

statements as part of the loan application process, banks generally base their lending decisions on other factors including the amount of collateral, business forecasts and site visits.

VI. POLICY RECOMMENDATIONS

85. **The recommendations of this ROSC are interrelated and mutually supportive and are designed to collectively improve the financial reporting environment in Albania.** These recommendations, which are explained below and sequenced in Figure 1, fall under the six major pillars of the accounting and auditing infrastructure. In many instances, the reforms in each pillar will need to be conducted in parallel as the six pillars reinforce each other. For example, strengthening the standard-setting process without similarly bolstering the monitoring and enforcement mechanism will fail to address non-compliance with accounting standards. In terms of priority, the emphasis will need to be on building technical capacity across all the pillars. Figure 1 provides a simplified overview of key recommendations and suggested timing for implementation. Critical success factors for implementation include leadership from the highest levels of government, capitalizing on current desire for change and balancing of the incentives and disincentives for compliance with financial reporting requirements.

86. **Accordingly, it is recommended that the statutory framework governing accounting, auditing and financial reporting be enhanced using a holistic approach, taking into account other laws and regulations, including company law, tax law, etc.** It is recommended that a multi-disciplinary group be established to undertake the following:

- a comprehensive review of all the legislation related to accounting, auditing and financial reporting in order to identify vague or conflicting requirements, including those related to consolidation, and applicable accounting standards for non-bank financial intermediaries and microfinance institutions.
- preparing an audit law compliant with the Eighth EU Company Law Directive to include, but not limited to, the establishment of a public interest oversight system for the audit profession, enhanced quality assurance for statutory audits, and regulations on the registration of local and foreign auditors, including audit firms.
- establishing appropriate thresholds for simplified financial reporting requirements and exemption from annual statutory audit, including the proxies used to determine economically significant entities. This will avoid burdening SMEs with excessive financial reporting and auditing requirements. Conversely, it will ensure that *public interest entities* are subject to more demanding transparency and disclosure requirements. This should be done through an analysis of the business structure in Albania.
- requiring *public interest entities* to make their legal entity (and consolidated) financial statements readily available to the public within a reasonable period after the balance sheet date.
- harmonizing the tax framework with accounting, auditing and financial reporting legislation. IFRS and NAS will introduce new categories of revenues and expenses, therefore guidance will need to be given on how to reconcile the accounting profit/loss with the taxable profit/loss. In the absence, of guidance entities will intermingle tax and accounting standards in the preparation of financial statements.

87. **It is recommended that the accounting standard setting structure be enhanced to make it sustainable.** This would entail:

- expanding the current standard setting body to include a broader range of stakeholders in order to systematically address the needs of private and public sector stakeholders in the standard setting-process, including the appropriateness of the scope of IFRS and NAS application, that is simplified reporting requirements for SMEs and more rigorous reporting requirements for *public interest entities*.
- mobilizing funding and technical expertise in order to ensure that the accounting standards are up-to-date.
- documenting, disseminating and implementing a clear strategy for the drafting and adoption of standards, which includes an effective consultative process. This will help address the low level of awareness and implementation of accounting standards currently exhibited.
- exploring synergies with respect to translating accounting and auditing standards according to International Accounting Standards Committee Foundations (IASCF) and IFAC translation policies. The NAC should explore opportunities to collaborate with the auditing standard-setter, including pooling resources and using common software.
- banking and insurance regulators to engage in international forums exploring the relationship between prudential and general purpose financial statements in order to design prudential filters. This would address regulators' concerns that application of IFRS could jeopardize regulatory criteria of own funds and introduce volatility in the financial statements. In this context, the Bank of Albania should have regard to (i) the guidelines on a common reporting framework (COREP)²² to be used by credit institutions and investment firms when they report their solvency ratio to supervisory authorities under the Capital Requirements Directive, and (ii) the guidelines establishing a standardized financial reporting framework (FINREP) for credit institutions operating in the EU. This framework enables credit institutions to use the same standardized data formats and data definitions for prudential reporting in all countries where the framework is applied, reducing the reporting burden for credit institutions that operate cross-border, and lower barriers to the development of an efficient internal market in financial services. This is particularly important in the context of Albania where a significant portion of the banking sector is foreign owned.

88. **It is recommended that a sustainable auditing standard setting structure be created.** This would necessitate:

- establishing a sustainable auditing standard-setting process, ensuring the translation of ISAs and developing relevant audit practices, especially for SMEs
- mobilizing funding and technical expertise to ensure that ISA are translated in a timely manner. This could include exploring synergies with respect to translating IFRS.

