

## **Towards application of new standards on accounting and auditing – Albanian challenge on implementing IAS/IFRSs and ISAs**

### **1. Necessity of the accounting reform. Analyses of the factors that justified the model selected**

Since 1947, together with the establishing of the command economy and nationalizing the property rights on all kinds of property, the need to establish an accounting system, to reflect and report on relationships of the individual entities to the communist government, became evident. The first accounting system was copied by the former Soviet Union and then translated in accordance with the needs and mentality of Albanian accountants. There was also an influence from the Italian school, because most of the accountants and academics involved in accountancy field, especially during the first years of communist regime, were coming from that school. Based on the laid down objectives of the command economy, the primary goal of accounting was “to follow up step by step” the accomplishment of planned numbers. So, the basic task of accounting information was to produce periodically relevant actual data for each of the planned indices and serve for analyzing of the economic performance. Another task of accounting was to serve to the safeguarding and use of enterprises’ assets.

The former accountancy system constituted by a simplified Chart of Accounts and the application of the rule of the Civil Code. The Chart of Accounts was used for the planning process and reconciling the National Public Accounts. The main aim of financial reporting was to present information on the financial position of the enterprises during financial periods for their limited range of users. Amongst the users of the financial statements were the Government agencies direct responsible for the respective industries, Bank of Albania, on which was laid the responsibility of the payments system and the settlement agency among different entities. User of the financial statements was also the National Planning Commission (a kind of Ministry of Planning Economy).

Accountants employed in the state-owned-enterprises of industrial and agricultural sector and other cooperative’s organizations composed the accountancy profession. The accountants were mainly educated at the university and/or in the other higher schools of economics. There were not any professional in the private practice, because this was not allowed.

There were principal and technical differences between the former accounting system used in a command economy and the accounting system operating in a market economy. The principal differences consisted on taking into account by the new system of main accounting principles applicable in IASs, when by the previous system most of them have been ignored. The manual of new accounting system (General Accounting Plan) published in 1993 gives some explanations on these technical differences. Such differences were mainly result of the differences in principles applicable, and partially from the need to disclose financial information and reports in line with the market economy requirements.

The inherited situation prevailing in the early nineties, when country was entering to the new conditions of market economy system, highlighted the immediate need for: (1) introducing and implementing a new accounting system that should be in line with the latest trends in this field; and (2) creating independent accountancy professions capable to give their services with high level of professionalism and integrity.

A careful studying and analyses of the existing situation, evidencing primarily all the difficulties that such a process would face, foreran the accomplishment of these two important tasks. Some of these difficulties are mentioned below:

- **Lack of appropriate knowledge.** Implementing a model of EU Standards in the accountancy field (i.e. in compliance with EU directives' requirements) would have always required appropriate theoretical knowledge and practical experience. In the early nineties such a new experience almost didn't exist in Albanian environment.
- Another difficulty was **lack of trained and skilled people** capable to lead such a reform in practice. It was mid-nineties when the first generations of post-communist accountants, equipped with new accounting knowledge, were prepared both within Albanian higher education institutions and abroad.
- **Need for application in a very short time.** New Accounting legislation and rules must be adopted quickly so as to open the way for developing accountancy reform and ruling out accounting system and standards and the work for developing the accountancy professions.

Beyond these difficulties, the early transition period of Albania from command toward market-oriented economy (1991 – 1994) was characterized by an intensive work that paves the way for the future developments. The output achieved was *“the preparation of new legal and regulatory framework that helped in reforming Albanian accounting system in line with the fourth EU Directive”*. Summaries of these events are mentioned below:

- January 1993, Albanian Parliament approved the new law “On accounting”.
- July 1993, Albanian Government approved the Albanian National Accounting Code, (Plani Kontabel i Pergjithshem - PKP).
- Since 1994, Albanian entities begun to prepare and present their financial statements and maintain their accounting systems, based on (PKP) Albanian National Accounting Code.
- During the years 1993 and 1994 the Albanian Ministry of Finance organized and developed training seminars with accountants throughout the country, on the new accounting system and on transformation from the previous system.

