

DEVELOPMENTS OF PUBLIC INTERNAL FINANCIAL AND CONTROL SYSTEMS IN ALBANIA

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Abstract

This paper is based on Albania's inspiration for its membership in the European Union, by putting in place effective PIFC systems in public entities.

The Public Internal Financial Control (PIFC) was developed by the European Commission as a structured model for guiding national governments in establishing a state-of-the-art control environment in their income and spending units. This framework it aims to give reasonable assurance that transactions comply with the principles of a sound financial management, transparency, efficiency, effectiveness and economy, as well as with relevant legislation and budget guidelines¹. One of the conditions for all candidate countries that aim to enter European Union is to have in place effective internal control systems in the public sector. Therefore, it is expected that the candidate countries should establish and develop these systems according to the concept developed by the European Union, based on international standards and the best practice of European countries.

In this context since the year 2008 the Republic of Albania has undertaken intensive activities on the establishment and development of the internal financial control system in the public sector in accordance with the provided framework.

This paper presents the steps Albanian government has taken in implementing PIFC in the public sector. In addition, the impact that PIFC implementation has on the development of the public management, the status of these systems and the planned reforms in the future period are discussed. In the end closing opinions are provided as well as recommendations for further improvements in the PIFC systems.

Keywords: Public internal financial control, internal control components, public finance management.

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¹European commission definition of PIFC, included in Chapter 32 of the *acquis communautaire*.

1. Introduction

The Ministry of Finance is leading the public finance reform, based on best practice applied by European Member States and in conformity with European Commission requirements as specified in Chapter 32 of the EU Acquis Communautaire related with PIFC. In this context the area of internal controls is of crucial importance.

In keeping with the set concept, Republic of Albania has undertaken numerous activities during the last years for the establishment and development of the system, including: the adoption of the initial strategic documents, drafting of laws, the creation of organizational capacities and capacity building, and the implementation of the system with the public units.

Based on the assessment reports of OECD and DG Enlargement and on the annual reports published from Ministry of Finance on “Functioning of Public Internal Financial Control System at the General Government Units (GGU)”, it is noticed that Albania has a well developed PIFC legal framework in place, nevertheless many GGU² have problems with implementation.

In December 2014, Government of Albania adopted Public Finance Management Strategy 2014-2020, where among many areas where improvements are considered, the development of internal control systems in the public sector is stated as key to enhancing the effectiveness and efficiency of the public sector.

2. Brief history of the PIFC developments in Albania

The roots of the Albanian regulation of the public control system go back to 1992. This was the date of the establishment of the High State Control, the Albanian supreme audit institution. The next milestone was in 2003, when the first law on internal audit was approved by the Parliament and the General Internal Audit department was established within Ministry of Finance. This law was the basis for developing the concept of audit activity in public sector and establishing the independent structure of internal audit. Based on this law the financial control structures turned into internal audit structures. Based on best practice a new law on Internal Audit in the Public Sector no.9720, was approved in 2007.

² Based on the law no.9936, dated 26.06.2008 “On the Management of the Budgetary System”, General Government Units, comprise central and local government units as well as special funds (social and health insurance funds).

Furthermore, as a part of the legislative improvement process, in 2008 the Parliament approved the law no.9936 “On the Management of the Budgetary System in the Republic of Albania”, where the introduction of PIFC is set out.

Based on this main legal basis and in line with national and international professional developments in the internal control field, in 2010 the new Financial Management and Control law no.10296, dated 08.07.2010 was approved and also the existing law no.9720, dated 23.04.2007 “On Internal Audit in the Public Sector”, was amended.

As a result, the legislative basis for a harmonized PIFC has been set up composed of three pillars (i) Sound financial management and control (FMC) systems as a primary responsibility of managers in each unit of public expenditure. (ii) Independent and objective function of Internal Audit (IA), to support management and to provide reasonable assurance that control systems are established in accordance with rules and standards, according to the principles of a sound financial management. (iii) Central Harmonization Units (CHU) in the Ministry of Finance, to design and implement a methodology, to harmonize and standardize the quality system for FMC and IA.

A full law harmonization has been realized in the area of PIFC. Most of the methodologies and guidelines were drawn up and published from 2010 in the Ministry of Finance website.

The new PIFC system is based on the COSO model³. The internal control system of the general government units, in accordance with the COSO model, contains five well-known components. With the implementation of the COSO model and its components, the internal control system is covering all operational functions of the general government units, the relevant regulations and internal instructions (control environment), the identification of possible factors which can hinder the legal and effective implementation of the functions (risk management), the establishment of legal functioning assurance provisions (control activities), the related continuous communication tasks and the continuous monitoring and internal auditing of the public units (monitoring).

