



**SIGMA**

**Support for Improvement in Governance and Management**

A joint initiative of the OECD and the European Union, principally financed by the EU

**ALBANIA**

**PUBLIC EXPENDITURE  
MANAGEMENT SYSTEM**

**ASSESSMENT MAY 2009**

## 1. Summary

### *Main Developments since last year*

Progress has been made since the review conducted a year ago. The Organic Budget Law (OBL) has been approved and steps have been taken towards implementing it, particularly with regard to improved budget preparation timetabling, the appointment of authorising officers with clear responsibility for effective financial management and budget implementation, and the cascading of budget allocations to lower-level spending-units. An update of the 2005 Policy Paper on Financial Management and Control has been prepared and is under active discussion. A number of key posts and other vacancies have been filled in newly created directorates with important co-ordinating and control functions. Work has started on a more comprehensive strategy for capacity development.

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

The provisions of the OBL with regard to the timetabling of budget preparation and the clarification of roles within the budget process are positive, although the introduction of the “authorising officer”, with overarching responsibilities for financial management in an administrative rather than a political position, is likely to take time to be understood and made to work in practice. Moreover, the still existing political involvement in appointing top civil servants may influence negatively the development of a sustainable public expenditure management system. The budget cycle provisions are now aligned more realistically with what has proved to be necessary in practice in piloting and implementing the reform of the budget process in recent years. A significant omission is a clear framework for bringing currently off-budget activity, such as in state-owned enterprises and off-budget charging, under transparent control. The OBL includes very high-level provisions with regard to budget implementation, and care will be required to ensure that when the foreseen (in the OBL) Financial Management and Control Law (FMCL) is developed the two laws taken together provide a robust overall approach to public financial management.

A continuing concern is the gap between the ambitious reforms in resource allocation and budget formulation that Albania has adopted and the processes and capacities to implement plans and budgets effectively. Some measures are being taken. More comprehensive monitoring procedures were introduced in 2008, and attempts have been made to consolidate projects/ project management and to put procurement into a multi-year framework in order to avoid the short-term approach to expenditure mobilisation and the bunching of expenditures at year-end that is still apparent. However, it is recognised that much more needs to be done to create a culture of positive and effective management of resources that matches the performance aspirations behind budget formulation reforms. Political will is indispensable here. Unless the gap between the ambitious budget reform and the implementation of the plans is steadily closed, experience suggests that, at best, the gains in policy orientation and quality of actual expenditures will be limited in practice and, at worst, budget reforms will gradually degrade if they are seen to have little impact.

Work is in hand or planned on key basic financial management functions, such as transaction control, accounting, and audit and debt management. Taken together, the areas being addressed are the right ones for the establishment of a framework of strong financial management procedures. The current preparation of a policy and law on financial management and control will help to give this work focus. The completion of this work appears to be handicapped, however, by slow progress with the computer systems that underpin some of these developments. These delays are due to technical problems, to the lack of experience in handling those problems comprehensively, and to the need for greater attention to change management – positioning these systems within the wider role that they must play. For example, they must strengthen and at the same time streamline process controls and provide information for management purposes and for audit so as to assure management of the robustness of systems rather than just detecting problems after they appear.

So far, Albania appears to have been less affected by the impact of global recessionary influences than have many other countries in a similar position, but warning signs, such as a falling trend in revenue

growth and difficulties in raising bonds, are emerging. An important role for the new macro-fiscal directorate is likely to be the strengthening of the overall fiscal framework and the co-ordination of risk management strategies so as to minimise as far as possible the impact of macro-fiscal pressures on multi-year ceilings/sectoral plans and the emergence of “stop-go” or other disruptive tactics. Management of these risks will have important implications for deepening the multi-year and results-oriented budget formulation reforms that Albania is adopting, which are very dependent on stability and predictability at the micro-level for their effectiveness.

Although a more balanced framework for budget preparation and budget execution would be preferable, amending the OBL should not be the primary objective of the Albanian authorities. Reforms in budget preparation, which have already been piloted, should be further implemented.

There are a number of key budget execution areas where progress is more important and which need to be seen together in order to have a significant impact in closing the above gap. All of these areas are already receiving attention, but “how” they are tackled and made to support each other will be very important.