In Albania there was not any basis to design or to invent our own original system. The only way in our post-communist environment was the selection, adaptation and implementation of a model that would be in line with EU Directives and EU practices. Taking into the consideration our country integration goals, and the former legal and professional traditions, any model selected has to be one that could be implemented easily in practice.

At that time, while working to install a new accountancy profession and new accounting standards, the experts involved, along side the model they chosen for implementation, also they have taken into account the international benchmarks reflected in the IASs and ISAs, so the new legislation included most of the principles and policies arising by these benchmarks.

For the following reasons, briefly described below, the most appropriate system to be chosen was the Codified Accounting System (National Accounting Code), which was quite similar to the French system of accounting:

**Tradition.** A similar model of Accounting System, which was based on a strict regulatory and legal framework, **has been in place in Albania since 1947**. For practitioners of the accounting profession, those that traditionally have been working within such a detailed regulatory framework and other explanatory guidelines, the new Accounting System (National Accounting Code) chosen, wouldn't be difficult to be adapted and implemented.

**Need for general or wider application.** New Accounting System should be such a system that could be applied by a wide range and various entities. It could not be limited only to the traders (including both sole trader and legal persons), but also it has to be applied to other than trade industry (such as legal entities in the public sector, etc). Furthermore, it has to be applied both for maintaining accounting books and for the preparation of Financial Statements. Coverage of this wide range of accounting duties and responsibilities couldn't be achieved easily, without adopting an appropriate accounting system (i.e. one model of the EU continental part).

**Lack of experience.** In the circumstances where practitioners of accounting were not equipped with sufficient experience and knowledge on International Generally Accepted Accounting Standards and practices, presenting such standards in form of written guidelines and other explanatory material and codes became necessary.

**Linkage between accounting and fiscal practices.** In Albania, like in other neighboring countries, a strong link between accounting and fiscal rules exists. The accounting financial result is the basis for calculation of corporate income tax. So business entities should work towards harmonizing and developing effectively their information systems according to their needs.

**Requirements arising from other related laws and regulations.** Law "On commercial companies" provided to some extent for the selection of a EU model of continental accounting system. Regulation for commercial companies require the preparation and presentation of financial statements in a format and methodology that reflect the true and fair view of the financial position of the entities and their cash flows during the accounting period.

The approval of General Chart of Accounts (National Plan Comptable) has served as a guide for both professional accountants and economic entities; it was the first detailed instruction on how they have to organize accounting and prepare annual accounts (i.e. financial statements).

Alongside with this general chart of accounts were approved separate chart of accounts for banking sector and for the local and central government departments (public sector or government sector accounting).

For some entities, such as banks and other similar financial institutions, the relevant laws and regulations applicable has foreseen applying two types of standards, either local standards or international accounting standards. Based on this, for these types of entities was prepared a special chart of accounts, fully in line with IAS 32 and 39. From this point of view these financial institutions seems to have made very good steps towards applying international accounting standards. Anyway, still is early to say that they apply full IAS, as far as, they do not comply with all the requirements of all applicable IASs. Sometimes, such institutions are obliged to represent their financial statements in accordance with IASs requirements. This is important especially for those financial entities that are listed in EU stock market or in any other international stock market, where their shares are quoted and where they pretend to raise capital investments. So from this viewpoint these institutions have to face extra cost for converting their financial statement from their local format to another internationally accepted format.

The same rule is for foreign entities, other than financial institutions, operating in Albania and listed in international stock markets. They have to present two types of financial statements and also their auditing have to be done twice. So, to perform such obligation, they have to incur extra costs. Recently, even big size entities launched by the government for privatization, are facing the same thing. To be attractive from potential investors, their financial information has to present their true and fair view of the financial results and other economic operations. So, their financial statements have to be represented once again (two times) based on internationally accepted standards (such as IAS/IFRSs) and audited by independent auditors according to generally accepted standards and procedures (such as in this case ISAs issued by IFAC).

