,476	175,766	164,608	191,430	181,965
Of which Revenue from tax and customs	98,088	115,174	108,778	125,592	123,082	98,088
Of which Revenue from local gov't	5,900	5,224	8,054	7,923	11,344	9,613
Of which Social insurance contribution	26,087	25,637	30,659	28,688	33,688	33,262
Of which Others	20,538	21,528	21,879	19,219	20,806	16,007
Actual/Budget (total domestic)		94.4%		93.7%		95.1%

(Source: Marco Department of Ministry of Finance)

Indicator	Brief Explanation	Rating
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3. Aggregate revenue outturn compared to original approved budget	Actual domestic revenue collection was below 94% of budgeted domestic revenue collection only in one of the last three fiscal years.	B
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Indicator 4: Stock and monitoring of expenditure arrears

A high level of arrears can indicate a number of different problems such as inadequate (or lack of) commitment controls, cash rationing, inadequate budgeting for contracts, under-budgeting of specific items and lack of information. Payment arrears include outstanding payment that is due under specific legal obligation but unpaid; salaries, pensions, suppliers, services, rents, interest on domestic and foreign debt.

In terms of payment on salaries and social insurance, there is no payment arrears. In terms of payment on goods and services provided, there is no system to keep track of government obligation and payment because MoF Treasury department doesn't have commitment control system and only account transactions on a cash basis, thus, unable to know when and how much line ministries incur obligations with vendors. Improvement in the monitoring of arrears by the Ministry of Finance depends on modernisation of the treasury system. Currently, the treasury system does not allow for capture and recording of information at the commitment stage. This prevents efficient expenditure management and control. The introduction of a commitment accounting system is required to generate timely information on payment arrears. This is part of a Treasury Modernisation project currently under finalization supported by the World Bank. On the other hand, financial statements have been prepared on modified accrual basis, which include accounts payable (arrears and other obligations) information. Neither internal nor external audit certifies the statements and it is noted to have significant inconsistency.

Indicator	Brief Explanation	Rating
4. Stock and monitoring of expenditure payment arrears	Little payment arrears exist in salaries and social insurance. But no monitoring is in place for contract-related arrears due to lack of commitment control	D

2. Transparency and Comprehensiveness

Indicator 5: Classification of the budget

A robust classification system allows the tracking of spending on the following dimensions; administrative unit, economic, functional and programs.

As a part of treasury modernization efforts under World Bank-funded PARP, Government of Albania has revised budget classification and chart of accounts in 2005. The new classification system has the following categories:

- (i) Administrative, for accountability and budget administration;
- (ii) Functional, for historical analysis and policy analysis;
- (iii) Programs, for the formulation of policies and accountability performance.
- (iv) Funds, for budget administration;
- (v) Economic categories, for statistical reports and control on fiscal situation;
- (vi) Objects, for control and internal management;

The administrative classification system maintains the institutional hierarchy and thereby permits both planning for and tracking of budgetary resource usage. Following the current structure of the National Government of Albania, there are over 2000 spending units and over 300 local institutions. The new system also merges current 14 functions into 10 high level functions (and 69 sub-functional level), which is in conformity with COFOG standard.

Old Functional Classification	New Functional Classification
01. General public services	01. General Public Service
02. Defence	02. Defense
03. Public Order and Security	03. Public Order and Safety
04. Education	04. Economic Affairs
05. Health	05. Environmental protection
06. Security and Social Assistance	06. Housing and Community Amenities
07. Shelter and Communal Services	07. Health
08. Entertainment, Culture, and Religious Issues	08. Recreation, Culture, and Religion
09. Energy	09. Education
10. Agriculture, Forestry, Fishing and Hunting	10. Social Protection
11. Mineral Resources	
12. Transport and Communications	
13. Other Economic Services	
14. Other Expenditures	

The 'program' classification is located under sub-functional level and shows the planned budgetary allocations to specific program (i.e., Function – Sub-function – Program). Actual number and concrete boundary of program is now under review, as a part of MTBP Policy and Programming Review. It is noted that as the new budget classification and chart of accounts was introduced in late 2005 and adopted for 2006 Budget preparation. However, it is yet to be tested whether actual transactions will be appropriately classified into each category (e.g., bringing Ministry of Defense budget into Defense function from General Service Function)

Indicator	Brief Explanation	Rating
5. Classification of the budget	Budget includes administrative, economic, and functional classification of expenditures. Functional classification is in conformity with	A

	COFOG standard and sub-functional levels. Program classifier is located under sub-function. Yet, recording transactions with new classification system is yet to be tested.	
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Indicator 6: Comprehensiveness of information included in the budget

Annual budget documentation (the annual budget and budget supporting documents), as submitted to the legislature for scrutiny and approval, should allow a complete picture of central government fiscal forecasts, budget proposals and out-turn of previous years. According to the PEFA Guidelines, the annual budget documentation should include information on 9 elements as follows:

- i. **Macro-economic assumptions, including at least estimates of aggregate growth, inflation and exchange rate:** Macro-economic assumptions including GDP growth, inflation and exchange rate are included in the budget even though the quality of analysis could be improved further. **(Satisfied)**
- ii. **Fiscal deficit, defined according to GFS or other internationally recognized standard:** Fiscal deficit is defined according to GFS standard. **(Satisfied)**
- iii. **Deficit financing, describing anticipated composition:** Composition of deficit financing is only divided into foreign and domestic financing. **(Satisfied)**
- iv. **Debt stock, including details at least for the beginning of the current year:** No information provided. **(Unsatisfied)**
- v. **Financial Assets, including details at least for the beginning of the current year:** No information is provided. **(Unsatisfied)**
- vi. **Prior year’s budget outturn, presented in the same format as the budget proposal:** No information on prior year’s budget outturn is presented. **(Unsatisfied)**
- vii. **Current year’s budget (either the revised budget or the estimated outturn), presented in the same format as the budget proposal:** Actual spending until September is presented only at the consolidated level (e.g., expenditure and revenue by types for whole government). **(Unsatisfied)**
- viii. **Summarized budget data for both revenue and expenditure according to the main heads of the classifications used (ref. PI-5), including data for the current and previous year:** Budget is presented by administrative classification and contains only domestic, foreign and total expenditure information. It doesn’t contain expenditure information by function nor economic classification. While MTBP document contains expenditure forecast by economic, administrative and

functional classification, it sometimes deviates from annual budget and is not a binding document, thus, doesn't qualify as a substitute. **(Unsatisfied)**

