

**PROJECT INFORMATION DOCUMENT (PID)
IDENTIFICATION/CONCEPT STAGE**

Report No.: PIDC63043

Project Name	
Region	EUROPE AND CENTRAL ASIA
Country	Albania
Lending Instrument	IPF
Project ID	P159931
Borrower Name	Ministry of Finance
Implementing Agency	Ministry of Finance
Environment Category	C - Not Required
Date PID Prepared	21-Jul-2016
Estimated Date of Approval	30-Sep-2016
Initiation Note Review Decision	The review did authorize the preparation to continue

I. Introduction and Context

Country Context

Albania is a middle-income country that has made enormous strides in establishing a credible, multi-party democracy and market economy over the last two and a half decades. Following graduation from IDA to the IBRD in 2008, Albania has generally been able to maintain positive growth rates and financial stability. Before the global financial crisis, Albania was one of the fastest-growing economies in Europe, enjoying average annual real growth rates of 6%, accompanied by rapid reductions in poverty. Between 2002 and 2008, poverty fell to about 12.4%. However, after 2008 average growth halved and macroeconomic imbalances in the public and external sectors emerged. Poverty increased again in 2012 to 14.3%. Unemployment increased from 12.5% in 2008 to 17.6 % in 2014, with a slight improvement to 17.3% in 2015, while youth unemployment reached 32.1 % in the same period.

While Albania avoided a recession immediately post-2008, loose fiscal policies led to rapidly rising public debt (from 55 percent of GDP in 2008 to a projected peak at 72 percent in 2015). Substantial and growing public debt increased the vulnerability of the economy to high interest costs, rollover risks, and the potential of crowding out private sector growth. Lax fiscal policy and poor control over public financial management led the government to accumulate payment arrears to businesses which were estimated at 5.2 percent of GDP in 2013, and which were finally cleared in late 2015. Government arrears contributed to a deterioration in market activity and a rise in nonperforming loans (NPLs). As the crisis hit, problems of portfolio quality (stemming from an easing of credit standards and an overexposure to sectors such as construction) came to the fore and the NPL ratio climbed from 6.5 percent in 2008 to almost 25 percent in late 2014. Rising government arrears, loans in foreign currency to unhedged borrowers, cumbersome judicial procedures, and difficulties with collateral execution also contributed to the rise in NPLs.

Looking toward the future, Albania is focused on supporting economic recovery and growth, broadening and sustaining the country's social gains, and reducing vulnerability to climate change. Key challenges for Albania going forward include fiscal consolidation and strengthened public expenditure management, regulatory and institutional reform, reduction of infrastructure deficits, and improvement in the effectiveness of social protection systems and key health services.

Sectoral and Institutional Context

Albania has participated in a number of detailed reviews of its PFM. These include two PEFA assessments (2006 and 2011), a Public Expenditure Review (2006), a Public Finance Review (2013), a Public Finance Functional Review (2016), annual EU-SIGMA reviews, and other analysis by the World Bank, the IMF, the EC, and other organizations. The various reviews have plotted the progress Albania has made in improving its PFM. The last PEFA assessment for Albania from 2011 concluded that Albania has an adequately functioning fiscal and budget management system, in the sense that the system has enabled the government to finance and execute a budget that delivers public services to the general population. Albania scores relatively well on comprehensiveness and classification of the budget, basic treasury operations (including budget, and payroll controls), financial reporting/transparency and public access to government budget and financial information. Lagging areas, as identified in the 2011 PEFA assessment include: (i) multiyear perspective in fiscal planning and policy formulation; (ii) internal audit; (iii) implementation of the integrated planning system (FMIS); and (iv) the scope and nature of the external audit function.

The Government of Albania is committed to gradual introduction of a modern system of public sector accounting based on international standards. Public accounting in Albania is currently done on a cash basis with elements of accruals with regard to assets and liabilities. Cash based accounting and subsequent insufficient commitment control is seen as one of the factors which lead to the significant accumulation of arrears in the public sector. In accordance with Albania's PFM Strategy, approved by the Council of Ministers and published in December 2014, the Government wants to make a gradual transition to accrual accounting aligned with International Public Sector Accounting Standards (IPSAS).

While progress has been made on the development of IT systems, modern approaches to accounting in the public sector are in their infancy. Assets and liabilities, as well as revenues and expenses, are not comprehensively reported and the present system lacks important data on commitments and expenditure arrears. Lack of data is mainly related with the low level of professional capacities of staff, both at central and local level. Moreover, financial reporting from extra budgetary institutions is provided on an ad-hoc basis and their transactions are not reflected in the Treasury System (AGFIS). Disclosures in financial statements are rudimentary and need further development. The future production of useful financial statements depends on the development of a comprehensive IT system and practical accounting standards which are prepared in accordance with international norms.

A significant and sustained program of skills development will be required to effectively apply IPSAS/EPAS. There is no tradition of a modern accounting profession in the public sector, and as a result implementation capacity is extremely weak. The CHU has capable and knowledgeable staff and the MoF will start the process of recruiting additional staff in the Treasury Financial Reporting Unit later this year. These staff will need a considerable amount of support in developing the new legal framework, accounting standards and capacity building programs. There will also be a need to

develop the professional accounting skills of finance staff in budget agencies. This includes the development of accountancy curricula, teaching and examination processes, and other elements that ensure developing adequate competences for professionals. In addition, work needs to begin on increasing awareness of the importance of quality financial reporting amongst a broad range of other stakeholders (government auditors, government officials, parliamentarians and civil society organizations).