For the majority of the Albanian entities that consist on small and middle size entities, the actual applicable accounting norms are those prescribed by the actual law on accounting and by general chart of accounts. Use of these guidelines and regulations by professional accountants on SME's accounting, during the last decade, have helped in creating (1) a good experience and (2) an indispensable basis on how to apply these requirements and find right solutions, so the actual situation on accounting seems to be improved compared with the

starting point or “cross road” of the year 1993. But, alongside with the improvements made, and the experience gained, concerns still remain: as far as a big number of transactions between sellers and buyers are carried out in cash, the completeness of the accounting transactions and events presented in SME’s balance sheets and their income statements remain in question. Several discussions, bringing together various institutions such as government departments, banks, business entities, etc., have taken place and a lot of practical solutions and ideas have been given on how to work to make the market environment a more formalized economy. But, to some extent, as far as the most important user of SMEs financial statement remain fiscal authorities, these discussions have been restricted or limited to dealing with fiscal issues only. There is no doubt that government authorities are more interested in collecting incomes through taxes, and it seems that the only obligation for SMEs with regarding to the true and fair view of financial statements is related with taxation only. While, from one side the role of the tax authorities is increased, from the other side SME’s accounting being oriented primarily to tax issues is not developed as expected. In such a circumstances, must be done a clear distinction between the general-purposes published financial statements and other declarations for fiscal purposes. This will lead to a further classification of SMEs, and separation of those entities that shall produce fiscal declarations only, from other entities that will be obliged to apply in full accounting rules and regulations.

New accounting system would not have been able to give the required results if it was not associated with the preparation of training materials and with training of professionals to enable them for implementing such a system in practice and, without developing new independent accountancy professions. Training was considered crucial not only for the accounting system, but also for the expected performance of the new market economy our country was entering. Ministry of Finance (National Accounting Council) in cooperation and with the support of various foreign donors and projects (such as GTZ) lunched a short-term training program for the existing accountants (employed accountants), which covered the explanations on the new accounting system, new accounting law and National Accounting Code, as well. Through these short-term training courses organized in close cooperation with foreign experts and other academic staff of the Faculty of Economics in Tirana (Department of Finance and Accounting), practitioners were trained intensively on new accounting issues and on preparation of new models of financial statements. Also, they were given the necessary instructions on how to transform accounting of the entities from the old system to a new one. During the years 1993 and 1994, more than 3,500 accountants were involved in training. However, the process of learning new accounting standards was not quite an easy

task and a quick one, especially for those accountants of old generation, who had gathered a lot of experience in applying the previous accounting system. Training in the capital Tirana was followed by other trainings of accountants in main cities of Albania.

## **2. Development and Enhancement of Accountancy Professions:**

Part of the accounting reform was the development of the independent accountancy professions that will be able to provide relevant services to the business entities independently, practices that were not known until now. Even in this area, there was no need for any invention. EU models already exist, so the main focus of the work would be on adopting a model relevant to our conditions and to our accounting system chosen. Here below is described briefly the development and actual situation of the two independent accounting professions (certified accountant and chartered auditor).

### **Certified Accountant's profession**

The ordinance of Minister of Finance has set forth the criteria for selection, preparation and certification for the Certified Accountant's title.

According to MoF ordinance are entitled to apply for obtaining the certified accountant's title only those individuals provided with an University degree (diploma) in accounting, management, economics or similar, who have been working for at least three years in accounting and in preparing financial statements of commercial companies.

The Ministry for Finance (Department of Public Accounting) organizes with applicants every year at least one week intensive training course on accounting, on preparation of financial statements and other relevant legislation issues. Training means updating their knowledge and is combining both theoretical and practical professional competence. At the end of training an examination test is organized (there is only one exam applicants have to pass successfully so as to be provided with this certificate – Certified Accountant).

Hence, chartered accountant's title is provided to those that pass successfully this exam. According to regulations, a holder of such certificate will be allowed to enter the profession as independent professionals in the public practice, **only after** his or her prior employment relation with the last employer terminate.

Initially, these procedures started in 1998, and since that time, have continued regularly every year. Department of Public Accounting has provided up to date, with Certified Accountants' certificates more than 800 applicants. Anyway, providing with the CA's title does not necessarily mean that CA profession is automatically organized or self-regulated.

The first attempt to create a self-regulatory body dates in May 2000 with the establishment of the Association of Albanian Certified Accountants (LPKM). This association, which is working closely with the Department of Public Accounting in the Ministry of Finance, makes efforts to enforce internal rules for its members, emphasizing the need for CPD (determined obligatory according to the relevant ordinance of Ministry of Finance), professional standards, ethical behavior, etc., and is involved in more updating training and retraining courses.

