



**SIGMA**

**Support for Improvement in Governance and Management**

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**ALBANIA**

**EXTERNAL AUDIT**

**ASSESSMENT MAY 2009**

## 1. Summary

### *Main Developments since last year*

The twinning project with the National Audit Office of the United Kingdom and the Netherlands Court of Audit, which had started in 2007, finished in 2008. Based on the experience of the project, the High State Control (HSC) completed, early in 2009, a new Strategic Development Plan (SDP) for the period 2009-2012. To reinforce the number of staff available for auditing, the number of audit departments was reduced from six to four in 2009. Expectations that the HSC headquarters would be relocated to new premises, indicated in Sigma's 2008 assessment report, did not materialise. Amendments to the Law on the "State Supreme Audit Institution" of 1997 (SSAI Act) have been drafted and are due to be sent to parliament in September 2009.

### *Main Characteristics (strengths and weaknesses)*

The supreme audit institution of the Republic of Albania, the High State Control (HSC), is functionally, operationally and administratively independent. The Constitution provides a solid basis for its functioning. The objectives, scope, powers, and organisational structure of the HSC are set forth in the Law on the "State Supreme Audit Institution" of 1997 (SSAI Act). The total number of staff in the HSC is 160 (of whom 118 are auditors), which is regarded as sufficient by the HSC management.

The current approach to financial audits does not focus yet on certifying financial statements but rather concentrates on detecting violations of laws. However, the twinning project has had a positive impact on the development of financial as well as performance audit work. The HSC has developed new mechanisms for ensuring audit quality. Finally, the HSC has started to develop its HRM system.

The HSC management realises that work remains to be done before the HSC can become a modern institution functioning in accordance with the INTOSAI standards. The new SDP mentions the need for adjusting the regulatory framework for its remit and scope of audit; setting criteria for the dismissal of the HSC Chairman and for determining the status of staff; training more staff in the audit methodology of financial audit and performance; audit step by step; further developing human resources; and revising the information technology (IT) architecture of the institution.

By developing a new SDP, the management of the HSC has shown its determination to improve the HSC's performance. Introducing a modern methodology for financial and performance auditing in phases is a sensible approach for thoroughly preparing the staff of the HSC for their new tasks. However, the capacity to implement the SDP is limited. Moreover, the instability created by the reorganisations of the last few years might have affected the quality of HSC audit work. External support in implementing the SDP seems indispensable.

In addition to the central headquarters, there are three local offices in Tirana, Skodër and Vlorë (in total 22 staff). The existence of the local offices may need to be reassessed as their context of operations evolves. In the meantime, however, it is necessary to develop the quality of the work performed by the local offices through appropriate training and efficient steering from headquarters.

Due to the removal plans, no investments were made to maintain or upgrade the existing IT network, which is about ten years old. In the event that relocation of the headquarters will take more than two/three years, a management decision on the IT situation at headquarters and in the regional offices will be needed.

The impact of HSC audit work is increasing. The National Assembly appreciates the HSC recommendations, which increasingly concern structural measures, although disciplinary measures for violations still constitute the main part of the HSC's reporting to the National Assembly.

Article 3 of the SSAI Act refers to the audit of the accounts of the HSC by an independent body appointed by and reporting to the National Assembly. The HSC accounts have not been audited since 2002, whereas the supreme audit institution of the Albanian State should play an exemplary role for

other public bodies with respect to its own budgetary and financial management. A practical solution to comply with this legal provision now needs to be quickly found.

### ***Recommendations for Reform***

It is recommended that the HSC:

- finalise drafting of the amendments to the SSAI Act as speedily as possible and reach agreement on any modifications with the relevant external bodies – especially the Ministry of Finance ; in particular, adjustments of the SSAI Act are needed with regard to its remit, to the scope of audit, and to criteria for dismissal of the Chairman and for determining the status of the staff;
- specify in the draft amendments the HSC's role in auditing the budget execution annually; this should ensure that the HSC will be involved in the budget process on a timely basis, in line with the provisions and deadlines set by the new Organic Budget Law (see Sigma's 2009 assessment of Public Expenditure Management in Albania);
- continue with refining its theoretical policies for audit planning strategy, audit manuals, quality management and training programmes and provide rigorous leadership in implementing these policies in phases on an organisation-wide basis;
- intensify its efforts to improve mutual relations with the Ministry of Finance, especially with the General Directorate of Internal Audit. Discussions to reach agreement on the imminent amendment of the SSAI Act would offer an opportunity to build up mutual trust as a basis for co-operation;
- conclude co-operation agreements with the Ministry of Finance and IA units; these agreements should regulate such matters as regular liaison, joint training events, the development of common standards, the sharing of audit findings, and especially the clear definition of each side's respective scope of responsibility;
- consider, in the medium term, whether the regional offices can be closed in order to make more efficient and effective use of the resources available; in the meantime, however, it is necessary to develop the quality of the work performed by the local offices through appropriate training and efficient steering from headquarters;
- more actively pursue its goal of moving into new premises, taking into account the additional space requirements, depending on decisions concerning the possible closure of regional offices.

## 2. Legal Framework

The supreme audit institution of the Republic of Albania, the High State Control (HSC), was established in 1992 as a parliamentary institution independent from the government. The HSC's legal basis is stipulated in articles 162-165 of the Albanian Constitution. Concerning external audit, the Albanian Constitution establishes:

- the status of the HSC;
- the legal position (appointment, dismissal, protection) of the Chairman of the HSC;
- the remit of the HSC audit;
- reporting by the HSC to the National Assembly;
- relations of the HSC with the government.

The objectives, scope, powers, and organisational structure of the HSC are included in the Law on the "State Supreme Audit Institution" of 1997 (SSAI Act), last amended by law in 2000 as well as by a Constitutional Court decision in 2002. The last amendment of the SSAI Act in 2002 reflects a decision of the Constitutional Court, which stated that in principle it would be possible for the National Assembly, upon the proposal of the President of the Republic, to dismiss the Chairman of the HSC from office on any grounds. This decision is not in line with the INTOSAI Lima Declaration, which foresees limited grounds for dismissal of the head of an SAI. These limited grounds should be specified in the Constitution, or at least in the SSAI Act. Criteria for dismissing the HSC Chairman are lacking, in both the Constitution and the current SSAI Act.

The SSAI Act gives authority to the HSC to audit the services of the state and "other state judicial (i.e. legal) persons". Companies in which the state has a majority of shares or whose debts are guaranteed by the state can be audited by the HSC. It is also authorised to audit state funds (employment, retirement and health) adopted by the National Assembly, funds provided to private organisations, and funds from foreign donors provided via the state budget. Regarding local government, the HSC audits the expenditures of local government entities and the use of state transfers to these entities. The HSC has the authority to carry out all types of audits. This includes financial audit, performance audit and other specific audits ("legality; regularity; financial management; and performance aspects").

The annual audits cover the execution of the state budget and budget support to municipalities, state funds, and the National Bank.

The HSC's operations are financed by its own budget and approved by the National Assembly, and it can independently recruit and dismiss staff. Its operational independence has increased. Prior to 2007 the HSC's operational independence could have been violated by the government. As from 2008 only the Standing Committee on Economy and Finance of the Albanian Parliament reviews the HSC's budget proposal. However, like all other institutions, the HSC also has to deliver its share of general budget cuts aimed at stabilising the state budget.

Following an amendment of 1 June 2000 to the SSAI Act of 1997, the HSC has been established as an office-model institution, headed by a chairman. The National Assembly elects the HSC Chairman by majority vote, upon the proposal of the President of the Republic, for a term of seven years. This term can be renewed. The legal design of the institution, with a term of office of the HSC Chairman of seven years, should promote a reasonable degree of stability and independence, as general elections to the National Assembly occur every four years. The lack of legal grounds for dismissal of the Chairman might, however, negatively influence the stability and the independence of the institution.

Sigma's May 2008 assessment of the HSC concluded that the remit and scope of audit of the HSC needed further clarification in the SSAI Act.

Under the twinning project with the UK National Audit Office (UK NAO), which terminated in January 2009, the HSC started to revise the SSAI Act. The draft amendments to the Act provide for the following: a limited number of criteria in line with the INTOSAI Lima Declaration for dismissing the HSC Chairman; the right to audit final beneficiaries of EU funds and revenues; annulment of the

specification in article 22 of the current law, which prescribes that the audit standards issued by the HSC are compulsory for the government's internal audit bodies; and technical updates.