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

- Care will be required to ensure that, together with the new OBL, related legislation in place or being prepared provides a coherent framework for public financial management as a whole.
- Monitoring processes for budget implementation of programmes/activities need to be seen to have a real and positive impact leading to a demonstrable improvement in the quality of expenditures. Initially, it would seem preferable to demonstrate this impact in depth in a small number of selected areas so as to provide an example for others. It is vital to support this monitoring through the gradual development of strong information systems based on both financial and service data, of which the proposed FMIS will be a core element (step-by-step approach).
- The Financial Management and Control Policy Paper that has been drafted (and the law and related operational manual that will be derived from it) would benefit from being extended to focus not just on clarification of responsibility for control processes, but also on how financial management processes will empower the more dynamic management of resources and implementation of budgets that are sought.
- Fully integrating the management systems for internal and external debt will be important for putting into practice the gains of combining the two organisational units for internal and external debt.
- There is an urgent need to move beyond the firefighting of technical implementation problems of recent years to ensure that accounting system development is on a firmer footing and that the core system is fully reliable and relied upon. Options for the system’s longer-term role and development thereafter need to be evaluated. As it will take time for both financial and non-financial information systems to adequately support budget formulation reforms, focusing on a limited number of key areas so as to deepen monitoring and demonstrate impact seems to be important.
- Efforts to support the above monitoring with a capacity development strategy – for the Ministry of Finance but also for line ministries – that spans all of the above key areas should be encouraged. It is important for this strategy to be about more than just skill development, but to also address the managerial culture changes required, issues of motivation and effective staffing and retention measures.

It will take time for the gap to be closed and phasing will be important, as will attention to how these various aspects of reform support each other at each phase of the process.

Efforts to avoid fragmentation of reforms caused by project-based support by donors are also to be encouraged and will help the government to establish the linkages across functional developments.

The emergence of the multi-donor trust fund, to which donors contribute to support government efforts in public financial reform, is helpful and is already showing signs of promoting a more holistic approach to reform.

## 2. Legal Framework

Work on a new Organic Budget Law (OBL) has been in hand since 2002 following the introduction of a Medium-Term Budget Programme (MTBP). The law governs both budget preparation and budget execution; it also regulates issues related to government borrowing, accounting and auditing. Related aspects are procurement, which is regulated by a new law passed in 2006, and internal audit, which is regulated by a law passed in June 2007. The procurement and internal audit laws are both undergoing further review, in parallel with the preparation of a Financial Management and Control Law (FMCL) to deepen legal provisions with regard to budget implementation. A Law on Debt Policy was also approved in 2006.

The need for a new OBL has been recognised for some time in order to reflect developments in budgetary practice in recent years and to address weaknesses in the current law. A milestone was reached in June 2008 with the passage of the law by parliament.

### 2.1 Central Government

The new OBL contains a number of improvements in the regulatory framework and process definition. A balanced budget is required and controls over the creation of special funds have been created. A common classification system must be adopted in line with national requirements. There are tighter rules for the transfer of funds. A mid-year review of budget implementation and sustainability is required. There are reporting and progress review requirements. In general, the new OBL sets out more fully the budget preparation and monitoring calendar and brings the start of the process forward in order to allow more time for analysis and prioritisation within the medium-term budget framework that has been developed in recent years. Roles and responsibilities have been more clearly defined and a framework has been established for greater budget management delegation. The rights of parliament to information, including information about the levels of debt and contingent liabilities, have been extended and the timing improved. Provision for improved transparency has been made through requirements for the publishing of the medium-term budget plan and the posting of budget implementation progress reports on the government website. More discipline has been introduced regarding the rules for the transfer of funds. Penalties for contravention of required practice have been clearly defined. A framework has been established for the fiscal and budgetary management responsibilities of sub-national bodies.

A continuing weakness is the lack of a clear definition of the scope of both the budget and public accounts. In particular, the law is not clear about the information that is to be included with regard to donor-financed activity and about the financial relationship of the government with state-owned enterprises, which are defined only by implication and not directly. Furthermore, past practice has been to allow some portion of revenues collected by budget entities to remain “off-budget” – for example, a percentage of the collected fees and charges is used by budget entities according to their own specific priorities. The provision of a clear definition of what is to be encompassed by the budget and by public accounts is often an important characteristic of the OBL in other countries. A significant change is the separation of responsibilities for financial management between the political directorate in a ministry and its top civil servant, the General Secretary. The latter becomes an “authorising officer”, with separate authority and responsibility for ensuring the maintenance of standards of financial management in accordance with the OBL. While this separation of functions is a potentially useful step forward in terms of clarifying administrative responsibility, it will represent a significant change in the administrative culture of Albania. However, as appointments of top civil servants are still political nominations, there is a risk that the introduction of the different responsibilities of politicians and civil servants in managing public resources might not work out as foreseen in the new OBL and consequently might not create a sustainable environment in which the quality of the public expenditure system can develop and further improve (see also Sigma’s 2009 assessment report on the Public Service in Albania).