As a new association dealing with enhancement of the accountancy profession, it is in need for assistance, especially for developing professional standards and professional ethics.

#### **Authorized Auditor's Profession (Chartered Auditor's Profession)**

Laws "On commercial companies" and "On state owned-enterprises" require for statutory audit of the respective entities that should be performed by independent authorized auditors, as a basis for giving an independent opinion for parties concerned and the public in general.

The work for organizing the audit profession started in 1995, when the Government Regulation No. 1, dated 2 October 1995, was approved. The regulation provided for developing the profession of Authorized Auditors, through establishing a self-regulatory body (IEKA) "Institute of Authorized chartered Auditors". The role of IEKA as a Professional Association was to develop the profession in general, to develop auditing and ethical standards, quality control procedures, to process for recognition and certification for its members, to develop education and training programs, as well as the overall protection of its members and the profession, etc.

The organization structure of IEKA represents a model where there is a mixture between self-regulatory regime and the participation of public administration departments that remains in charge of supervising, registration and disciplinary issues. The Institute has its own bodies, such as General Assembly Meeting, Council and Internal Control Committee that manage the activity of IEKA. At the same time the Minister of Finance supervises IEKA. Also at the Institute are set up the following commissions or bodies comprising members both from



Public Administration Departments and from IEKA (in these bodies the Public agencies representatives have the majority and the leading role).

- Commission for Registration - dealing with registering and producing every year a Chart of all authorized auditors, member of the Institute, licensed to perform statutory audit of financial statements of entities in Albania.
- The Appeal Chamber for Registration is a second stage body to appeal in case of disagreement with the resolutions of Registration Commission.
- Disciplinary Commission - Dealing with disciplinary issues regarding IEKA members, sued by the Institute, their colleagues or public agencies for violations of legislation, professional standards, or code of ethics.
- The Appeal Chamber for Discipline is a second stage body to appeal against the resolutions of the Discipline Commission in case of disagreements.

The entering in the profession during the first transitory period (up to end of 2000) was dependant on the following conditions:

- University education degree in economic Sciences;
- Practical experience in accounting and/or auditing field, for at least three years;
- Obligatory training in auditing for two weeks, organized by IEKA, supported by foreign consulting agencies;

Chartered Auditor's profession is supported by two projects of EU PHARE programs (1) Year 1996 – 1998, PHARE A1- 9404/015 “Auditing Reform in Albania” led by ATC a British Training Firm based in London - with main objective to establish the Albanian Institute of Authorized Chartered Auditors (IEKA). Through five exam tests, out of about 400 applications, was selected the first generation of auditors comprising 54 members, which for first two consecutive years didn't receive the final certificate. (It was considered as testing period for the profession in Albanian environment). (2) Year 1998 –2000, PHARE AL 97-08 –D1 –97-01 “Audit Reform –Technical Assistance to the Institute of Authorized Auditors of Albania” led by French Institutes of Accountants & Auditors (CNCC & OEC) in consortium with the Institute of Chartered Accountants of Scotland (ICAS). Two other generations of Auditors respectively 26 and 49-chartered auditors were prepared. The total number of chartered auditors prepared within the framework of the two above projects is 129. Only 107 exercise their profession in the public practice.

To be awarded with chartered auditor's title, applicants had to pass five written examination tests, organized by an Examination Board of the assessment of professional competencies (led by the members from the Ministry of Education and Sciences), comprising the following subjects:

- Accounting, Financial Analysis and Internal Control System,
- Commercial and Civil Law,
- Penal Code and Labor Law, Social Insurance Law
- Legal Framework and Auditing Standards,
- Company's Management,
- Taxation.

From January 2001 entering the auditor's profession has preceded, normally. This means that all the candidates who want to apply for entering the profession of Authorized Auditor should perform practical experience for at least three years before the qualifying exams take place (The Practical Experience Rules are approved by the General Assembly of IEKA on June 2000). An agreement between the candidate, the Audit Firm (Auditor) and IEKA should be signed. It may be in the form of Employment Contract or Service providing Contract, where the candidate is obliged to perform at least 600 hrs audit work per calendar year. Practical Experience is performed in an Audit Firm or at an Auditor's office that has at least three years of experience in auditing businesses. The supervision of the practical experience at the institute is done by a commission, which comprises members from the Institute and the Ministry of Education and Sciences.