89. **It is recommended that systematic institutionalized monitoring and enforcement mechanisms be established to ensure compliance with accounting and auditing standards.** This would require:

- updating legislation to clearly outline the authority of regulatory bodies to enforce accounting and auditing standards and to modernize the sanctions currently existing in order to make them better deterrents. While they were developed in the context of

²² The guidelines are available at <http://www.c-eps.org/standards.htm>.

listed companies, Albania may wish to have regard to the principles of accounting standard enforcement set out by the Committee of European Securities Regulators. Qualified audit reports should trigger investigations of the entities and unqualified audit reports, which should have triggered a qualification, should also lead to investigation of the audit firm.

- establishing a system of quality assurance subject to public oversight. Quality assurance for the statutory audit is fundamental for ensuring good audit quality, which adds credibility to published financial information and adding value and protection to shareholders, investors, creditors and other stakeholders. The system may draw upon existing practices in EU Members States, especially countries, which joined the EU on May 1, 2004, which have had to implement quality assurance systems in circumstances similar, albeit not identical, to Albania's. Also, IFAC SMO 1, *Quality Assurance*, is a useful guideline in this regard. The results of the external quality assurance system should feed into the Continuing Professional Development program and/or the disciplinary system, as appropriate.
- requiring statutory auditors and audit firms that conduct statutory audits of *public interest entities* to prepare and publish annual transparency reports. These reports should include a description of the network and its legal and structural arrangements, where the audit firm belongs to a network; information on the governance structure of the audit firm; a description of the internal quality control system; a list of the *public interest entities* which were audited by the audit firm during the years; and other relevant information that would assist users of the financial statements to gain confidence in the quality of the audit work conducted.
- establishing an effective system of investigations and sanctions to detect, correct and prevent inadequate execution of the statutory audit. The system may provide effective, proportionate and dissuasive civil, administrative or criminal penalties in respect of statutory auditors and audit firms, where statutory audits are not carried out in conformity with the Audit Law, ISA, and/or the Code of Ethics for Professional Accountants. Also, every measure taken or sanction imposed on statutory auditors and audit firms should be appropriately disclosed to the public. The system may draw upon existing practices in EU Members States and IFAC SMO 6, *Investigation and Discipline*, is a useful guideline in this regard.
- adequately staffing, in terms of numbers and expertise, the bodies responsible for monitoring and enforcement. Reviewers must have expertise to review financial statements to determine whether the accounting standards have been complied with. Likewise, reviewers of audit firms should have the capacity to assess whether the internal control mechanisms within firms are adequate and effective to ensure the performance of high quality audits.
- enhancing the register of statutory auditors and audit firms so that interested parties can determine rapidly whether a statutory auditor or an audit firm has been approved, etc. This will be facilitated through registration in a public electronic register. Availability of the public register in foreign language would greatly increase its usefulness especially in the context of foreign direct or portfolio investment.

90. **It is recommended that the professionalism and the quality of the work done by the accounting and auditing profession be improved.** This would be facilitated by:

- clarifying IEKA's mandate to include serving the public's interest.
- removing audit fee rate setting by the Government, which currently restricts the scope and quality of auditors work. Instead more reliance should be placed on the

quality assurance review and investigation and disciplinary process to monitor auditor independence and audit quality.

- seeking (full) membership of international bodies, such as IFAC and, over time the European Federation of Accountants. Membership in these international bodies often provides the discipline and structure to help local professional bodies adhere to minimum standards, which helps them improve.
- Clarifying the role and responsibilities of Certified Accountants and considering the merits of a regulatory underpinning.

91. **With regard to education and training, it is recommended that the number of accounting and auditing professionals able to prepare high quality financial statements and conduct high quality audits, respectively, be increased. Initiatives to attract bright graduate to the profession and to raise the recognition of the accounting and auditing qualifications in Albania should also be launched.** This would require:

- revamping the university accounting curriculum to include more material on IFRS, ISA, business ethics and corporate governance.
- providing incentives for individuals to join the profession. Incentives could be by way of government and business entities offering scholarships for university students to study accountings.
- updating the qualification standards in line with IFAC IES. This would include updating the content of the professional examination syllabus, the content of the professional examination and the assessment of the examination in order to include critical areas that are currently omitted. This would lead to better qualified professionals and better recognition of the qualification. Given the shortage of resources in Albania, synergies should be explored between the education and qualification of accountants and auditors.
- co-ordinating and facilitating training courses, particularly in the areas of IFRS and ISA, taught by regional and international experts. Accounting and auditing courses should progress from basic to advanced level. In addition, courses should be provided in specialist areas such as financial reporting and auditing of banks and insurance companies.
- systematically monitoring members for CPD compliance and considering suspending licenses of members for non-compliance.
- establishing a professional accountancy education centre to provide up-to-date training in accountancy, auditing and financial reporting and other related subject areas.
- establishing or re-establishing linkages with international accountancy professional bodies.