The new OBL is a mixture of a framework law, with references to secondary legislation, and a law which includes all of the required details. As a reflection of the emphasis in recent years on

developing an MTBP, it includes more details about budget formulation and fewer about execution and reporting. Only broad provisions are made with regard to financial management and control, internal audit and inspection, and references are made to more detailed provisions that will be included in other legislation, including the FMCL, which has yet to be fully developed. Although the rights of parliament to information have improved, reporting to parliament could be further strengthened if it were informed of progress in budget execution during the budget year. Furthermore, the OBL does not mention the role of the supreme audit institution in Albania, the High State Control, in auditing the budget process and in informing parliament of the results of its work. The High State Control Act of 1997 should clarify the procedures to be followed annually for informing parliament regarding the regularity and performance of the government's operations.

Work on implementing the new OBL has commenced. New budget timetables and procedures are being implemented in the budget preparation for 2010 and appear to be working well. All ministries and local bodies have been asked to nominate an authorising officer as their top administrator rather than the minister. Ministries have done so, but the process for local bodies will take a little longer. However, given the significant culture change implied in the authorising officer concept from the tradition where the minister was ultimately responsible for everything, including financial management, it is likely that the concept has not yet been fully understood, in spite of the workshops that have been held. It is important to quickly implement the proposed FMCL so as to clarify which responsibilities are attached to the position of authorising officer, followed by appropriate capacity development. Otherwise, the result could simply be confusion and a blurring of responsibilities.

The Public Procurement Law (PPL) is operational and has important implications for effective budget execution. There are some views within budget entities that the PPL provisions are too cumbersome and time-consuming and that they are contributing to the continuing weaknesses in budget execution. While part of the problem may be due to the lack of familiarity and of capacity to adapt from previous weak practices, this issue needs to be kept under review, along with the development of the proposed FMCL.

The development of a system of internal audit is also important for effective budget execution and probity. It is recognised that the new Internal Audit Law of June 2007 will need to be further updated in the light of changes in roles and responsibilities contained in the new OBL. The OBL makes separate provision for internal audit on the one hand and inspection activities on the other. This implies – although it is not directly stated – that these two functions should be separate. In practice, internal audit teams are still expected to carry out inspection-type functions, which undermines their capacity to develop a more independent and objective approach to internal audit. As an aid to effective and efficient budget execution, internal audit does not yet function as an important management tool. To further clarify the distinction between the roles of internal audit and inspection, consideration is now being given to the development of a Law on Inspection.

**In general, and in spite of the omissions referred to above, the Organic Budget Law (OBL) is in line with international standards, and the approval of the OBL and the first steps towards its implementation are positive achievements. Care will be required to ensure that, together with the OBL, related legislation in place or being prepared provides a coherent framework for public financial management as a whole.**

## **2.2 Local Government**

The new OBL provides an improved framework for public expenditure management at the local government level, in line with most of the measures envisaged for central government (see section 2.1). The Minister of Finance has the power to stipulate accounting and internal auditing standards that local authorities must observe.

As the equivalent to national provisions at local level, authorising officers will have responsibilities for maintaining standards of financial management in the local authority (with regard to the risk of an unsustainable public expenditure environment, see section 2.1 above). However, they will have dual responsibility to the council of the local authority and to the principal authorising officer in the

Ministry of Finance (MoF). How this dual responsibility will work in practice can only be tested; it is important that it is not implemented in such a way that it undermines local accountability for their own financial management.

There are positive provisions in the OBL with regard to requirements for the central government to declare transfers to local authorities by a specified time in the year and to declare the basis of those transfers. These requirements can serve as a basis for stabilising the amounts transferred over a period of years, but are not sufficient to provide a predictable basis for local budget planning.

Provision is made for local borrowing and the power to issue guarantees, together with controls over the amount of debt, based on parameters related to the underlying health of local finances, and requirements for notification of the exercise of powers and for the registration of new debts with the MoF. These provisions in themselves appear to be sound. It is not clear from the OBL, however, how and in what circumstances the MoF is empowered to constrain the exercise of such powers by local authorities, for example in the event of a severe fiscal downturn or of a threatened excess of the overall cap of 60% of GDP provided in the law for all public debt.