Furthermore, the draft amendments provide for institutionalising the relationship with internal audit systems, especially by allowing the HSC to rely on internal audit results. Other amendments to the SSAI Act address the status, role and qualification of HSC staff. However, the draft amendments do not specify the procedure of HSC's annual reporting on the audit of the budget execution, nor are they harmonised with the Public Internal Financial Control reform. The HSC plans to table the amendments of the SSAI Act in the legislative process via the Standing Committee on Economy and Finance in September 2009.

**The supreme audit institution of the Republic of Albania, the High State Control (HSC), is functionally, operationally and administratively independent. The Constitution provides a solid basis for its functioning. The objectives, scope, powers, and organisational structure of the HSC are set forth in the Law on the "State Supreme Audit Institution" (SSAI Act). Although a large part of this law is in line with the INTOSAI Lima Declaration and with international auditing standards, the law needs adjustments with regard to its remit, the scope of audit, and criteria for the dismissal of the chairman and for determining the status of the staff. The procedure of HSC's annual reporting on its audit of the budget execution should also be firmly established in the SSAI Act. The amendments will be sent to parliament in September 2009.**

### 3. Institutional Framework

Internal reorganisation of the HSC took place following the latest legal amendment to the SSAI Act in 2002. To reinforce the number of staff available for auditing, the number of audit departments was reduced from six to four in 2009. Two of the three support departments were reorganised as well. Audit methodology has been transferred from the Department of Public Relations to the Directorate of Legal Issues, Quality Assurance and Methodology. The third support department, Department of Economic Administration and Human Resources, has not changed. Since early 2009, the HSC's organisation also comprises an internal audit unit. The total number of staff in the HSC is 160, of whom 118 are auditors.

In addition to the central headquarters, there are three local offices. One of these offices is located in Tirana and has a staff of 10, another is in Skodër with a staff of six, and a third in Vlorë, in the south of the country, also has a staff of six. The geographical distribution of the regional offices reflects their task to cover Albania's administrative centres. The staff members are subordinate to the departments for the state budget audit and property administration. The Tirana headquarters exercises weak supervision of the regional audit offices by means of visits. Originally the regional offices had been set up to fill the gap created by the lack of control of regional and municipal expenditures by the government. The HSC's regional offices do not co-operate with the internal audit services of regional administrations. The staff of Regional Offices only analyse the internal audit reports on irregularities.

The HSC headquarters in Tirana is located in the building of the parliament's administration, but it will have to move to a new location. Since the beginning of 2007 the HSC management has been waiting for a decision by the Council of Ministers as to which building it will occupy. The expectations entertained last year by the HSC's Chairman that the HSC would be able to relocate soon have not materialised. In fact, these plans are "frozen". Due to the relocation plans, investments in the IT network, which is now 10 years old, have been dispensed with, but a modern network architecture with a central data security system is badly needed. Funds were invested to buy 30 new laptops and PCs. Sixteen auditors were trained to work with the IDEA software in the twinning project and experimented with the software in practice. Further training has been scheduled. All headquarters staff have access to Internet. The HSC has two IT experts. The regional offices have internal IT networks, but these networks are not connected to the headquarters Intranet.

The twinning project paid special attention to improving the audit methodology and audit practices of financial audit and performance audit. Six pilot exercises in financial audit were carried out, in line with the audit process, for certifying financial statements according to INTOSAI standards. Through

the pilot audits, which were carried out jointly with the twinning partners, the HSC has been familiarised with this type of audit and has benefitted from it. A financial audit manual, which was drafted with support of the twinning partner and tested during pilot audits, was completed in spring 2009 and made available on the Intranet for the auditors in the central headquarters. During the twinning project the HSC carried out four pilot performance audits and drafted a manual for performance audit. The new audit manuals for financial audit and performance audit have been made available in electronic form to the staff of the regional offices, and training in the use of these manuals of the staff in the regional offices has been scheduled for the third quarter of 2009.

