

1. ACTIVITY OF THE SUPERVISORY COUNCIL OF THE BANK OF ALBANIA

The decision-making process at the Bank of Albania is guided by the principles of lawfulness, professionalism, independence, and transparency. The Supervisory Council is the highest decision-making and supervisory body of the Bank of Albania. It is composed of nine members voted and appointed by the Assembly of the Republic of Albania.

The Supervisory Council has the ultimate responsibility to decide on the strategy of the Bank of Albania, the appointment of heads of departments, the approval of the organisational structure, as well as the fulfilment of obligations related with risk management and compliance.

In order to increase efficiency, the internal audit functions are delegated to the Audit Committee, which is responsible for the financial reporting process and the internal audit system.

The Supervisory Council has performed its activity in line with the provisions of the organic law and the procedures established in the regulation on the organisation and functioning of this body.

Highlights in the activity of the Council for 2017, include: (i) the establishment of the Resolution Department; (ii) the approval of the Macro-prudential Policy Strategy; (iii) the approval of the operational risk tolerance level at the Bank of Albania; and, (iv) the update of the Medium-term Development Strategy of the Bank of Albania.

THE SUPERVISORY COUNCIL - THE HIGHEST DECISION-MAKING BODY OF THE BANK OF ALBANIA

The Council held 15 meetings in 2017. Eight of these meetings focused on the review and approval of the monetary policy, divided in 4 quarterly and 4 intermediate meetings. In these meetings, after reviewing the latest macroeconomic development and factors that affect the performance of consumer prices in Albania, the Council took decisions on the key interest rates.

Throughout 2017, the Council has not changed the key interest rates, namely: (i) the policy rate at 1.25%; (ii) the overnight deposit rate at 0.25%; and (iii) the overnight lending rate at 2.25%.

Four meetings were dedicated to the analysis of the developments in the banking sector and in non-bank financial institutions. The other meetings addressed: (i)



the annual programme of the Council; (ii) the Annual Report of the Bank of Albania; and, (iii) the medium-term strategy, and the annual and medium-term budget.

a. Decision-making

The Supervisory Council has the power to approve all the decisions, regulations and guidelines of general application, issued by the Bank of Albania.

During 2017, the Council approved 82 decisions, of which 61 were acts approved for the first time and 21 were amendments to existing acts. The Council approved 29 regulations (of which 8 new and 21 amendments to existing regulations) and 1 guideline of general application.

These above-mentioned acts were issued in accordance with the duties of the Council, as defined in the organic law, such as: (i) monetary stability; (ii) licensing, regulation and supervision of banks and other financial institutions; and (iii) provision of the financial infrastructure (currency issue, the functioning of the Albanian Financial Instrument Settlement and Registration system, statistics, etc.).

b. Management and internal organisation

The organic law stipulates that the Council is responsible for: (i) approving the Statute and the internal regulations of the Bank of Albania; (ii) determining the organisational structure; and, (iii) approving the appointment of the heads of departments and defining employment conditions at the Bank of Albania.

In November, the Council approved the Medium-term Development Strategy 2018-2020 of the Bank of Albania, which is an update of the Strategy 2016-2018. The update was a necessary step before the approval of the budget of the Bank of Albania for 2018 and its medium-term heuristic budget for 2019-2020.

The strategy includes the main functions of the Bank of Albania: the policies (monetary, international reserve, banking supervision); financial infrastructure (currency issue, payments systems); other functions (research, statistics); and supporting services (human resources, legal issues, accounting and finance, procurement and services, IT).

In March, at the end of the probationary period, the Council approved the appointment of the head of the Financial Statistics Department.

c. Budget

The Council decides on the budget of the Bank of Albania, the management policies and the procedures on using financial assets to carry out the operational activity of the institution.



In November, the Council approved the 2018 annual budget and the medium-term guiding budget 2019-2020. The budget was drafted in accordance with the Medium-term Development Strategy of the Bank of Albania and departmental projections on medium-term incomes and expenditures. For the first time, this year, capital expenditures and the projections included in the budget were preliminarily approved by the Capital Expenditures Committee.

The budget aims at providing for the implementation of the main functions, the normal conduct of the activity and the fulfilment of the strategic objectives of the Bank of Albania. It is prepared by based on reference to the current situation in international markets, developments in the domestic market, the capital expenditure plan, and reflects the necessary operational expenditures for due management of assets and human resources.

THE SUPERVISORY COUNCIL AS THE HIGHEST SUPERVISORY BODY OF THE BANK OF ALBANIA

The Council considers the exercise of its supervision responsibility on the policies, management and operations of the Bank of Albania as particularly important.