During the practical experience the candidate is trained especially for those disciplines, where the university has not been provided appropriate knowledge, as well as for practical competence.

The Albanian Institute of Chartered Auditors, as a self-regulatory professional organization and with the core activities supervised by the Minister of Finance and other public government agencies, from January 1<sup>st</sup> 2003, has fully endorsed and implemented, as national standards, the International Standards on Auditing issued by IFAC, together with the Code of Ethics and the Continued Education and Qualification Guidelines.

**3. Developing relevant set of accounting standards and structures necessary for implementation of the new accounting law**

The approval by the Albanian parliament of the new accounting law recently is considered as a good opportunity to comply with the International Financial Reporting Standards (IAS/IFRS). The new accounting has been prepared with financial assistance from World Bank, within the programme of accounting reform in Albania. This law is the first step in developing good accounting practice and it has to contribute to the truth and fairness of Albanian financial reporting.

Albania like other southeastern European countries must increase both domestic and foreign investments in order to achieve the expected levels of economy growth. However, at present foreign and domestic investors often presume that the financial reporting provides limited information about the real financial conditions of the enterprise. This is especially true for small and medium sized enterprises that need to establish confidence of potential lenders and investors. Although, during the last decade has been made a considerable progress, major reform of accounting practice still need to take place, because while is not evidenced a sufficiently high level of commitment on the fundamental accounting principles applicable in a market economy, a significant priority were given to auditing, despite the fact that there was very little scope for a real auditing due to lack of proper accounts.

The success of the new accounting law, fully applicable from January 2006, which has to replace the existing law of January 1993, depends on the completion of the following tasks:

a) Performing appropriate training on applying IAS/IFRSs. The new accounting law on accounting and financial statements express explicitly the fact that international accounting standards (IAS/IFRS) will be purely or **applied “in full” to a group of important** business entities operating in Albania, such as second – tier banks, **insurance and** re-insurance companies, listed entities, foreign companies and/or their subsidiaries or branches operating in Albania, considering their parent companies in the origin country apply such standards. IAS/IFRS shall be applied in full by some big size entities even if they are not listed in any stock exchange (such as Power Corporation, Albtelecom, etc)

Within this part of the new accounting law, increasing awareness of, and training in, international accounting standards ought to concern a wide spectrum of Albanian society, comprising accounting professionals, auditors, heads of businesses, teachers, and management level members of the civil service working in the areas of tax (tax controllers), accounting or statistics (INSTAT).

b) Drafting of a new set of accounting regulations and standards in conformity or in line with international accounting standards and which will apply to other enterprises of all sizes that operate in all sectors of activity. This set of accounting regulations and standards should take into account: (1) the fact that Albanian economic development is largely based on the dynamism of small and medium sized enterprises, and (2) the existence of recent regulations and standards in the areas of financial institutions and the accounting for the public sector. As to this category of entities IFRSs are not really appropriate to serve as the basic accounting regulations, it is necessary for such purpose, to develop a set of national accounting standards for all entities, that will not be subject to the use of IFRSs as described in the new law on accounting and financial statements. Bearing in mind all the factors analysed in the first part of this paper, the development of new Albanian accounting standards shall be associated with further work on writing the detailed regulations on bookkeeping and organization of accounting, regulations on the use of chart of accountants, format of financial statements associated with explanatory material on their compilation, interpretation of accounting regulations for taxation purposes separately from other purposes such as statistical information and management purposes.

Recent accounting reform financed by World Bank has included all the above needs in its terms of reference for developing national accounting standards. In addition to the development of the national accounting standards, within this reform is foreseen:

- The organisation of the National Accounting Council and putting in place procedures, which will allow the council to carry out, the role attributed to it in the new law.
- Preparation on the basis of IAS/IFRS-s, as well as on the new accounting regulations and standards, training materials to be widespread all over the country
- Strengthening of the accounting profession and proper defining of the role of accounting in the economy through the professional organization of accountants.