Communication with the press and the public is considered to be rather positive. Regular meetings are held to maintain contacts with press agencies and citizens. The HSC is a member of INTOSAI (1994) and EUROSAI (1996); it also participates in the co-operation network organised by the Presidents of SAIs in EU candidate and potential candidate countries and the European Court of Auditors.

**The HSC is steadily improving the institutional framework of the head office so as to reinforce audit capacity and reduce overheads. Continuously seeking possibilities to improve the efficiency of its operations is a laudable ambition. On the other hand, the organisation needs time to adapt to the new organisational set-up.**

**Once the introduction of the new Organic Budget Law and of the PIFC concept shows positive results, the HSC might reconsider the need to maintain its three regional offices. In the event that the relocation of the headquarters takes more than two/three years, a management decision on the IT situation in the main building and in the regional offices seems to be needed.**

#### **4. Reform Agenda and Capacities**

In the somewhat difficult public sector environment of Albania, the HSC has substantially progressed (see point 5) in its audit activities as well as in its internal management and organisation.

This has been due, in the first place, to the efforts of the SAI itself and its staff. However, the role of technical assistance has also been important in contributing to the drafting of a development strategy for the period 2005-2008. Exchange of experiences in the key areas of audit and audit support activities with the Polish Supreme Chamber of Control took place in 2006, with the support of SIGMA. A twinning project with the National Audit Office of the United Kingdom and the Dutch Court of Audit started in January 2007 and ended in September 2008. The twinning project focused on institutional reform, improvement of audit practices, reform of the legal framework, and improvement of support processes, such as HRM and communications. According to HSC officials, the twinning project has been very helpful in all areas.

Despite the progress achieved, the HSC management realises that work remains to be done before the HSC can be transformed into a modern institution in accordance with the INTOSAI standards. Not only does the regulatory framework need to be adjusted, but also the audit process has to be further developed and the information technology (IT) architecture of the institution needs to be revised. The HSC has committed itself to meet the requirements for the HSC indicated in the Stabilisation and Association Agreement 2007-2012 for Albania and completed, in early 2009, a Strategic Development Plan (SDP) for the period 2009-2012. This plan is mainly based on the experience of the twinning project 2007-2008 and concerns activities to be carried out in the areas of legal framework, audit methodology, human resources, administrative support and IT. The SDP gives a good overview of what has to be done in each area, although the human resources part is weak in targeting activities. The IT part is in essence an investment plan for the coming three years. The objectives and activities concerning the core activity of the HSC – auditing – are on the other hand clearly formulated.

**With the Strategic Development Plan (SDP), the management of the HSC shows determination to improve the HSC's operations according to a well-structured, step-by-step approach. However, the capacity for implementing the SDP is limited. External assistance in implementing the SDP seems indispensable.**

## 5. Assessment

The present draft for amending the SSAI Act takes into account both the results of the twinning project and the recommendations made by SIGMA. The amendments to the Act had not been finalised by the end of May 2009.

Article 29 of the implementing Council Regulation (EC) No. 1085/2006 establishing an instrument for pre-accession assistance (IPA) of 12 June 2007 requires that a (potential) candidate country receiving pre-accession assistance designate an audit authority, whose task is to certify vis-à-vis the EU, independently of the national authorities that approve funding, the effective and sound functioning of the implemented national management and control systems and compliance with all prerequisites under EU law for the disbursement of funds. To this end, the Audit Authority has to carry out an annual audit programme and to report its audit findings to the EU. During the Sigma assessment there were indications that the HSC might be asked to shoulder the tasks of the Audit Authority. Accepting these tasks of the Audit Authority would not be in line with principle 3 of the INTOSAI Declaration of Mexico, which concerns the independence of the SAIs and indicates that SAIs should not be involved in operational activities of the executive branch.

Concerning the proposed amendment of article 7 of the SSAI Act, according to which the HSC may audit the funds that are provided by the European Union or other international organisations, this amendment should not only make clear that the HSC is entitled to audit the spending of EU funds up to the final beneficiaries of EU funds, but also that the HSC should audit the functioning of the EU fund management system, set up by the government according to EU requirements, including the functioning of the Audit Authority.

The existence of the local HSC offices may need to be reassessed as their context of operations evolves. In the meantime, however, it is necessary to develop the quality of the work performed by the local offices through appropriate training and efficient steering from headquarters.