- ix. **Explanation of budget implications of new policy initiatives, with estimates of the budgetary impact of all major revenue policy changes and/or some major changes to expenditure programs:** No information on policy initiatives nor policy changes is provided in annual budget. While MTBP has sections to provide these information, it is still rudimentary also not qualify as a substitute. **(Unsatisfied)**

Indicator	Brief Explanation	Rating
6. Comprehensiveness of information included in budget documentation	The 2005 budget documentation satisfies 3 of the requirements for information from the 9 listed by PEFA	C

Indicator 7: Extent of unreported government operations

Annual budget estimates, in-year execution reports, year-end financial statements and other fiscal reports for the public, should cover all budgetary and extra budgetary activities of central government to allow a complete picture of central government revenue, expenditures across all categories, and financing. According to the PEFA Guidelines, the following dimensions are to be assessed;

- i) **The level of unreported extra-budgetary expenditures:** Albania has only two extra budgetary funds; Social Insurance and Health Insurance. Both of them are fully incorporated into annual budget and end-of-year financial statement **(score: A)**
- ii) **Income/expenditure information on donor-funded projects which is included in fiscal reports:** Foreign financing figures are seriously underestimated in the Treasury accounts. Both poor recording by the Government and poor coordination by donors have been attributed for **(score D)**.

Indicator	Brief Explanation	Rating
7. Extent of unreported government operations including those funded by donors.	While extra budgetary funds are appropriately accounted for, donor-financed projects are very poorly recorded, resulting in data inconsistency and poor planning	D+

Indicator 8: Transparency of inter-governmental fiscal relations

Sub-national governments (SNG) in many countries have wide-ranging expenditure responsibilities. Clear criteria, such as formulas, for the distribution of grants among SNGs and between central Government and SNG are needed to ensure allocative transparency and medium-term predictability of funds available for planning and budgeting of expenditure programs by SNGs.

The system of revenue assignment in Albania has experienced a major overhaul, which started with the introduction of new local tax, charges, and fee legislation in December 2002. In 2003, local governments' consolidated budgets have been responsible for as much as one-fourth of total government expenditures. The existing local government expenditure consists of conditional transfer, block/unconditional transfers and tax and non-tax own revenue. Trend clearly shows a gradual shift in the direction and structure of public expenditure from conditional transfers to unconditional (independent) transfers.⁶

- i. **Transparency and objectivity in the horizontal allocation among SNGs:** Mechanism for conditional grants, which consist of 75% of total local revenue in 2003, still keeps the features inherited from the old command economy of non-transparency, being unpredictable and depending basically on the bargaining (bureaucratic and political) powers between local authorities and line ministries. The unconditional grant, which consist only about 10% of local government revenue in 2003, was initiated with a provisional formula for distribution based on differential local needs and is evolving toward a true equalization transfer. Nevertheless, the determination of the size of the unconditional grant is not yet transparent and predicable (**score: C**).
- ii. **Timeliness of reliable information to SNG on their allocations:** SN governments are informed of their allocation from transfers from central government only in February of fiscal year. The Annual Budget approved by the Parliament only has aggregate amount to be transferred to all SN governments without allocation to specific SN governments. This in fact seriously undermines planning and executing capacity of SN governments (**score: D**).
- iii. **Extent of consolidation of fiscal data for general government according to sectoral categories:** By March, each local government submits to MoF the final statement of accounts, which are integrated into the national budget's final statement of accounts presented to the Council of Ministers and Parliament for approval. In addition, each local government submits quarterly spending reports to MoF. Fiscal information on SN governments has consistent format (e.g., functional and economical classification) that allow timely consolidation (**score: A**).

⁶ Albania: Decentralization in Transition, August 2004, World Bank

Indicator	Brief Explanation	Rating
8. Transparency of Intergovernmental Fiscal Relations	SN governments suffered from delayed information of transfers and unclear allocation mechanism on conditional grants. On the other hand, SN governments are obliged to provide actual spending reports in a timely and consistent manner	C+

Indicator 9: Oversight of aggregate fiscal risk from other public sector entities

Central government will usually have a formal oversight role in relation to other public sector entities and should monitor and manage fiscal risks with national implications arising from activities of sub-national (SN) levels of government, autonomous government agencies (AGA) and public enterprises (PE), including state-owned banks, but may also for political reasons be obliged to assume responsibility for financial default of other public sector entities, where no formal oversight role exists.

- i. **Extent of central government monitoring of AGAs and PEs:** AGAs and PEs submit financial statements to Ministry of Economy Trade and Energy annually. The public enterprises are required by the Law on the Commercial Companies, amended in 1995, to send audited financial statements to the Ministry. In addition, for the PEs with more than 20 million lek in capital there is the requirement to appoint two auditors. For the AGA there is no such requirement; the only obligation is to submit to the Ministry the annual financial statements, which are checked for their accuracy by an appointed specialist within the Ministry (**score: C**).
- ii. **Extent of central government monitoring of SN governments' fiscal position:** At this point, no SN governments are allowed to generate fiscal liabilities without central government consent. Only exception made is to Tirana Municipalities, where Council of Europe Bank made a credit agreement with central government and central government made an on-lending to Tirana. Currently, law on local government finance is being drafted to allow SN governments to borrow, but only with central government approval or guarantees (**score: A**).

Indicator	Brief Explanation	Rating
9. Oversight of aggregate fiscal risk from other public sector entities	While central government closely monitoring SN governments' fiscal position and no contingency liability is incurred. However, PE and AGA's financial statements are not properly monitored, thus, poses potential contingent liability to government	C+

Indicator 10: Public access to key fiscal information

Transparency will depend on whether information on fiscal plans, positions and performance of the government is easily accessible to the general public or at least the relevant interest groups. The PEFA guidelines identify 6 types of information to which public access is essential, as discussed below:

- i. **Annual budget documentation: A complete set of documents can be obtained by the public through appropriate means when it is submitted to the legislature:** Annual budget documents, including fiscal stance, MTBP, and appropriation law, are posted on Ministry of Finance Website and can be downloaded. **(Satisfied)**
- ii. **In-year budget execution reports: The reports are routinely made available to the public through appropriate means within one month of their completion.** No in year budget execution reports are available to public. **(Unsatisfied)**
- iii. **Year-end financial statements: The statements are made available to the public through appropriate means within six months of completed audit.** Supreme Audit Institute carries out external audit on central government on a rolling basis. SSA produces ‘Audit Bulletin’ four times a year, each Bulletin covering three months period. These reports are made available to the public within a month following the three month period. In addition, the HSC generally submits annual audit reports on the state budget execution to the parliament within three months of completed audit. **(Satisfied)**
- iv. **External audit reports: All reports on central government consolidated operations are made available to the public through appropriate means within six months of completed audit.** Format and presentation of audit report and annual activity report could be greatly improved by providing executive summary and clearly stating major issues and conclusion. SSA publishes two reports annually; SSA activity report in spring, which describes activities performed by SSA in previous year, and the report on budget execution in fall, which provides auditor’s comments on budget execution. **(Satisfied)**
- v. **Contract awards: Award of all contracts with value above approx. USD 100,000 equiv. are published at least quarterly through appropriate means.** In accordance with point 3 of article 17, law 7971, dated 26.07.1995 “On Public Procurement” for tenders that are advertised in the Bulletin of Public Procurement, it is compulsory that the procuring entity shall make the advertisement of the winning bidder in the Bulletin of Public Procurement, before the signing of the contract and the publication is being done regularly. **(Satisfied)**
- vi. **Resources available to primary service units: Information is publicized through appropriate means at least annually, or available upon request, for primary service units with national coverage in at least two sectors (such as**

elementary schools or primary health clinics). Information on resource made available to primary service delivery unit is not usually available. A pilot local government participatory budgeting project has been recently completed to provide more information to citizens and incorporate their preference into resource allocation process. **(Unsatisfied)**

Indicator	Brief Explanation	Rating
10. Public access to key fiscal information	The government makes available to the public information on 4 of the 6 listed types	B

3. Policy-based budgeting

Indicator 11: Orderliness and participation in the annual budget process

While the Ministry of Finance (MoF) is usually the driver of the annual budget formulation process, effective participation in the budget formulation process by other ministries, departments and agencies (MDAs) as well as the political leadership, impacts the extent to which the budget will reflect macro-economic, fiscal and sector policies. Fully participation requires an integrated top-down and bottom-up budgeting process, involving all parties in an orderly and timely manner, in accordance with pre-determined budget formulation calendar. The PEFA guidelines identify the following dimensions to be assessed:

- i. **Existence of and adherence to a fixed budget calendar:** There have been notable improvements in budget formulation in recent years, particularly with MTBP. The budget calendar has been revised in 2005 with more streamlined process between MTBP and annual budgeting. However, it is deemed to be overly complicated given the limited capacity in the government. Due to the general election in 2005, budget formulation process for 2006 budget was interrupted and draft budget proposals from line ministries, which were submitted before election, were revised to reflect the changed government programs **(score: A)**.

- ii. **Clarity/comprehensiveness of and political involvement in the guidance on the preparation of budget submission (budget circular or equivalent):** A detailed budget circular (Budget Preparation Instruction Part A and Part B) existed since the inception of MTBP and was revised in 2005. Under this circular, political stakeholders including Council of Ministers and Parliament are involved at the earlier stage of annual budgeting, starting with macro-forecasting approval. Also, sector ceiling approved by Council of Ministers are reflected in the Instruction Part B with which line ministries prepare their budget request. For the first time, the responsibility of preparing investment budget is transferred to MoF from MoE to ensure complementarities between recurrent and investment budgets. However, this new circular is yet to be exercised only in 2006, when 2007 Budget is to be prepared. In 2005, due to general election during the summer, budget preparation process was interrupted and failed to follow the instruction given by the circular **(score: B)**.

- iii. **Timely budget approval by the Parliament:** For the last three years, the Parliament has approved the budget before the start of fiscal year according to legal mandate (November 20th) (score: A).

Indicator	Brief Explanation	Rating
11. Orderliness and participation in the annual budget process	Albania has a fixed budget calendar, which engages political and other stakeholders throughout the process. Parliament also approves budget before the start of fiscal year.	A

Indicator 12: Multi-year perspective in fiscal planning, expenditure policy and budgeting

Expenditure policy decisions have multi-year implications, and must be aligned with the availability of resources in the medium-term perspective. Therefore, multi-year fiscal forecasts of revenue, medium-term expenditure aggregates for mandatory expenditure and potential deficit financing must be the foundation for policy changes. The PEFA guidelines identify the following dimensions to be assessed:

- i. **Preparation of multi-year fiscal forecasts and functional allocations:** Albania has introduced MTBP since 2001. It includes macroeconomic and revenue forecasting and three year forecasts by economic, functional and administrative classification and they are revised on a rolling annual basis. However, links between multi-year estimates and subsequent setting of annual budget ceilings are not clear; nor MoF and line ministries strictly adhere to the ceiling from MTBP in annual budget preparation and little explanation is provided for differences (score: C).
- ii. **Scope and frequency of debt sustainability analysis:** The government rather relies on analysis provided by IFIs such as World Bank and IMF. For instance, the last DSA was conducted in 2005 jointly with World Bank and a local research institute, and presented to the government. However, the government does not have capacity to conduct its own debt sustainability analysis and IMF PRGF program aims to build capacity by 2008 (score: C).
- iii. **Existence of sector strategies with multi-year costing of recurrent and investment expenditure:** Four ministries, MoAF, MoT, MoLSA and MoH, have developed sector ‘expenditure’ strategies and other ministries are expected to prepare their strategy by 2006. However, the linkage between sector strategy and actual resource allocation is not clear (score: C).
- iv. **Linkage between investment budgets and forward expenditure estimates:** One of the major steps taken to integrate recurrent and investment budgets is to transfer responsibility of investment budget preparation from Ministry of Economy to Ministry of Finance in 2005. The budget circular for investment

project has a column to calculate recurrent cost implication; however, most of these columns are left blank. In fact, investment projects in Albania are extremely fragmented (more than 1,600 projects in 2006 budget, only 100 projects are above US\$ 1 million) and many of domestically financed projects are in fact maintenance-type interventions. In terms of linkage between investment decision and sector strategies, only 4 ministries have their investment decision based on sector strategies, with rough recurrent cost implication included (**score: C**).

Indicator	Brief Explanation	Rating
12. Multi-year perspective in fiscal planning, expenditure policy and budgeting	Government has introduced MTBP since 2001 and several progresses are made since then. However, linkage between MTBP ceiling and actual resource allocation is still very weak and sector strategies still lack costing information for investment and forward estimate for recurrent costs.	C

4. Predictability and Control in Budget execution

Indicator 13: transparency of taxpayer obligations and liabilities

Effective assessment of tax liability is subject to the overall control environment that exists in the revenue administration system but is also very dependant on the direct involvement and co-operation of the taxpayers from the individual and corporate sector. A good tax collection system encourages compliance and limits individual negotiation of tax liability by ensuring that tax legislation is clear and comprehensive and that it limits discretionary power of government officials involved, such as the revenue administration, the ministry of finance and investment promotion agencies.