³Committee of Sponsoring Organizations of the Treadway Commission (COSO) is a private sector initiative, jointly sponsored and funded by: American Accounting Association (AAA), American Institute of Certified Public Accountants (AICPA), Financial Executives International (FEI), Institute of Management Accountants (IMA), The Institute of Internal Auditors (IIA), dedicated to providing thought leadership through the development of frameworks and guidance on enterprise risk management, internal control and fraud deterrence.

Ministry of Finance has also adopted strategic documents, setting up the implementation plans of the internal control systems in the GGU, like the 5 year implementation plan of a modern FMC system (2011-2016)" approved by the Minister of Finance Order no.11841, dated 10.06.2011. Then, in December 2014, as whole set of public finance management reforms was developed by the Government for the period 2014-2020, strengthening internal control systems objectives and actions to be taken in this field until 2020, become part of this document.

3. Main actors in the PIFC developments and monitoring

The main actors of the PIFC system in Albania are: the Minister of Finance - Central Harmonization unit for Public Internal Financial and Control (CHU/PIFC), Principal Authorizing Officer, Authorizing Officer and Executing Officer within GGU, IA units in allGGU.

3.1. Ministry of Finance - CHU/PIFC

The key role and responsibility for the harmonization and development of PIFC rests with the Ministry of Finance, which fulfils its role through the operations of the CHU/PIFC. The main duties of this structure is methodology development for FMC and IA, as well as providing guidance to public units in the implementation of PIFC as the basis for monitoring and control of public finances. This unit also collaborates with all public units and internal auditors in the public sector with the purpose to review and resolve problems and to introduce cooperation in the frame of the established effective internal control systems.

CHU/PIFC has developed methodologies for the standardization of basic internal controls, FMC manual and internal audit manual, as well as other guidelines reference issues related to the development of the PIFC system.

This harmonization unit also prepares annual reports to the Government, containing the undertaken and needed activities for further developing the PIFC System in Republic of Albania. Moreover, this unit is in charge of organizing continuous training capacity for internal auditors and employees in charge of FMC in the public sector.

3.2. Principal Authorizing Officer

The Principal Authorizing Officer is the highest rank employee by civil service law in the Ministry of Finance, responsible for preparation, implementation, internal financial control,

monitoring, reporting, and accounting of the state budget, who is accountable to the Minister of Finance.⁴

3.3. General Government Units (Authorizing Officer and Executing Officer)

Within each public unit, a management hierarchy is obligatory to be in place, with the head of the unit having the main responsibility for the approval of policies and internal rules of internal control, while the individual managerial responsibilities being assigned to Authorizing Officer and to every manager within the unit (including the heads of the subordinate units).

3.3.1. Authorizing Officer

Authorizing Officers are highest rank employees of GGU, responsible for preparing, implementation, internal financial control, monitoring, reporting, and accounting of their budget and are accountable to the Principal Authorizing Officer.⁵

Second level authorizing officers are public administration employees in each subordinate unit of GGU, with the same responsibilities as first level authorizing officers for their respective unit.

According to FMC legal basis the authorizing officer/head of the institution⁶ is responsible for establishing, implementation and development of the sound FMC system in his/her institution, including the establishment of rules for efficient, effective and economic use of resources available. This responsibility cannot be delegated.

The system of a sound FMC should be established by the management and on the basis of the general directions and recommendations of the CHU/PIFC.

3.3.2. Executing Officer

Executing officer has also a key role in implementing FMC system. The executing officer of a public unit is the head of the finance division of the public unit, directly responsible to the authorizing officer of the unit and is responsible for the quality of the following core processes:

- a) Medium term Budget Program (MTBP) and annual budget planning;

⁴The definition of this function is taken from the Law no. 9936, dated 26.06.2008 "On Management of Budgetary System in the Republic of Albania", Art 3, 18.

⁵Ibid. art. 19.

⁶Authorizing officer is the highest level of management based on the civil servants law. In line Ministries in Albania, this position belong to the Secretary General. While in other independent public units and municipalities the head of the unit has this function.

- b) Reporting and monitoring during budget executing process;
- c) Support function (controlling) for the authorizing officer (management).

3.3.3. Internal Audit Units

Based on IA legislation in force, all the public units must be covered with internal audit service through one of the ways provided for by the law. Currently, there are about 102 IA units established in public sector. These units perform their activity in line with the regulatory frame issued by the Ministry of Finance which is based on the international standards of IA field. IA function reporting line is at the top management level of the GGU. The head of the GGU is responsible for establishing an independent IA function and create all the necessary conditions that this function it can be performed in line with the accepted international standards set up in the country legal basis. More detailed information on IA activity is provided in section 4.2 below.