The delay in moving to another headquarters has negative consequences for the development of information technology within the HSC. While the HSC has accomplished the goal of granting each headquarters staff member access to the Intranet and the Internet, urgently needed investments in the network have not been made due to the expected relocation of the HSC. A central data security system is still lacking. With only two IT experts, the relevant staffing is insufficient.

In the last few years the HSC's core audit processes have been well functioning given the present stage of development, and suitable support processes for current operations have been developed, taking into consideration the resources available.

The current approach to audits does not focus yet on certifying financial statements but rather concentrates on detecting violations of laws. In 2008 the HSC carried out 152 audits and in these audits it found irregularities amounting to the equivalent of 1.12% of annual state expenditures, i.e. 4 billion LEK (30.2 thousand euro). Of this amount, 2.7 billion LEK (20.4 thousand euro) could be recovered. The HSC undertakes follow-up audits each year to verify whether the sums have been recovered. In 2008 these audits numbered 122, out of the total of 152 audits.

The HSC sees itself only at the beginning of building up the necessary audit capacity. Up to now, only a few auditors have gained practical experience from the pilot audits, and these auditors pass on their know-how by means of a structured training programme. The HSC increased the number of its financial audits from four, carried out as pilot audits, to eight in 2008. Twelve financial audits are planned in 2009. The audit teams are to be reinforced by staff who participated in the pilot audits in order to make their expertise available to other auditors.

Similarly to financial audit, the difficulty of performance audit resides in its practical implementation during fieldwork. The HSC intends to carry out seven performance audits in 2009. Also with the support of the twinning partners, the HSC has developed a performance audit manual, which was finalised in February 2009 and is available on the Intranet.

While progress has been made in both performance audit and financial audit work, the HSC has still a long way to go to put into place a reliable system for imparting corresponding standards and professional capacities to its entire staff.

IT audits were not part of the twinning project and such audits have not yet been carried out by the HSC. The latter does not have the necessary experts in any case. However, in view of the fact that a public sector IT infrastructure is being built up in Albania and that this will involve considerable investment, the HSC will have to prepare itself for this audit matter in a timely manner.

Under the component “Institutional Reform”, a framework for audit planning has been developed. This framework defines criteria for using the HSC’s scarce resources and assists the HSC management in prioritising audit activities. The Annual Plan 2009 is based on this framework.

In addition, a tool for planning resources of individual audits has been developed. Streamlining the planning processes of audits (annual and individual) is certainly a step forward in the HSC’s attempts to improve the efficiency of its operations.

In the fight against fraud and corruption, the HSC monitors the government’s activities but does not carry out specific audits. In the twinning project the HSC developed a checklist for detecting and reporting suspicions of fraud. During regular audits in 2008, a total of 32 cases of violation of laws was reported to the Prosecutor’s Office.

Currently, quality control in the HSC focuses on the implementation of the traditional compliance audit and the legal aspects of audit results. Audit reports are first revised on the level of audit departments. Among other checks, this includes a review and, where appropriate, a revision by a lawyer and by the director of the audit department. The reports are subsequently reviewed by the lawyers and the head of the Directorate of Legal Issues, Quality Assurance and Methodology. In the next step, they are submitted to the Director General, who reviews them in accordance with high-quality criteria before forwarding them to the Chairman of the HSC for final review and approval.

In addition, in the course of the twinning project, the HSC developed a new quality assurance tool for controlling the quality of performed financial audits and performance audits. In February 2009 a quality report on 15 audits was produced.

The relationship to the entire Ministry of Finance needs to be improved (for example, the HSC was not involved in the development of the new Organic Budget Law) and specifically the relations of the HSC with the General Directorate of Internal Audit (IA) in the Ministry of Finance, which are still strained. Both institutions concentrate largely on detecting violations of laws instead of focusing their activities on helping to improve the government’s operations. Current working relations are formal and consist only of the exchange of planning documents.