- i. Clarity and comprehensiveness of tax liabilities.**
- ii. Taxpayer access to information on tax liabilities and administrative procedures.**
- iii. Existence and functioning of a tax appeals mechanism.**

Indicator	Brief Explanation	Rating
13. Transparency of taxpayer obligations and liabilities	N/A	N/A

Indicator 14: Effectiveness of measures for taxpayer registration and tax assessment

Effectiveness in tax assessment is ascertained by an interaction between registration of liable taxpayers and correct assessment of tax liability for those taxpayers. Taxpayer registration is facilitated by control mechanisms introduced by the revenue administration. Maintenance of a taxpayer database based on a unique taxpayer identification number is an important element of such a control system, but is most effective if combined with other government registration system that involve elements of taxable turnover and assets. In addition, Revenue Administration should ensure compliance with registration requirements through occasional surveys of potential taxpayers e.g. by selective, physical inspection of business premises and residences.

Indicator	Brief Explanation	Rating
14. Effectiveness of measures for taxpayer registration and tax assessment	N/A	N/A

Indicator 15: Effectiveness in collection of tax payments

Accumulation of tax arrears can be a critical factor undermining high budgetary outturns, while the ability to collect tax debts lend credibility to the tax assessment process and reflect equal treatment of all tax payers, whether they pay voluntarily and need close follow up. The level of tax arrears itself does not necessarily correlate to the effectiveness of the tax collection system, since a major tax assessment drive may substantially increase tax arrears. However, the RA's ability to collect the tax assessed is critical, unless the overall level of arrears is insignificant. Part of the arrears collection efforts relates to resolution of tax debt in dispute. In some countries, tax arrears in dispute constitute a significant part of the total tax arrears, for which reasons there may be a major difference between gross and net arrears.

Indicator	Brief Explanation	Rating
15. Effectiveness in collection of tax payments	N/A	N/A

Indicator no. 16: Predictability in the availability of funds for commitment of expenditures

Effective execution of the budget requires that the spending ministries, departments and agencies (MDAs) receive reliable information on availability of funds within which they can commit expenditure for recurrent and capital inputs. This indicator assesses the extent to which the central ministry of finance provides reliable information on the availability of funds to MDAs, that manage administrative (or program) budget heads (or votes) in the central government budget and therefore are the primary recipients of such information from the ministry of finance. The PEFA guidelines identify the following dimensions to be assessed:

- i) **Extent to which cash flows are forecasted and monitored:** Fiscal statistics on expenditure and revenues are compiled and made public on the internet on a quarterly basis. These statistics show a trend for the revenue and expenditure based on actual figures from previous fiscal years and they are the basis for the budget institutions forecasts. A cash flow forecast is prepared by the Treasury Department of Ministry of Finance on a quarterly basis (**score: B**).
- ii) **Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment:** Until 2005, the 36 local branches of the Treasury set two-monthly spending ceilings for the Budget Institutions based on the annual budget and implementation plan⁷ Based on this bi-monthly ceiling but subject to cash availability, MOF informs line ministries of the resource available every two months (usually before the end of first week). However, this means that reliable information about cash availability for budget institutions is not available beyond the two-month ceilings set by the MOF. Also a comparison between the allotments and actual spending shows that the two monthly allotments do not effectively limit the overall spending, which tend to increase during the fiscal year and accelerate further during last two months of the year. On the other hand, the central unit of the Treasury, the Debt and Treasury Department of the Ministry of Finance (MOF), receives daily information on revenue and expenditure amounts administered by the commercial banks. Reports on collected revenues from the tax and customs administrations are received monthly and reconciled with the amounts cleared with the BOA from the commercial banks (**score: C**).
- iii) **Frequency and transparency of adjustment to budget allocations, which are decided above the level of management of MDAs:** Subject to the MOF's approval, budget institutions may reallocate appropriations between different expenditure items and such reallocations (sometimes referred to as virements) are frequent⁸. This large number of virement requirement is said to distract time and resource from already thinly spread capacity of Ministry of Finance. In terms of transparency of virement decisions, guideline for obtaining the MOF approval is set out in the annual budget circular. However, there are quite a number of incidences where line ministries requested virements to MoF and MoF, without having authority to reject it on the basis of economic analysis, had to accept them as long as it meets administrative procedures (**score: C**).

Indicator	Brief Explanation	Rating
16. Predictability in the availability of funds for commitment of expenditures	Publicly available budget execution and fiscal reports appear to be reliable and frequently updated but significant in-year budget adjustments are frequent but carried	C+

⁷ In 2006, spending ceiling for line ministries is on a monthly basis. MoF states that even though the period of ceiling is reduced to a month, accuracy of ceiling increases as it closely reflects what line ministries submits – previously two month ceiling has been prepared rather by mechanical division of annual spending limit into six equal allocations.

⁸ More than 20,000 virements have been made every year since 2001. Source: PEIR (2006).

	out with some transparency. Two month allotment to line ministries serves as a guideline for available funds. However, as evidenced by the large number of virements allotted amounts are not sufficiently realistic nor allotted period is long enough to provide predictability to line ministries.	
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Indicator no. 17: Recording and management of cash balances, debt and guarantees

Debt management, in terms of contracting, servicing and repayment, and the provision of government guarantees are often major elements of overall fiscal management. Poor management of debt and guarantees can create unnecessarily high debt service costs and can create significant fiscal risks. The maintenance of a debt data system and regular reporting on main features of the debt portfolio and its development are critical for ensuring data integrity and related benefits such as accurate debt service budgeting, timely service payments, and well planned debt roll-over.

- i. **Quality of debt data recording and reporting:** Fiscal data is considered of fairly high standard, but minor reconciliation problems occur. The IMF has reported that the coverage of external government debt could be improved and that there have been some irregularities in the presentation of and recording of old external arrears (**score: B**).

- ii. **Extent of consolidation of the government’s cash balances:** A close-of-business cash position of the treasury single account (TSA) is made available to the Treasury from the Bank of Albania (BOA) on a daily basis. Payments related to state budget appropriations are executed through sub-accounts to the TSA in the BOA. Revenue and payments are made through the private banks, while agreements between the banks, the BOA and the Treasury ensures that all accounts are cleared and balances transferred to the TSA in the BOA at the end of each day. Reconciliation between the transaction data available from the Treasury’s financial accounting system and the cash balance at the BOA are done monthly. Extra-Budgetary Funds (EBFs) including Health Insurance Fund have their own banking arrangement outside the TSA (**score: B**).

- iii. **Systems for contracting loans and issuance of guarantees:** All state guarantees are reported to and recorded by the Debt Management unit of the MOF (**score: B**).