**While the OBL provides a stronger framework for central/local fiscal relationships, the more gradual implementation of the OBL at local level is probably a good thing. In particular, the appointment of authorising officers at local level, with a dual responsibility to the Ministry of Finance and to the local chief executive, potentially creates a subtle change in the relationship between local and central governments, and time will be needed for this change to be understood and for lessons to emerge.**

### **3. Institutional and Process Framework**

#### **3.1 Organisation**

Steps continue to be taken to realign functions within the MoF to reflect both modern practice and developments in expenditure management processes within Albania. Budget execution functions have been consolidated within the General Treasury Directorate. The General Treasury Directorate has established a Directorate for Central Co-ordination and Harmonisation of Financial Management and Control to provide oversight of internal control processes. Until now the management of these controls has been highly fragmented, and the new directorate is intended to supervise and ensure the implementation of a stronger overall framework. Improved co-operation between the departments of the General Budget Directorate is taking place with the development of the integrated planning and budgeting system, for example co-operation between the departments dealing with sector budget formulation on the one hand and investment programmes on the other. Monitoring functions within the General Budget Directorate are being enhanced. In addition, developments within the directorate are aimed at consolidating central public expenditure management relationships with sub-national bodies that had previously been attached to the Ministry of the Interior.

Internal debt management and external debt management have been brought together to form a single General Directorate of Debt Management. A General Directorate for Macro-Fiscal Management and Forecasting has also been established. The establishment of these new general directorates gives a higher status to these important functions. A new department has been created to co-ordinate the implementation of donor-financed projects; it will mainly focus on contracting EU projects and some World Bank projects and function as the Central Finance and Contracting Unit (CFCU)<sup>1</sup>.

There has been some improvement in filling vacancies within the MoF, including key posts such as the heads of the General Directorates of Debt Management and Macro-Fiscal Management and Forecasting and of staff of the new Directorate for Central Co-ordination and Harmonisation of Financial Management and Control. The IT function has been strengthened. However, significant vacancies remain and retention of staff is a continuing problem. Tackling these problems goes beyond

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<sup>1</sup> This department is not involved in the task of donor co-ordination, which is carried out by the Department of Strategy and Donor Co-ordination in the Council of Ministers.

the boundaries of the finance function. Work on the elaboration of a strategy for public service development has been ongoing for some time in the Ministry of Interior (MoI) and now in the Council of Ministers (CoM), but it seems to be held back by the need for supporting legislation, which will require the approval of 60% of parliamentarians.

The ambitious nature of some of the reforms that are being introduced requires strong and well co-ordinated programmes of capacity development, which address not only skill development but also cultural change and motivation. Efforts so far have been largely donor-funded, project-based and fragmented. The need for an overarching strategy in this respect has been recognised, and such a strategy is currently being worked on in the Department of Public Administration (DoPA) in the MoI, in co-operation with relevant staff in the MoF and financed by a multi-donor trust fund set up to support budget reforms. This work is fundamental to the success of the reforms and needs to be well-rounded, tackling both budget formulation and implementation and the creation of new attitudes towards resource management.

Within the CoM a department has been established to fulfil a strategic function in the Integrated Planning System (IPS) currently being introduced and to play a role in strengthening the links that are being forged between planning and budgeting systems. This department is helping to establish stronger relationships between the CoM, the Ministry of European Integration (MEI) and the MoF, which are actively and positively co-operating to implement the integrated procedures. The CoM has also taken over donor co-ordination functions from the Ministry of Economy, although further database development is recognised as necessary.

Also under the IPS processes, budget entities have been required to establish a strategic and planning committee, chaired by their respective ministers, and a structure of working groups, led by their respective general secretaries, to formulate budget plans for each programme. These working groups draw in managers related to each programme and involve them directly in the process of activity identification and prioritisation within the strategic plans already submitted by each budget entity.

**These organisational reforms are positive, and even more so now that progress has been made in filling the posts that had been created. This reform makes it possible to focus attention now on capacity development within the structures that have been created, where a more integrated and holistic approach is essential. Work to more fully integrate the management systems for internal and external debt will be important for putting into practice the gains of combining these organisational units.**

### **3.2 Macro-Fiscal Policy and Control**

The emergence of the new General Directorate for Macro-Fiscal Management and Forecasting is timely, as Albania moves towards elections and the global recession begins to bite. Although the situation is improving, there is still some volatility in fiscal forecasts and further improvements in models are necessary. It is an advantage that the head of the directorate has recent experience with the IMF and therefore has international experience of macro-fiscal discipline, but for sustainable solutions the staff of this new directorate should be trained on a permanent basis.

While so far Albania has not been as severely affected by recessionary pressures as some countries, danger signals exist. Debt in relation to GDP increased by a couple of points in 2009 (although the stock of domestic debt at the end of April 2009 has been reduced compared to the situation at the end of 2008), lack of liquidity in the market is beginning to have an impact – for example, on short-term bond issues, which make up a significant part of Albania's debt – and revenue growth is beginning to slow. These signals point to the need for both the further strengthening of the overall fiscal framework, including the hardening of parameters within that framework, and the development of risk management strategies aimed at handling uncertainty with the minimum disruptive impact on policy and service delivery. The budget reforms that are being introduced remain vulnerable to this disruption.