3.4. Monitoring function of Ministry of Finance

In order to follow up PIFC implementation and progress in GGU, CHU/PIFC, monitors continuously internal control systems in the public institutions.⁷ This evaluation is mainly based on the personal statement of authorizing officers of GGUs and on the annual report pertaining to the internal control system quality. All the GGUs are subject to the obligation of submitting to the Ministry of Finance the annual statement and report on the internal control system situation at the representative units, as well as the answers to the self-evaluation questionnaires. The statement format and report structure is a standard imposed by the Ministry of Finance by instruction no. 28, dated 15.12.2012 "On the Submission of the Annual Statement and Report on the Quality of Internal Control System at Public Units", in the context of putting in place the by-law acts of FMC. Also, every head of GGUs has to report yearly to the Ministry of Finance on the internal audit activity during the year.

The results of this monitoring are presented annually in a consolidated report, which is sent to the Government, High State Control Institute as well as to Parliament.

As it is stated above, Ministry of Finance monitoring of internal control systems takes place mainly by self-assessment and the evaluation of the annually questionnaire answered by the authorizing officers. CHU/PIFC should establish a monitoring system with on the spot controls to verify the provided information. This should be done in close cooperation with the

⁷Based on article 25 and 26 of the FMC law.

IA units of the organizations which have to audit the performance of the organization and the functioning of the internal control according to their audit plan.

4. Public Internal Financial Control environment in the public sector

PIFC system contains a comprehensive and consolidated control system, including the structure, method, administrative procedures and internal audit which are set to achieve management objectives based on principles of transparency, legality, efficiency and effectiveness. The elements of the internal control system in Albania have been described in the FMC law, and extend to all subsystems of the GGUs, as well as other public entities that use public funds or donor funds.

4.1. FMC system implementation

As mentioned in the previous sections, the FMC system in Republic of Albania is regulated by the respective legal framework and by internal acts. The established control environment presents a basis for the whole internal control system which creates discipline and climate that affects the quality of internal control.

However, the main role of FMC to lead to better performance, more transparency, more efficiency and effectiveness, in terms of spending public money is not yet fully understood by all public units. Still there is low awareness starting from the top management on the benefits of a sound internal control system for the managerial accountability. The internal reporting does not provide management reasonable assurance that the organization's objectives are met in an effective and efficient manner, transparently and in compliance with the law.

Generally, in the public sector there are clearly defined organizational structures which shows who is responsible for which sector in the institutions. During 2014, under Public Administration Department's guidance, job descriptions of civil servants were improved in order to present clear duties, responsibilities and expected specific results from each employee, as well as to clearly establish the responsibility of each manager in the institution. This improvement creates conditions for overcoming the situation where the relevant laws and bylaws, are the only criteria for an employee in performing his/her control activities. In addition to this, some GGUs under CHU/PIFC guidance are developing written guidelines and procedures regarding processes where internal controls are performed, in order to clearly define the execution of the process and the accountability of managers and employees. By developing such documents every employee gets a clear message from top management that

the control responsibility should be taken seriously and to understand their own role in the entire internal control system.

Management accountability and delegation of tasks are underdeveloped and misunderstood. The strict hierarchical system and the administrative tradition seem to be more based on sanctions than on incentives and support. Horizontal information and communication are poor, different units and organizations are not used to share information and experience.

The process of risk management and establishment of controlling procedures has not been fully understood or implemented. Even if risk register are developed they are not updated. Risk identification and assessment generally is not performed in the GGUs, which is crucial in order to establish effective controls. Effective controls based upon risk assessment provides for successful achievement of the objectives of the institution.

Adequate segregation of duties is not practiced in public sector institutions. This phenomenon is encountered more often in units with limited number of staff. The duties and responsibilities should be systematically segregated to several employees in order to have efficient and balanced verifications. This should contribute to decreasing the risk of abuse and errors that would provoke loss of assets and irregularities.

In order to be able to make the right decisions the managers need appropriate, timely, up to date, accurate and available information. However, in many GGUs there are no appropriate integrated IT systems which could decrease the load of manual work. The introduction of IT facilitates the process of reconciliation at all levels of activities and will mitigate the risk of errors. Effective IT systems produce accurate reports that contain operational, financial and non financial information which would facilitate business processes and its controlling. In establishing such systems the reliability and the security of the IT systems and data should be mainly the concern of the management and the internal auditors.

As it is necessary that internal control systems are supervised, during the routine management activities it is concluded that monitoring of control activities by the management is executed in ongoing basis at most public units. Regarding the review by the internal audit of internal control systems, in order to assess the quality of their functioning and to provide sustainable development, internal audit structures have no capacities to perform this task yet.