INDICATOR	SUMMARY ASSESSMENT	RATING

INDICATOR	SUMMARY ASSESSMENT	RATING
17. Recording and management of cash balances, debt and guarantees.	The quality of recording and reporting of debt and guarantees appear to be high and Government cash balances are consolidated on a regular basis.	B

Indicator 18. Effective Payroll control

The wage bill is usually one of the biggest items of government expenditure and susceptible to weak control and corruption. This indicator is concerned with the payroll for public servants only. Wages for casual labor and discretionary allowances that do not form part of the payroll system are included in the assessment of general internal control (I-20). However, different segments of the public service may be recorded in different payrolls.

- i) **Degree of integration and reconciliation between personnel records and payroll data:** Databases of personnel records are maintained by the individual budget institution and there are no direct links between personnel record databases and payroll as of June 2006. Payroll is not yet executed through the Treasury system and is managed by ministries and spending agencies. Reconciliations between information in timesheets and the budget execution data, which are received from the Treasury are performed by finance officers of individual budget institutions on a monthly basis (**score: B**).
- ii) **Timeliness of changes to personnel records and the payroll:** Updates of personnel records, including payroll are done manually in paper records or “books” at the level of budget institutions. Payroll is updated on a bi-weekly basis⁹ and personnel record is updated every time there is a change in personnel (**score: A**).
- iii) **Internal controls of changes to personnel records and the payroll:** The records provide an audit trail of the changes made, which are authorized by the budget institutions’ finance offices. The procedures for making changes in personnel and payroll records are determined by the Law on the Status of the Civil Servant (No. 8249/1999) for civil servants – 1,100 people out of 120,000 public employees – and the rest of public employees are managed by labour code and a number of related implementing government decrees (**score: A**).
- iv) **Existence of payroll audits to identify control weaknesses and/or ghost workers:** In addition to the controls performed by the budget institutions’ finance offices, the internal audit unit (IAU) of line ministries, the MOF’s General Directorate for Internal Audit (GDIA), and the SSA has audited the budget institutions’ payroll management on an annual basis. The IAUs of some budget institutions perform 100 percent checks on payroll transactions (**score: B**).

⁹ Payroll is updated by individual ministries and spending agencies but treasury does not verify the accuracy of the payroll but simply make payment according to the calculation by ministries. While this means independency of payroll update could be questioned, the PEFA methodology does not address the issue of independency directly.

INDICATOR	SUMMARY ASSESSMENT	RATING
18. Effectiveness of payroll controls.	Appropriate procedures for payroll controls do exist but the fact that payroll and personnel records are not integrated and often not computerized undermines the credibility of the systems.	B+

Indicator no. 19: Competition, value for money and controls in procurement

Significant public spending takes place through the public procurement system. A well-functioning procurement system ensures that money is used effectively and efficiently. Open competition in the award of contracts has been shown to provide the best basis for achieving efficiency in acquiring inputs for and value for money in delivery of programs and services by the government. This indicator focuses on the quality and transparency of the procurement regulatory framework in terms of establishing the use of open and fair competition as the preferred procurement method and defines the alternatives to open competition that may be appropriate when justified in specific, defined situations.

- i) **Evidence on the use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases:** The percentage of contracts awarded through open tendering is approximately 38 percent of the total number of public contracts awarded in a year (due to insufficient statistics, this data is taken from the Annual Reports of the PPA for years 2003 and 2004) but the accuracy of procurement-related information is not sufficient (**score: C**).
- ii) **Extent of justification for use of less competitive procurement methods:** There exists clear overuse of the direct procurement method, which fails to ensure transparency and effective use of public funds. Although the public procurement law establishes open tendering as the preferred procurement method, the gap and unclear legislative regulations, in fact, easily permit the use of direct procurement and rules that define criteria of exceptions are missing. Public Procurement Agency (PPA) that has the authority to accept or reject the requests for direct procurement has rejected approximately 60-70 percent of total requests, largely due to the insufficient information and grounds for use of that method. This would be interpreted that requests are not justified. In addition, in most cases, the direct procurement is used at the end of the fiscal year, which indicates poor procurement planning (**score: D**).
- iii) **Existence and operation of a procurement complaints mechanism:** There is a complaint review mechanism in place, which is performed by Public Procurement Agency, but it is ineffective to carry out this task. As mandated by the Public Procurement Law, PPA is the highest administrative body for review of complaints. If parties are not happy with the decision given by PPA, they bring the case to whichever Court has jurisdiction over the case. PPA has a conflict of interest in carrying out this task,

as they have legislative and executive functions simultaneously. Furthermore, there are no records in PPA of how many complaints were reviewed, or what the result was. The only information is about the cases adjudicated in Courts. However, no accurate data is available and the team could not assess the effectiveness of the system. Another feature of the system is the shortened period for filing a complaint, which restricts the time for lodging complaints

INDICATOR	SUMMARY ASSESSMENT	RATING
19: Competition, value for money and controls in procurement	<p>(i) Available data shows that less than 50% of contracts above the threshold are awarded on an open competitive basis, but the data may not be accurate (Score C).</p> <p>(ii) Although regulatory environment establishes use of open competition as preferred method there are weaknesses in the system that results in overuse of direct procurement (Score D)</p> <p>(iii) Existing system on complaints review is poorly designed (Score C).</p>	D+

Indicator 20. Effectiveness of internal controls for non-salary expenditure

An effective internal control system is one that (a) is relevant (i.e., based on an assessment of risks and the controls required to manage the risks), (b) incorporate a comprehensive and cost effective set of controls (which address compliance with rules in procurement and other expenditure processes, prevention and detection of mistakes and fraud, safeguard of information and assets, and quality and timeliness of accounting and reporting), (c) is widely understood and complied with, and (d) is circumvented only for genuine emergency reason.

- i. **Effectiveness of expenditure commitment control:** There are no commitment controls for individual payments or contracts at the level of the Treasury. Whereas bi-monthly spending ceilings are issued by the Treasury to the Budget Institutions, available data suggest they do not effectively limit the individual Budget Institutions spending to actual cash availability (**score: C**).
- ii. **Comprehensiveness, relevance, and understanding of other internal control rules/procedures:** Basic regulations for processing transactions and approving contracts exist but comprehensive written procedures, including detailed job descriptions, are generally lacking in the budget institutions. At the level of the Treasury, procedures for controls and release of all types of non-salary expenditure do exist and are followed. However, ineffective procurement regulations tie the hands of the budget institutions and results in reallocations made during the year. (**Score for dimension (ii) set at B**).
- iii. **Degree of compliance with rules for processing and recording transactions:** Compliance with rules appear to be fairly high, but the overspending compared to allotments suggest that simplified procedures are used occasionally (**score: B**).