**The new General Directorate for Macro-Fiscal Management and Forecasting will potentially play an important role in co-ordinating risk identification and risk management at the**

## **macro-fiscal level and in minimising disruption and uncertainty for the management of budget plans at the sectoral level.**

### **3.3 Budget Preparation**

According to the new OBL, the budget is prepared on a cash basis covering local municipalities as well as the Social Security Fund and the Health Fund. According to the new OBL, foreign financing should be included in the budget, but in reality not all foreign funds flow through the budget and the Treasury.

In recent years, the focus has been on developing links between national strategies and priorities and the medium-term budgeting system that Albania has been seeking to develop since 2002. Until now, the linkages between those strategies, the medium-term budget statements produced and the annual budget have been very weak, resulting in some impact – but limited – on both what is implemented in practice and the quality of expenditures in the provision of services.

The Integrated Planning System (IPS) is a planning and monitoring framework (introduced in 2005), which aims to ensure that the core policy and financial processes developed by the government function in an integrated manner. These core processes are:

- National Strategy for Development and Integration (NSDI), which establishes the government's medium to longer-term goals and strategies for all sectors;
- Medium-Term Budget Programme (MTBP), which requires each ministry to develop a three-year rolling plan for the delivery of programme outputs aimed at achieving its policy objectives and goals within the ministry's expenditure ceiling, as set out in the government's fiscal plan.

The IPS aims to provide a set of operating principles and supporting structures to ensure that government planning and monitoring take place in as efficient and harmonised a way as possible (see also Sigma's 2009 assessment report on Policy-making and Co-ordination in Albania).

Given the importance that Albania attaches to the European integration agenda, the IPS is seen by the government as contributing significantly to enhancing the government's ability to deliver this agenda, since European integration will be at the centre of the NSDI, reflected in every sectoral and cross-cutting strategy, and taken into account whenever decisions regarding priorities need to be set and implementation monitored.

The IPS has seven core products:

- an Integrated Planning Calendar, which will be issued to ministries at the beginning of each year, covering the major requirements and deadlines for all core policy and financial processes;
- combined training programmes, to be delivered wherever feasible;
- each year, a Ministry Integrated Plan, which will contain the major commitments (including a list of proposed investment projects) for the core policy and financial processes;
- a single External Assistance Strategy document, to be produced annually, which identifies all priority areas where external assistance is needed;
- a single Ministry Monitoring Plan, to be negotiated annually with each ministry and encompassing all key outputs and indicators to be monitored by the centre;
- an IPS Information System (IPSIS), to serve as the primary system for integrated reporting on progress towards achieving the outputs and indicators contained in the Ministry Monitoring Plan; and
- Ministry Annual Reports, which will present the results achieved versus the targets set for all processes.

Under the IPS the above national strategy covering all sectors has now been prepared, with definitions of objectives, programmes and costs; the strategy has been designed in such a way as to provide a hook into the budgeting process. The strategy has been developed on the basis of sector strategies prepared by ministries and a number of cross-cutting strategies. Not all of these strategies have been completed, and still outstanding, perhaps crucially, is the public administration reform strategy. At the same time, budget entities are now preparing medium-term budget statements, which are required to address the priorities set out in the national strategy, within the ceilings set by the MoF and identifying the activities that can be implemented within their programmes.

This process appears to be functioning in practice. The MoF is working closely together with the MEI and the Department of Strategy and Donor Co-ordination in the Council of Ministers in the preparation of the 2009 budget round and the working groups seem to have made progress in preparing their activity plans within the ceilings (although the process allows for supplementary bidding, provided that within the ceilings the activities given priority are at least addressed), and the results are being actively discussed at a political level. Problems appear to be arising with regard to the clarity of activity definition and costing, although prioritisation within budgetary ceilings does appear to be taking place.

An important part of the new processes is the fixing of ceilings within which budget plans are to be produced; these ceilings are updated as the cycle unfolds. With a more integrated planning/budgeting process, it is important to achieve some degree of stability of the ceilings in both inter-budgetary and intra-budgetary cycles. Lack of predictability undermines both the linkages made and the quality of budget implementation. Some budget entities continue to complain of instability in this respect, and attention to risk management within the framework of the macro-risks referred to above and to minimisation of the impact of frequent changes is of paramount importance if budget entities are to be held effectively accountable for improving the quality of expenditures. A related problem that has emerged is the frequently changing definition by budget entities of the activities that they plan to implement. The General Budget Directorate is taking steps to dampen these changes, but it is clear that more remains to be done to create a climate in which plans remain consistent from one cycle to the next and that any changes made in both ceilings and activity plans are transparent and fully accounted for.