Relationship to CAS/CPS/CPF

Strengthening public service management and service delivery is one of the main priorities of the World Bank's current Country Partnership Framework (FY15-19), which was endorsed by the Bank's Board in May 2015. The CPF was preceded by a Systematic Country Diagnostic (SCD), which identified the reduction of macro-fiscal vulnerabilities to sustain growth as one of priority areas in Albania.

II. Project Development Objective(s)

Proposed Development Objective(s)

The proposed development objective of the project is to: develop a road map for public sector accrual accounting implementation and to support the early stages of this reform, including building essential technical skills.

Key Results

The proposed project is expected to achieve the following results which are aligned to the Albania PFM Strategy (2014-2020).

- a. Development of a national guide, institutional arrangements and long term action plan for transition from the existing public sector accounting and financial reporting framework, in alignment with the development of treasury system (AGFIS) into AFMIS.
- b. Presentation of financial statements in accordance with selected IPSAS standards.
- c. Improved quality of accounting, statistical and financial reporting evidenced by the PEFA assessment; Baseline: PEFA assessment 2011 finding that the current modified cash system of accounting is neither compliant with the 1993 Law on Accounting or IPSAS;
- d. Improved technical capacity of the Financial Reporting Unit of the MOF (in charge of Public Accounting rules implementation) and Central Harmonization Unit (in charge of Public Accounting methodology) in improving the quality of public sector financial reporting in accordance with international standards.
- e. Development of a sustainable public sector accounting qualification compatible with international good practices; and improved understanding and application of relevant accounting standards by practitioners and public sector auditors.
- f. Greater awareness of the benefits of improved public sector accounting and financial reporting by stakeholders (government officials, politicians, media and civil society organizations).

III. Preliminary Description

Concept Description

The proposed project encompasses activities under two broad components:

Component 1 - Development of public sector accounting and financial reporting in line with IPSAS.

Component 1.1: Assessment of the current situation on public accounting will be financed under separate Band Executed TF - P159932 which complements this project. The aim of this activity is to conduct a gap analysis comparing national accounting standards against IPSAS using the World Bank's standardized toolkit (Report on the Enhancement of Public Financial Reporting REPF). The results of this gap analysis will incorporate a roadmap for the further development of national accounting legislation and guidance, taking account of the Albania's needs and capacity constraints.

Component 1.2: Development of public accounting legal and regulatory framework. Under this component, the project will support the development of public sector accounting standards in accordance with IPSAS in Albania. This component encompasses the following activities: i) translation of IPSAS into Albanian, ii) development and enactment of national accounting legislation, and iii) national level implementation guidance.

Component 1.3: Review and amendment of the national chart of accounts . This component will include: i) the review, and ii) if needed, the amendment of the national chart of accounts in order to be fully in line with accrual accounting/ budgeting and statistical needs.

Component 1.4: Gradual implementation of international accepted accounting standards in line with IPSAS .

The project will focus on the implementation of the selected set of standards in budget institutions at central government level, and at least one pilot at a subnational government level. The implementation of the new accounting standards comprises both, the technical roll-out as well as training in the use of the new standards, including the generation and interpretation of financial information produced by the new standards. Training needs will be identified at the outset of the program (cf. capacity gap analysis under component 1). Support will also be provided to the MoF staff in leading the reform and address change management within the MoF and other budget institutions.

Component 2 - Development of MoF capacities and of professional accounting skills for public accounting practitioners

Component 2.1: Technical capacity building of the Financial Reporting Unit and Central Harmonization Unit (CHU) at the MoF .

This activity includes: i) defining institutional responsibilities, and ii) setting up a work plan for the newly created Financial Reporting Unit (Treasury) and the CHU.

Component 2.2: Development of professional accounting skills and a sustainable public sector accounting training mechanism .

In order to improve the professional accounting skills and develop local training capacities, the following activities are foreseen under this component: i) training of a selected number of financial officers to obtain an internationally recognized professional qualification certificate, ii) training of a sufficient number of trainers through the train of trainers approach, and iii) institutionalization of a local training and certification program at a local institution to ensure the sustainability of the development of public accounting skills in the long-run. The training foresees a two year training of one cohort (25 students in English) to obtain a professional qualification in IPSAS. Out of this cohort, a maximum of 15 candidates will be selected to receive additional methodological training to become trainers and be able to deliver the training afterwards. A continuous training and certification mechanism will be established and institutionalized at a local institutions. A dedicated working group, comprising all relevant stakeholders, will be established to define the content of the training and prepare the relevant legal framework to regulate training for public accountants in

Albania.

In terms of sequencing of the activities, the preparatory work for the implementation, i.e. components 1.1-1.3 will precede the gradual implementation of the new standards under component 1.4. However, capacity building activities (components 2.1 and 2.2) will start immediately, in order to ensure that the localization of the training program can be achieved within project duration. An overview on the sequencing of activities is provided in annex 5.

IV. Safeguard Policies that Might Apply

Safeguard Policies Triggered by the Project	Yes	No	TBD
Environmental Assessment OP/BP 4.01		x	
Natural Habitats OP/BP 4.04		x	
Forests OP/BP 4.36		x	
Pest Management OP 4.09		x	
Physical Cultural Resources OP/BP 4.11		x	
Indigenous Peoples OP/BP 4.10		x	
Involuntary Resettlement OP/BP 4.12		x	
Safety of Dams OP/BP 4.37		x	
Projects on International Waterways OP/BP 7.50		x	
Projects in Disputed Areas OP/BP 7.60		x	

V. Financing (in USD Million)

Total Project Cost:	1.125	Total Bank Financing:	0
Financing Gap:	0		
Financing Source			Amount
Free-standing TFs for Albania Country Unit			1.125

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