#### **4. Putting in place a favourable environment for the development of financial reporting**

Accounting regulations and standards are useful only when they are complied with, and when they contribute to the publication of reliable and relevant financial reporting by enterprises. Thus three initiatives, which would contribute, to the transparency of financial reporting should be envisaged in the medium term:

- Setting up of a “one stop shop” for both the legal registration of financial statements and the supervision of procedures in respect of the creation and operation of enterprises;

- Creation of management support centres, whose objective would be to assist small business in management and in the preparation of financial statements;
- Development of a single database centralising financial statements of enterprises either under the auspices of INSTAT (statistics office) or of the commercial registrar.

**Setting up “One stop shops”.** No “one stop shops” currently exists to facilitate compliance by enterprises with the legal procedures necessary, both at the time of their creation and throughout their existence.

- Legal procedures for setting up an industrial or commercial business are carried out separately with each of the branches of the civil service administration concerned: company’s office, commercial court, statistics office, tax authorities, social security bodies, etc. These procedures are currently long and very complex.
- Annual financial statements of enterprises must be submitted to both the tax authorities and the statistics office. In practice they are usually only submitted to the tax authorities.

If a “one stop shop” were to exist, enterprises would henceforth only have to submit their accounts once, as it would be the task of the “one stop shop” to distribute the information gathered to the different users. This would contribute to the harmonisation of published financial reporting.

These “one stop shops”, which could be physically located either in the commercial registrar’s office, in branches of the Central Bank, or in the Chambers of Commerce, could also provide information to the database centralising financial statements referred to below.

**Management support centres.** At the level of small business, psychological barriers (refusal to provide information to third parties, particularly to tax authorities, impossibility of separating the resources and income of the enterprise from those of its owner, etc.) form an obstacle to obtaining reliable financial information and reporting.

The lack of accounting knowledge among managers of these micro-enterprises forms another obstacle, and the current poor relations between the tax authorities and accounting professionals require that initiatives be undertaken in this area.

Setting up management support centres, whose target populations would be sole traders and small enterprises, would form both a technical and strategic response to the absence of accounting skills in small enterprises.

This would require strong co-operation between accounting professionals, tax authorities, banks, chambers of commerce and the professional associations representing the enterprises in question.

The benefits, which could be expected from creating such centres, to the extent that all interested parties accept the principle of their creation, are broadly as follows:

**At the level of the enterprise:** access to the banking system, management assistance catering to the enterprise's needs, obtaining a minimum level of financial information which can be used in the case of disputes with the tax authorities, protection against what heads of small business often perceive to be the arbitrary nature of decisions of civil service bodies, and, possibly, obtaining certain tax benefits.

**At a macro-economic level:** possibility to enhance the collection of economic and accounting information in respect of small and medium sized, and improved statistical knowledge of such enterprises,

It should also be emphasized that such management support centres could constitute a new area of business for the accounting profession as they would principally be geared towards a new client base which, at present, mainly operates in the "informal" sector. Such enterprises are currently largely disconnected from accounting systems, avoid control by the tax authorities and do not furnish the required information to the statistics office.

Finally the introduction of management support centres in the agricultural sector (co-operatives, central purchasing and sales enterprises, collectors) could form the first step in the organisation of the Albanian agricultural professions.

### **Creation of a single database of financial statements**

In the light of current developments in computer systems and applications, a single national database of financial statements should allow:

- Transparency of financial reporting of enterprises required to publish their financial statements,
- Provision of a harmonised database of and for enterprises,
- Provision of a financial analysis service,
- An economic overview of national productive activity to be obtained.

Moreover the distinction, which currently exists, between the areas of legal information and accounting and financial information is no longer justified: a database of financial statements could be broadened to include information of a legal nature.

Thus a database of financial statements could also deal with legal information in respect of the status of businessmen and of company (changes in articles of association, registration of annual financial statements, liquidation, etc.).

A database of financial statements, dealing solely with financial data, could be rapidly established under the auspices of INSTAT, where a section monitoring enterprises, which operate in a similar manner to that required for operation of a single database of financial statements, currently exists.

It could also be established under the auspices of the commercial registrar; however the cost would be higher as it would then be necessary to put in place the structure, the computer systems and the human resources, which would be required for the operation of the database.

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