**The greatest potential weakness of the reforms undertaken is their sheer ambition. While some ministries that were involved in earlier pilots appear to be implementing the reforms and carrying out monitoring well, a period of consolidation to allow capacities and budget implementation procedures to catch up across all ministries and local bodies seems to be required.**

### **3.4 Budget Execution**

There seems to be a gap between budget formulation and budget execution reforms. On the one hand, budget formulation reforms are very ambitious in their efforts to link resources to performance. Many, more developed, countries continue to struggle with such reforms. On the other hand, the new OBL has only dealt with budget execution very broadly, and legislation in this area is fragmented and incomplete. Closing this gap will be vital for the effective orientation of resource management to policy delivery and for the quality of expenditures. At present the General Budget Directorate prepares every year guidelines for the implementation of the annual budget in order to facilitate and improve the budget implementation process.

The Ministry of Finance requires the production of annual procurement and cash-flow plans and sets cash spending limits based on these plans. However, the plans are often highly inaccurate, mainly due to a lack of capacity in completing them, but also to poor understanding of techniques for more dynamic budget implementation, such as undertaking procurement planning as far in advance as possible. The new computerised FMIS now being introduced provides improved cash-planning tools, but systems for applying these tools are not yet fully developed.

In general, line ministries do not appear to regard the cash-spending limits issued by the MoF as being particularly onerous. What seems to be more of a constraint on effective budget execution is the combined effect of different procedures for budget implementation. For example, with regard to investment expenditure, each year the Ministry of Education carries out a competitive process among local bodies for investment in education facilities; these investments then have to be designed and mobilised and procurement arranged. All of this is arranged around an annual calendar so that actual implementation and spending are squeezed into the final few months of the year. The unsurprising results across many sectors are a significant concentration of spending activity within a short space of time and large underspending for the year as a whole. The lack of clear and implementable plans at activity/project level at the beginning of the year, together with specific assignment of responsibilities for action, also results in a high volume of transfers in the course of the year as concrete plans emerge.

The MoF is implementing some measures to tackle these problems, such as consolidation of projects so that they are more easily mobilised and moving towards the introduction of multi-year procurement plans so as to improve the timeliness of procurement mobilisation (initially through bringing forward annual plans so that they are prepared in the previous year rather than waiting for the new year to start). Improvements in actual practice are slow to emerge, however. Unless steps are taken to address these problems, there is a danger that weak execution will undermine the credibility of improved budget formulation and the process of rolling forward from one cycle to the next, which is fundamental to the integrated multi-year nature of the reforms that Albania is seeking to introduce.

At present, ex ante control of individual transactions is exercised by both staff responsible within budget entities for control and by the national network of Treasury offices. The Treasury's ex ante control still functions as the last beacon of control. The changing institutional structures, new roles defined within the OBL, enabling of increased delegation (also within the OBL), the facilities provided by the new computerised FMIS, and the growing network of internal audit teams all make it possible to consider a different model of internal and transaction control, based on enhanced managerial responsibility. It is not yet clear, however, which model Albania may be moving towards in the medium term or what transitional process may be appropriate. There is a need to define the direction and path towards any changed model, while taking into account the need to implement reforms gradually.

There is an opportunity to tackle budget execution issues more comprehensively through the work on a Financial Management and Control Law (FMCL) that started towards the end of 2008. This work began with the drafting of a PIFC policy paper. The draft policy paper recognizes the important inter-connection between internal control mechanisms and quality of expenditures, but does not yet seem to set a clear way forward in tackling not only the control of expenditure but also measures to encourage the active management of expenditure control to achieve policy and service objectives.

**It would be useful if this dimension of the role of budget implementation processes in supporting and encouraging the improved quality of expenditures could not only be reflected in the PIFC policy paper but also added to the FMCL now being drafted and to the manual and training that will be provided.**

### **3.5 Accounting and Monitoring**

Accounting systems are still largely cash-based with some aspects of modified accrual. There are plans to review International Public Sector Accounting Standards and to implement reforms as appropriate. The OBL proposes a modified accrual system for expenditure, recognising expenditure when it is incurred rather than when payments are made, while retaining revenue on a cash-received basis. This is probably a realistic next step.