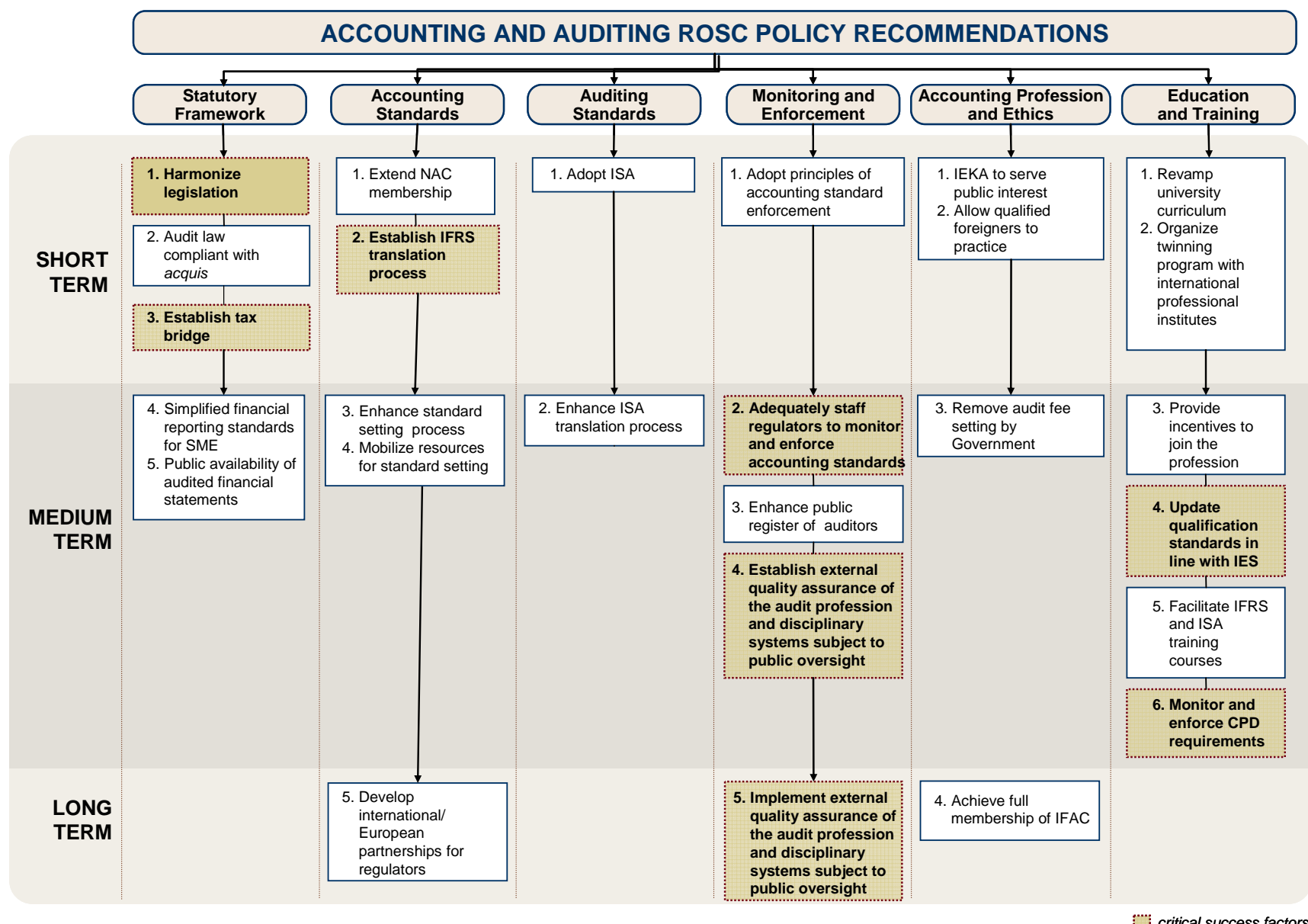


Figure 2: Policy Recommendations