INDICATOR	SUMMARY ASSESSMENT	RATING
20. Effectiveness of internal controls for non-salary expenditure	There are no commitment controls and whereas compliance with rules appears to be fairly high, spending ceilings do not effectively limit spending to cash availability. Existing rules and procedures in some cases lead to inefficiencies in the use of funds.	B

Indicator 21. Internal control and internal audit

Regular and adequate feedback to management is required on the performance of the internal control system, through an internal audit function (or equivalent systems monitoring function). Such a function should meet international standards such as the ISPPA¹⁰, in terms of (a) appropriate structure particularly with regard to professional independence, (b) sufficient breadth of mandate, access to information and power to report, (c) use of professional audit methods, including risk assessment techniques. The function should be focused on reporting on significant systemic issues in relation to: reliability and integrity of financial and operational information; effectiveness and efficiency of operations; safeguarding of assets; and compliance with laws, regulations, and contracts.

- i) **Coverage and quality of the internal audit function:** Internal audit in the Albanian public sector is at an early stage of development. Since the adoption of the Law on public sector internal audit (Law No. 9009/2003) all budget institutions with a budget of more than LEK 50 million have been required to have in place Internal Audit Units (IAUs), whereas other budget institutions may be audited by the IAUs of the line ministry they are reporting to. The independence of IAUs is formally ensured through the provisions of the mandatory internal audit manual and the law on internal audit: a manual, reflecting the approach promoted through the application of the International Standards for the Professional Practice of Internal Audit (ISPPA)¹¹, has been developed and its use is mandatory for all IAUs. In the manual it is specified that the “General Directorate of Internal Audit and the internal audit units in the public sector shall be functionally and organizationally independent from the audited entity.” This implies, among other things, that the IAU of a particular entity “report directly to the principal director of the public entity and through him to the General Director” of the MOF’s General Directorate of Internal Auditing. However, most auditors are not sufficiently trained to apply the manual’s methodologies to focus on systemic issues. Instead, they still tend to focus narrowly on compliance issues (**score: C**).

¹⁰ International Standards for the Professional Practice in Internal Audit, issued by the Institute of Internal Auditors.

¹¹ Council of Ministers (COM) Decision No. 345/2004 on the approval of the internal auditing procedure manual the ethical code for internal auditors and the charter of public internal auditing.

- ii) **Frequency and distribution of reports:** In accordance with procedures laid down in the internal audit manual, IAUs produce summary reports to the heads of the Budget Institutions on a monthly, quarterly and yearly basis. The IAU of the MOF presents an annual report to the COM on the internal audits performed, and the major findings and recommendations (**score: A**).

- iii) **Extent of management response to internal audit findings:** The procedures for following up on recommendations of other IAUs are not harmonized across the government and there are no formal requirements for the COM to take actions on the recommendations of this report. The internal auditors are reporting on the implementation of their recommendations in a somewhat complicated spreadsheet (**score: C**).

INDICATOR	SUMMARY ASSESSMENT	RATING
21. Effectiveness of internal audit.	In line with the Law on Internal Audit in the Public Sector and the 2004 internal audit manual, a modern internal audit system is being developed but is still to demonstrate its impact on the effectiveness of Government operations.	C+

5. Accounting, Recording and Reporting

Indicator 22. Timeliness and regularity of accounts reconciliation

Reliable reporting of financial information requires contact checking and verification of the recording practices of accountants – this is an important part of internal control and a foundation for good quality information for management and for external reports. Timely and frequent reconciliation of data from different sources is fundamental for data reliability. Two critical types of reconciliations are: (i) reconciliation of accounting data, held in the government’s books, with government bank account data held by central and commercial banks, in such a way that no material differences are left unexplained; (ii) clearing and reconciliation of suspense accounts and advances i.e., of cash payment made, from which no expenditure have yet been recorded. Advances would include travel advances and operational imprests, but not budgeted transfers to autonomous agencies and SN governments which are classified as expenditure when they are effected even if reporting on any earmarked portion of the transfers is expected periodically.

- i) **Regularity of bank reconciliations:** The consolidated financial statements on accrual basis have since 2001 been produced by the accounting department in MoF based on manual forms filled in by the spending units. All cash transactions pass through the treasury systems; however, only the ministries and other agencies have detailed information on assets and liabilities and MOF does not compile them into

one nation-wide database. This information must be combined in an integrated system. The Treasury reconciles the account balance of the TSA in the BOA with the consolidated records of the treasury system on a monthly basis (**score B**).

- ii) **Regularity of reconciliation and clearance of suspense accounts and advances.** Suspense accounts are not frequently used but when they are detailed information on the nature and the timing of these accounts must be send to the MOF along with the financial statements. Normally, these accounts are cleared within a period of two to three months. If no information is sent about these accounts, there is a unit within the accounting department which follows up with the subjects for completing the information. In addition, in the regulation no 19 dated 24.12.2003 “On the Preparation of the Financial Statements” there are not specific rules for advances, especially regarding the time limit for closing this accounts and the requirement for additional information about the nature of the advances (**provisional score B**).

INDICATOR	SUMMARY ASSESSMENT	RATING
22. Timeliness and regularity of accounts reconciliation	Bank reconciliations for the TSA including the payment system administered by the commercial banks and BOA take place monthly and typically within four weeks of end of period. The information available was insufficient to assess frequency of suspense account clearances.	B (provisional)

Indicator no. 23: Availability of information on resources received by service units

Problems frequently arise in front-line service delivery units providing services at the community level (such as schools and health clinics) in obtaining resources that were intended for their use, whether in terms of cash transfers, distribution of materials in kind, or provision of centrally recruited and paid personnel. The intended resource provision may not be explicit in budget documentation, but is likely to form part of line ministries internal budget estimate preparation. From line service delivery units, being furthest in the resource allocation chain, may be the ones to suffer most when overall resources fall short of budget estimates, or when higher level organizational units decide to re-direct resources to other purposes. There may be significant delays in transfers of resources to the unit whether in cash or in kind. Tracking of such information is crucial in order to determine, if the PFM systems effectively support front-line service delivery.

Collection and processing of information to demonstrate the resource that were actually received by the most common front-line service delivery units: In Albania, funds for primary schools and health institutions are managed from the local treasury and reported as a part of the consolidated accounting information to the respective line ministry (education and health) every month. Payments initiated by ocal government and executed by treasury offices are registered, but the records of the Treasury do not allow the tracking of payments for individual schools or health clinics. Receipts of in-kind

resources are verified locally, but no consolidated data is provided to central authorities for reconciliation (**score: D**).