The FMIS has been under development for some years (since 2002). It is now at the stage of parallel run and of addressing any problems, with a view to full accounting reliance being placed on it later in 2009. However, what is being tested at the moment is still largely a treasury accounting system for transaction control, cash-flow management, and formal accounting and budget reporting purposes. Although the Treasury system provides monthly data for all spending-units and local governments, it

does not yet fulfil a management accounting role and provide deeper analysis for managerial purposes in budget entities. Budget entities are still keeping their own accounting records on a largely manual basis, assisted by spreadsheet systems. As a result, reconciliation between treasury and spending entity records is still necessary and can be difficult and time-consuming. Furthermore, it will be difficult for budget entities to track expenditures, using their largely manual recording processes, to the deeper analytical level (such as activities within programmes) that is being developed through budget formulation reforms. Modules are available within the FMIS, which might be used to bring about a more integrated approach to the provision of financial information, through which different needs might be met from a single database. However, it will require careful planning and data-flow mapping if it is to work effectively. An EU-funded project for strengthening public financial management, which is to be started in early 2010, will focus on using the FMIS more effectively by linking more budget entities to all available modules of the system.

However, it is clear that to ensure the quality of this work a realistic option appraisal needs to be made. Alternative approaches are available. The investment and subsequent maintenance cost of each approach are large and varied, and the choice of approach will have important implications for sustainability.

Key issues to be considered in the appraisal are as follows:

1. The integrity and stability of the core system that has already been developed and its readiness to act as a platform to build on: there are continuing problems with transaction processing because of initial data capture as well as interface through the banking system when those transactions are captured and transmitted to the accounting system. It is necessary to move away from fire-fighting problems to a position where the remaining issues are comprehensively understood and assurance procedures are in place so that the system can be relied upon to provide core treasury and accounting functions;
2. The configuration of network extension to budget entities: the extent to which these entities have online access to the core system and the configuration of the network;
3. The business processes, data flows and controls that are to be used in the system roll out both between budget entities and Treasury/MoF and within budget entities;
4. The extent to which system functionality is to be used/extended or to act as a link to off-system functionality provided by other systems/processes.

All of these considerations will have implications for option appraisal and the ultimate cost of system roll-out. They will therefore also have implications for what should be tested in the next stages of system extension.

One concern is that sufficient resources must be devoted to the maintenance and further development of the FMIS once its core facilities are fully operational. Experience elsewhere suggests that the resources required are significant and that clear management structures are needed for the system to be effective. An estimation of the potential scale of resources required to extend and maintain the system has now been developed, but it would be affected by the appraisal suggested above. Steps have been taken to boost both the IT unit within the MoF and the physical environment for the system installation. However, the unit remains very vulnerable to staff retention problems and difficulties in recruitment as the system is rolled out further.

The CoM and MoF have worked together in developing processes for monitoring expenditures as well as results compared to plans under the integrated planning and budgeting systems that were implemented across all ministries in 2008. This monitoring requires both quarterly in-year progress reporting and a formal progress review early in the new year to inform the start of the next cycle. It is important that these reports lead to effective follow-up if the process as a whole is to achieve credibility and sustainability. Experience in 2008 appears to have been patchy, with some ministries that had been involved in the piloting of the process doing better than others that were relatively new to the process. To some extent, this patchiness is to be expected at this stage.

However, the integrated nature of the reforms being implemented in Albania has proved to be difficult to achieve for many countries that have tried to implement such reforms. The weakest link in the chain has often been effective monitoring and follow-up. The national strategy in Albania covers 14 ministries and comprises 75 programmes, which include several hundred activities. The new FMIS has not yet been able to provide an analysis by activity in line with budget plans, although it has the capacity to do so. The development of improved and auditable information on results achieved is also likely to be a challenge. The danger is if data problems create so much “noise” that follow-up is weak, the reforms will lose their credibility and this will in turn affect the level of engagement in subsequent cycles. It may be more effective to focus on key areas and ensure that the data is available to monitor these areas as a minimum. Work initiated by the CoM in 2008 to create an intermediate level of “outcome”-based indicators between policy objectives and output indicators already developed at activity level may help in this regard. Even so, it may be more effective in the near future to focus on selected outcomes in order to monitor in depth. It will also require careful attention to the steps to be taken if resources are consumed without results being achieved or if other mismatches occur as well as to the circumstances determining where help will be given or sanctions applied and the form of help/sanctions that are likely to be the most effective.