The impact of HSC audit work is increasing. Each year, the Chairman of the HSC presents to the National Assembly two reports: an activity report in April and a report on budget execution in October. The HSC recommendations more and more often concern structural measures, although disciplinary measures for violations still constitute the main part of the HSC’s reporting to the National Assembly. The report on budget execution includes violations of laws (including tax violations). After the Prime Minister issued a decree to ministers that HSC recommendations should be given follow-up, the rate of implementation of recommendations by the government increased from 48% in 2004 to 72% in 2005, 74% in 2006, 77% in 2007 and 78.2% in 2008. Public awareness of the role and task of the HSC is growing. According to the Chairman of the Standing Committee on Economy and Finance of the National Assembly, the quality of HSC products is improving. Compared with the reports of a few years ago, current HSC reports contain more information (for parliament) on important issues and on how public funds are used, focus more on performance, and show the relation between the HSC and the Prosecutor’s Office. One major improvement in the HSC’s reporting noted by the Standing Committee is that, compared to the previous situation, reports are no longer limited to descriptions of the actual situation, running over several pages, but focus more on recommendations for the legislature and for the executive branch. Due also to physical proximity, the Chairman of the Standing Committee considers the Committee’s own relationship to

the HSC to be rather positive. The Committee still perceives a need for legal provisions that better define the respective roles of internal and external audit.

The Standing Committee evaluates the performance of the HSC each year and drafts a resolution that includes recommendations to the HSC. This resolution is based on the action plan of the HSC, presented in its annual report.

Article 3 of the SSAI Act refers to the audit of the accounts of the HSC by an independent body appointed by and reporting to the National Assembly. The HSC accounts have not been audited since 2002, whereas the supreme audit institution of the Albanian State should play an exemplary role for other public bodies with respect to its own budgetary and financial management. The Chairman of the Standing Committee acknowledged that from the point of view of transparency, it is recommended to carry out this audit annually. A practical solution to comply with the legal provision now needs to be quickly found.

Regarding the support processes, the HSC has further developed its HRM system. A training needs assessment framework has been set up, which will be further developed over the coming years. The improved prestige of the institution in the last few years has also been reflected in the staffing situation, which has shown stability and a low turnover. The deplorable situation experienced in 2007, when many HSC staff left in order to take better paid posts in the then newly established Anti-Corruption Committee, has now been overcome. The HSC does not have any problems with recruiting the required staff with bachelor's or master's degrees in law, economic sciences or engineering. Almost all staff recruited have professional experience, e.g. in accounting. Individual annual training plans have been developed. In addition, a staff performance appraisal system has been introduced. The HSC is satisfied with its current workforce of 160 people.

**The twinning project has had a positive impact on the development of the HSC. Progress has been made in both financial audit and performance audit work. The further introduction of these types of audit in the HSC in phases is a sensible approach to thoroughly preparing the staff of the HSC for their new tasks. The HSC should consider preparing for IT audit.**

**The HSC has developed new mechanisms for controlling audit quality. Regarding support processes, the HSC has further developed its HRM system. While the HSC has managed to grant each headquarters staff member access to the Intranet and to the Internet, urgently needed investments in the network have not been made due to the expected relocation of the HSC.**

**The impact of HSC audit work is increasing. The HSC recommendations more and more often concern structural measures, although disciplinary measures for violations still constitute the main part of the HSC's reporting to the National Assembly.**

**Taking into consideration principle 3 of the INTOSAI Declaration of Mexico concerning the independence of supreme audit institutions, the HSC should not assume the role of an Audit Authority, which is involved in verifying the effective and sound functioning of national management and control systems for EU pre-accession assistance.**

## **6. Recommendations for Assistance**

The HSC participates in technical activities organised by the network of presidents of candidate country and potential candidate country SAIs, in co-operation with the European Court of Auditors and SIGMA, and it is involved in various training activities supported by EUROSAI and INTOSAI, in particular the INTOSAI Development Initiative (IDI).

In November 2006, the HSC signed a co-operation agreement with the Account Chamber of the Russian Federation, but there are also co-operation agreements with the SAIs of Denmark, Hungary and Poland, and it intends to sign similar agreements with France and the Netherlands in 2009.

The HSC has further plans to co-operate with neighbouring countries in "joint" audits.

**Currently, the HSC is not planning to seek any further external assistance, although the SDP indicates the need for twinning assistance in the area of performance audit and quality control. However, further training is required in the short term in financial audit and in the long term in performance audit, and assistance in implementing the SDP seems to be necessary.**