4.2. Internal Audit function implementation

The legal bases for internal audit in Albania clearly defines the functional independence as one of basic principle as well as the reporting line of this function directly to the head of public unit. In Albania the IA concept as an independent activity, supporting and advising management and providing reasonable assurance that the financial management and control systems have been established in compliance with the generally accepted rules and standards, is regulated by Law no. 9720, dated 23.04.2007 “On internal audit in the public sector”. However, the activities related to the development of internal audit system date back in 2003, when the first law on internal audit was approved and the General Internal Audit department was established within Ministry of Finance. This law was the bases for developing the concept of audit activity in public sector and establishing the independent structure of internal audit. Based on this law the financial control structures turned into internal audit structures. Later on, in order to reflect the international standards and the last developments in the field of IA, the legal base was reviewed in the year 2007 and in 2010.

Based on existing IA law all public units must be covered with internal audit service. The table below provides detailed information on the number of IA units established in the public entities in the last four years:

Table 1: Internal Audit Units establishment during 2012-2015

	Year 2012	Year 2013	Year 2014	Year 2015
Central Institutions	14	16	16	16
Depending Institutions	31	30	31	32
Prefecture & Sub/Prefecture	15	15	14	14
Independent Institutions	8	8	8	8
Local Institutions	41	37	31	32
Total	109	106	100	102

Source: Data gathered from the Ministry of Finance annual reports on internal audit activity

Based also in SIGMA assessment in 2013, the modernization of the IA function has been slow. IA units are still carrying out transaction-based compliance audits. The system based audit approach, described in the IA manual is not followed by most IA units. Management still requests IA to carry out activities related to financial inspection, although to a lesser degree than in previous years.

An analysis of audit reports show that systems and fields assessed with high risk by internal audit include procurement system and human resources system which present weaknesses in internal control systems and gaps in procedural and regulatory framework of the public unit.

After the research performed by IA units on internal control systems, the results show that, although, systems are established, they are weak or they do not function according to definitions in legal or sublegal acts.

5. Further PIFC reforms planned under European Union guidance

Based on Public Financial Management Strategy 2014-2020, the future PIFC developments stated in pillar five “On effective internal control”, of this document will consist mainly in strengthening implementation of internal control systems in all GGU⁸. In addition, the EU progress report recommendations provided yearly are considered to plan reforms a head in strengthening internal control systems.

GGUs are planned to be further guided by CHU/PIFC in developing a clear plan to implement FMC systems. Guidance will also be provided in introducing different FMC tools (such as clear organizational charts, book of processes, risk mapping and control plan). Moreover, IT supported control activities are planned to be strengthen on all levels in the public sector, with stricter access control, contingency plans for data protection and also developing IT audit capacities.

In the IA field, professionalization of IA function is considered, through continuous professional developments trainings provided by CHU/PIFC.

6. Conclusions and recommendations

This study focused on evaluating the steps Albanian government has taken in implementing internal control systems in the public sector, the status of these systems and the planned reforms in the future period.

It is concluded that in the public units in Albania, there is considerable scope for improvement to the practices and procedures used to establish effective and efficient internal control systems. In many government units, there is a lack of clarity on the steps to be taken in implementing such systems. None of the public units has an approved plan on implementing FMC.

In general, internal control systems are not completely known to heads of public units, therefore they have an unclear concept on the role of internal audit. Also, ensuring a better quality in the internal audit activity still remains a sensitive issue although solutions are sought in every assessment of this activity in the public sector.

⁸PIFC systems for all EU candidate countries are evaluated continuously by the European Commission.

Moreover, risk management is a poorly developed process in every GGU, as well as risk assessment during auditing activity are not employed and the level of auditing internal control systems is unknown. For this purpose additional training in risk assessment is needed, above all, for managers on all levels and for internal auditors.

Professional staff with the internal audit units remains an issue in all government levels. The absence of professionally qualified internal auditors has contributed to the under development of internal control systems in the public sector. Therefore, a revitalization of the IA function is needed focusing on strengthening IA units by means of developing the professional skills of IA staff. Management, should not only establish internal control systems, but also give sufficient consideration to the evaluation and monitoring of such systems in ongoing basis. Engagement of professional staff is an important factor to ensure effective and successful management of internal control systems established in public units.

All GGUs should improve their performance review procedures by developing internal documents which will clearly define who is doing what and in what way in the institution, and every activity will be controlled from the aspect of its compliance with the existing legal framework and accepted standards in order to determine the need of improving the processes. The internal auditors should have a special role in this.

The public units should start building modern management information systems which will enable quick and efficient reconciliation of accounting and other data as well as the production of financial and other type of reports.

In conclusion, the internal control systems in public units in Albania, in order to promote good governance, to ensure that taxpayers' money are used in an economic, efficient and effective way, presents numerous challenges in terms of implementation in accordance with international standards. In the future the focus should be on raising management awareness on the usefulness of the internal control and audit function, continuous staff capacity building, as well as performing the FMC and IA activities in accordance with international standards. The CHU/PIFC in the Ministry of Finance as the co-coordinating entity will have to play an important role in this process.

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