**There is an urgent need to ensure that accounting system development is on a firmer footing and that the core system is fully reliable and relied upon. Options for the system’s longer-term role and development thereafter need to be evaluated. As it will take time for both financial and non-financial information systems to adequately support budget formulation reforms, focusing on a limited number of key areas so as to deepen monitoring and demonstrate impact seems to be important.**

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

As its contribution to the national plan, in February 2008 the Ministry of Finance published a Strategy for Public Finance Sector Development up to 2013, which stated the following overall vision: *“The public finance sector shall be professionally oriented towards efficient, effective, transparent and with integrity, mobilization and use of domestic financial resources, in accordance with the policies and priorities set out in the Government Plan and the National Strategy for Development and Integration.”*

It is a comprehensive strategy with four pillars and within the pillar “Improvement of the public finances management according to international standards” seven strategic priorities are identified. The strategy includes a costing and a phasing of reform activity in two-year slices up to 2013. The key elements of reform in the public finance sector are found in this strategy, including the reforms already in hand, and in general the plan seems well-rounded. Very importantly, attention is paid to the need for creating appropriate incentives to encourage positive participation in the reforms, for example by awarding additional budget resources based on the quality of the budget proposals that have been made.

However, the strategy tends to reflect the way in which it was prepared, with individual departments within the Ministry of Finance proposing their own activities from within their own competencies. What comes out less strongly in the strategy are the cross-cutting issues that require the activity of several departments acting together in order to achieve an impact not just on processes, but on what the public expenditure management system as a whole is capable of supporting in terms of outcomes. For example, to achieve an improvement in the quality of expenditures requires not just improved linkages between plans and budgets, but also tackling some of the barriers to improved effectiveness of expenditures inherent in current budget execution processes, such as cash management and procurement planning. These linkages are less clear. Achieving transparency and accountability for budget performance also requires co-operation across several departments and a more holistic approach to the use of data.

The definition of step changes (for example, removing excuses for weak budget execution, such as commencing procurement planning only once the budget has been approved) towards these high-level outcomes (such as improved quality/effectiveness of implemented expenditures) would help to make

the strategy much more objective-oriented and the basis for sequencing clearer. It would also help define measures of achievement if the cross-cutting linkages were made and activities packaged together in terms of the outcomes that they contribute to (for example, measurable indicators could be related to the quality/effectiveness of expenditures). At the moment, proposed indicators for implementation of the strategy are largely of a process nature.

The strategy does provide a sequencing of activities, but the rationale for this phasing is neither stated nor is its basis clear. Relating proposed activities to targeted outcomes would also make it easier to establish milestones and to have an idea of the basic elements that need to be put in place before more complicated reforms can work effectively. As discussed in Section 2.3 above, there is a need for some basic budget execution reforms to catch up with the ambitious reforms in budget formulation already being implemented.

The strategy includes a section on the important question of capacity development. It also recognises an underlying problem of the lack of staff numbers and experience in key areas compared to the administrations of other countries. However, at present much of this section is largely a review of training activities already being carried out to support ongoing reforms. There is little provided in the strategy in terms of concrete and integrated proposals for ensuring the adequate staff and experience levels in key areas (in the Ministry of Finance and line ministries) to enable the further reforms envisaged in the strategy to go forward. The strategy recognises the need for a longer-term training plan, but capacity development is about much more than just training and encompasses broader issues of human resources management and motivation, which need to be addressed. A capacity-development plan would also need to address the needs for improved infrastructure to sustain the IT developments currently underway and referred to above. Work on such a strategy is currently being co-ordinated by the Ministry of Interior (DoPA), but has not yet been completed.

**Both the sectoral and capacity development strategies must be seen as “living” documents and adapted in the light of experience. They would benefit from greater cross-functional integration and realistic phasing based on that experience so as to underline the complementarities between functional developments at each phase.**

## **5. Recommendations for Assistance**

The US Treasury provides long-term advisors to assist the Department for Combating Money-Laundering and the Treasury and Debt Department. A CARDS project is also assisting the Tax Department. The IMF has provided support through a resident advisor and by periodic visits from its Washington-based country team to lead in areas such as fiscal forecasting and the preparation of national accounts.

A potentially important development has been the agreement on the terms and conditions of a multi-donor trust fund to support ongoing developments in the integrated planning and budgeting system. The fund will make 7.2 million USD available for the implementation of eight components of reform. The trust fund focuses on the development of the planning, budget formulation and related monitoring processes. The mobilisation of the fund has been slow, but now appears to be gathering pace. Support for more basic financial management procedures are provided by an EU-financed twinning project, which began in September 2008. An IT project for strengthening financial management, foreseen to start in 2010, will need to be preceded by the option appraisal for the FMIS referred to above.

**All key reform areas seem to be covered by the available assistance. The new trust fund provides flexibility for covering gaps and deepening reforms as progress is made. It is important, however, that assistance be more than technical. Many of the challenges facing financial management reform in Albania concern change management and capacity gaps, and needs in that respect can sometimes be more difficult to perceive and define. Dialogue with the government should keep in mind the potential need for such support and advice.**