INDICATOR	SUMMARY ASSESSMENT	RATING
23. Availability of information on resources received by service delivery units.	Information on cash resources received by primarily schools and health institutions is not captured by the Treasury and no information on in-kind resources is provided to any central government institutions.	D

Indicator 24: Quality and timeliness of in-year budget reports

The ability to “bring in” the budget requires timely and regular information on actual budget performance to be available both to the ministry of finance and Cabinet, to monitor performance and if necessary to identify new actions to get the budget back on track, and to the MDAs for managing the affairs for which they are accountable. Coverage of expenditure at both the commitment and the payment stage is important for monitoring of budget implementation and utilization of funds released.

- i) **Scope of reports in terms of coverage and compatibility with budget estimates:** The classification of in-year budget execution reports does allow for comparison between budgeted and actual amounts as per economic and organizational classification. Budget institutions do in some cases also maintain records of commitments, but there is no central reporting or monitoring of commitments such as major contracts closed by individual budget institutions (**score: C**).
- ii) **Timeliness of the issue of reports:** Budget execution reports for in-year periods are prepared quarterly and are issued within 6 weeks of the end of the quarter (**score: B**).
- iii) **Quality of Information:** Some inaccuracies in the budget execution data are likely due to the quality of, and inherent risks associated with, manual bookkeeping. However, data issues are typically recognized and reconciled by the MOF and do not compromise overall consistency/usefulness of financial reporting (**score: B**).

INDICATOR	SUMMARY ASSESSMENT	RATING
24. Timeliness, quality and dissemination of in-year budget execution reports.	In-year budget execution reports from budget entities are normally timely and accurate but do not provide information on commitments.	C+

Indicator 25: Quality and timeliness of annual financial statements

Consolidated year-end financial statements are critical for transparency in the PFM system. To be complete they must be based on details for all ministries, independent departments, and de-concentrated units. In addition, the ability to prepare year-end financial statements in a timely fashion is a key indicator of how well the accounting system is operating, and the quality of records maintained. In some systems, individual ministries, departments, and de-concentrated units issue financial statements that are subsequently consolidated by the ministry of finance.

- i. **Completeness of the financial statements:** the Council of Ministers (COM) submits a report to Parliament containing the consolidated state accounts for the preceding fiscal year. The COM report comprises complete information on revenues, expenditures and financial assets and liabilities (**score: A**).
- ii. **Timeliness of submission of the financial statements:** Within six months of the end of the fiscal year (before July 1),The COM report is provided to the State Audit Institute (SAI) at the same time as it is submitted to Parliament (**score: A**).
- iii. **Accounting standards used:** The financial statements contained in the COM report do not comply with IPSAS but they are in compliance with the public accounting plan (approved with COM decision no. 248/1998) based on the general principles and standards for accounting for annual accounts established in the 1993 Law on Accounting. Further details of the plan are provided in the General Accounting plan (COM decision no. 334/1993) (**score: B**).

INDICATOR	SUMMARY ASSESSMENT	RATING
25. Timeliness of the presentation of audited financial statements to the legislature.	The Government’s annual financial statements are comprehensive and timely and follow national accounting standards.	B+

6. External Scrutiny and Audit

Indicator 26: Scope, nature and follow-up of external audits

A high quality external audit is an essential requirement for creating transparency in the use of public funds. Key elements of the quality of actual external audit comprise the scope/coverage of the audit, adherence to appropriate auditing standards including independence of the external audit institutions (ref. INTOSAI and IFAC/IAASB), focus on significant audit such as reliability of financial statements, regularity of transactions and functioning of internal control and procurement systems. Inclusion of some aspects of performance audit (such as e.g. value for money in major infrastructure contracts) would also be expected of a high quality audit function.

- i. **Scope/nature of audit performed (incl. adherence to auditing standards):** The State Audit Institute (SAI) is responsible for annual audit of the execution of the state budget and submits a report each year in October to Parliament on its findings and recommendations. In accordance with the 1998 Constitution and the

1997 Law on the SSA Institution (No. 8270/1997) the SSA has a broad mandate to audit revenues and expenditure of all bodies financed wholly or partially by the state budget. The SSA bases its audits on the accounting records and financial reports from the Treasury and budget institutions, and their reports address a range of the government’s financial management practices, including procurement and debt management issues. The SSA’s annual audits cover all central government entities. They cover a wide range of audit types including legality; regularity and performance audit (as defined by the INTOSAI Auditing Standards) and generally adhere to auditing standards, focusing on significant and systemic issues **(score: B)**¹².

- ii. **Timeliness of submission of audit reports to legislature:** Audit reports from the SSA are typically submitted to the legislature in October, which is within four months after it has received the consolidated government accounts from the MOF (accounts submitted in July) **(score: A)**.

- iii. **Evidence of follow up on audit recommendation:** For the first time ever, in 2005 Parliament adopted a formal resolution in reaction to the SSA’s annual report on the Government’s budget execution for the fiscal year 2004. Whereas the SAI systematically follow-up on the implementation of past recommendations, the auditees (Government bodies) are in many cases not sufficiently responsive and fail to respond within the statutory 20 days after having received the SSA report. Within the last 1-2 years the SAI has however noted a general improvement in responsiveness: from 2003 to 2004 the SAI registered an improvement in the implementation of audit recommendations from approximately 50 percent to about 70 percent. While the concrete impact of the SSA’s recommendations of the Government’s financial management practices still appear to be limited **(score: C)**.

INDICATOR	SUMMARY ASSESSMENT	RATING
26. The scope, nature and follow up of external audit reports.	The Supreme Audit Institution is independent and performs a broad range of audits covering most Budget Institutions, but while systematic follow-up is done by the SAI there is little evidence that audit recommendations are being implemented.	C+

Indicator no. 27: Legislative scrutiny of the annual budget law

The power to give the government authority to spend rests with the legislature, and is exercised through the passing of the annual budget law. If the legislature does not rigorously examine and

¹² In the 2003 budget execution report it is stated the SSA audited 34 state central institutions and more than 46 agencies and local government units. Since PEFA states that the percentage of coverage shall refer to the “amount of expenditure of the entities covered” (and not the sample of transactions selected), the team has deemed that the institutions covered by audit constitute at least 75 percent of total expenditure, but this calculation is not made by the SSA.

debate the law, that power is not being effectively exercised and will undermine the accountability of the government to the electorate. Assessing the legislative scrutiny and debate of the annual budget law will be informed by consideration of several factors, including the scope of the scrutiny, the internal procedures for scrutiny and debate and the time allowed for that process.

- i. **Scope of the legislative scrutiny:** Parliament’s review covers fiscal policies, a Medium Term Budget Program (MTBP) as well as details of expenditure and revenue. However, the legislative budget review process hardly looks at medium term priorities; rather focuses on those of the coming year (**score: B**).
- ii. **Extent to which the legislature’s procedures are well-established and respected:** There exists a clear procedure for legislative budget review, which includes review by specialized committees such as education and health, and public hearing. However, the negotiation between parliament and executive government is conducted in a rather ad-hoc manner (**score: A**).
- iii. **Adequacy of time for the legislature to provide a response to budget proposals both the detailed estimates and, where applicable, for proposals on macro-fiscal aggregates earlier in the budget preparation cycle:** The statutory timetable set out in the Organic Budget Law on “Preparation and Execution of the State Budget of the Republic of Albania” allows 45 days for parliamentary and public debate on the Budget (**score: B**).
- iv. **Rules for in-year amendments to the budget without ex-ante approval by the legislature:** Whereas rules for in-year budget adjustments exist, they do allow extensive administrative reallocation. Currently, appropriation by the parliament is done at the level of program and reallocation at project level, which is below program level, is done with MoF approval and the degree of project level in-year reallocation has been quite extensive. Reallocation of program requires approval of council of ministers. Finally, the in-year reallocation has not caused expansion of total expenditure but been done with trade-off with other projects and programs (**score: B**).

Based on the above, the score for the indicator is set at B+.

INDICATOR	SUMMARY ASSESSMENT	RATING
27. Legislative scrutiny of the annual budget law.	Whereas Parliament’s review of the budget proposal is fairly broad in scope and well-regulated, the time allowed for review the budget proposal is insufficient and in-year amendment procedures allow extensive administrative reallocation	B+

Indicator no. 28: Legislative scrutiny of external audit reports

The legislature has a key role in exercising scrutiny over the execution of the budget that it approved. A common way in which this is done is through a legislative committee(s) or commission(s), which examines the external audit reports and questions responsible parties about the findings of the reports. The operation of the committee will depend on adequate financial and technical resources, and on adequate time being allocated to keep up-to-date on reviewing audit reports. The committee may also recommend actions and sanctions to be implemented by the executive, in addition to adopting the recommendations made by the external auditors.

- i. **Timeliness of examination of audit reports by the legislature:** The Parliament's scrutiny of the Government's annual budget execution is based on SSA's report on the budget execution and its opinion on the Report of the COM for the past financial year. The report is submitted in August/September and approved by Parliament in October of that year (**score: A**).
- ii. **Extent of hearings on key findings undertaken by the legislature:** In-depth hearings on the keys findings in the reports of the SSA take place occasionally, but typically only include MOF officials (**score: C**).
- iii. **Issuance of recommended actions by the legislature and implementation by the executive:** It is noted that Parliament does occasionally recommend action, and that 50-70 percent of recommendations are acted upon by the Government (**score: B**).

INDICATOR	SUMMARY ASSESSMENT	RATING
28. Legislative scrutiny of external audit reports.	The legislature's scrutiny of external audit reports is timely but insufficient both in terms of involvement of Government officials in hearings and issuance of recommendations for Government actions.	C+

7. Donors Related PFM System

Indicator D1: Predictability of Direct Budget Support

Direct budget support constitutes an important source of revenue for central government in many countries. Poor predictability of inflows of budget support affects the government's fiscal management in much the same way as the impact of external shocks on domestic revenue collection. Both the shortfalls in the total amount of budget support and the delays in the in-year distribution of the in-flows can have serious implications for the government's ability to implement its budget as planned.

- i) **Annual deviation of actual budget support from the forecast provided by the donor agencies at least six month prior to the government submitting its budget proposals to the legislature:** There are only two donors in Albania that provide budget support: one is the ongoing balance of payment support from EU and the other is Bank's three PRSCs and one FSAC since 2002. The second tranche of the FSAC was delayed for a year due to delays in the insurance sector reform, but the PRSC planned in 2003 was increased with the same amount. Normally, the exact amount was not agreed before the budget proposal was submitted to parliament **(score: D)**.
- ii) **In-year timeliness of donor disbursement (compliance with aggregate quarterly estimates):** The in-year schedule has not been agreed before the beginning of the fiscal year. **(score: D)**.

INDICATOR	SUMMARY ASSESSMENT	RATING
29. Predictability of direct budget support	The Direct Budget Support from EU and the Bank has normally not been agreed in full details, including exact amount and timing of disbursement, before the beginning of the year	D

Indicator D2: Financial information provided by donors for budgeting and reporting on project and program aid

Predictability of disbursement of donor support for projects and programs affect the implementation of specific line items in the budget Project support can be delivered in a wide range of ways, with varying degrees of government involvement in planning and management of resources. A lower degree of government involvement leads to problems in budgeting the resources and in reporting of actual disbursement and use of funds. While the government through its spending units should be able to budget and report on aid transferred in cash (often as extra-budgetary funding or through separate bank accounts), the government is dependant on donors for budget estimates and reporting on implementation for aid in-kind. Donor reports on cash disbursement area also important for reconciliation between donor disbursement records and government project accounts.

- i) **Completeness and timeliness of budget estimates by donors for project support:** Budget estimates for donor supported projects are made by budget entities as an integral part of the budget formulation process. The completeness has not been analyzed but is it

believed that a considerable deviation (40% – 50%) between budget and actual expenditures on foreign financed projects have been the case for the past years (**score: C**).

- ii) **Frequency and coverage of reporting by donors on actual donor flows for project support:** Information on frequency and coverage of actual disbursement has also not been made. A comparison of information from DAC with budget execution data from earlier years and an analysis of information provided by the Ministry of Economy compared with treasury data suggests that the coverage would be between 50% and 70%. (**N/A due to insufficient information**)

INDICATOR	SUMMARY ASSESSMENT	RATING
30. Financial information on projects	The financial information provided by donors for budgeting and reporting on project and program aid is not covering all donors and budget information has been over-optimistic.	C (partial)

Indicator D3: Proportion of aid that is managed by use of national procedures

National system for management of funds is those established in the general legislation of the country and implemented by the mainstream line management functions of the government. The requirement that national authorities use different (donor-specific) procedures for the management of aid funds diverts capacity away from managing the national systems. This is compounded when different donors have different requirements. Conversely the use of national system by donors can help to focus efforts on strengthening and complying with the national procedures also for domestically funded operations.

Overall proportion of aid funds to central government that are managed through national procedures: Less than 50% of aid funds to central government are managed through national procedures (**score: D**).

INDICATOR	SUMMARY ASSESSMENT	RATING
31. Proportion of aid managed by national procedures	The use of national procedures for the management of aid is very limited.	D