To ensure compliance with the law and other acts regulating the daily activity of the Bank of Albania, the Council has been regularly informed by the relevant internal and external audits.

a. Internal audit

The internal audit is an activity independent of the management, which provides evaluation, reporting and objective certainty, as well as includes the compliance, internal auditing and risk management functions.

i. Control over management

According to the organic law, the Governor is accountable to the Council for the implementation of the approved decisions, as well as for the guidance, control and oversight on the management and operations of the Bank of Albania.

The administrators (the Governor and the two Deputy Governors) have informed the Supervisory Council on monthly basis about the economic, financial and monetary developments, in accordance with the legal obligations.

The Council has been also informed about the institution's management policies and methods of using the financial assets for the realisation of the operational activity of the Bank of Albania. Every month, information was presented on the financial position and result of the Bank of Albania and the international reserve management.



ii. Activity of the Audit Committee

In order to improve the decision-making of the Council and the management of the institution, the Audit Committee exercises its duties supporting the strengthening of internal and external control lines. This Committee is responsible for: (i) the financial reporting process; (ii) the internal control system; (iii) the internal and external audit; and, (iv) compliance with the legal and sub-legal acts into force.

The Committee is composed of three members of the Council, appointed by the Council, for a three year period. The members of the Committee are: Mr Petraq Milo (Chair), Ms Ela Golemi and Ms Denada Prifti, appointed on May 2015.

In 2017, the Audit Committee met six times and discussed issues such as: (i) the annual work plan; (ii) the drafting of financial statements; (iii) the external audit; (iv) the performance of the Audit Department commitments; and, (v) the annual and medium-term budget.

The Committee meets regularly with the Inspector General, without the presence of the administrators, and discusses the organisation of the Audit Department, the auditing annual plan and the commitments' performance. These meetings enabled members of the Committee to be informed on the internal control systems and risk management.

The Inspector General has regularly informed the Committee, and in turn the Council, on the findings and recommendations by the Audit Department, which provide an independent guarantee on the effectiveness and quality of the systems mentioned above.

In March, the Audit Committee held a meeting with the external auditor (KPMG) to discuss on the audit for 2016 and the certification of the financial statements. During the meeting, the external auditor communicated to the members of the Committee: (i) its assessment on the accounting principles at the Bank of Albania implemented in financial reporting; (ii) the main issues discussed with the management during the auditing process, particularly those significant on financial statements and the audit report; and, (iii) the main difficulties encountered during the auditing process. The Committee was also made aware about the innovations in this year's external audit report, as a result of the adoption of the International Financial Reporting Standards (IFRS).

The members of the Committee met with the head of the department responsible for finance to discuss issues like: the preparation of financial statements in accordance with the IFRS, internal control on financial reporting, the external audit process performance, and the draft of the annual and medium-term budget.



iii. Internal audit

The Inspector General and the Audit Department, periodically and independently: (i) assess the accounts and the accounting records, the management and operational procedures of the Bank of Albania, to ensure the implementation of the legal and sub-legal acts; and, (ii) offer reasonable assurance on the efficiency of the control system, risk and processes management, in order to fulfil the institutional objectives.

Based on the Internal Audit Policy, the Council approved the work plan of the Audit Department for 2017, which had been preliminarily approved by the Audit Committee. The annual plan is based on international internal audit standards and updated risk assessments on the identified functions in the revised audit universe. It also reflects the suggestions of the Council, Audit Committee and administrators related to the functions/processes that need to be audited, or requests for advising/investigating on specific issues, as well as the available budget for the year.

The Inspector General reported regularly to the Council on the realisation of this plan and the results of the auditing commitments.

iv. Risk management

In March, the Council approved, for first time, the operational risk level of tolerance at the Bank of Albania. The residual operational risks, classified as "high" and "medium", by the periodic assessment of the Inspector General, are now treated in accordance with the procedures set forth in the Operational Risk Management Policy. The approval of the level of tolerance was preliminarily discussed at the Audit Committee. The administrators, after joint consultations, may decide on how to handle risk, in accordance with the Policy and the level of tolerance defined by the Council.

In December, a regulation was approved on the administrative investigation of signalling (whistleblowing), protection of confidentiality and protection from retaliation at the Bank of Albania. The Regulation is pursuant to the relevant law and aims to prevent and counter corruption, promote signalling on actions or practices suspected of corruption, and protect the signalling employees.

b. External audit

The organic law provides that the Bank of Albania's accounts and records may be checked by external auditors of internationally-recognised auditing institutions appointed by the Council. The external auditor expresses his opinion if the reports prepared by the Bank of Albania represent fully and fairly the financial situation of the institution, in accordance with generally-accepted international accounting standards.



The financial statements of the Bank of Albania are audited so as to offer a reasonable reassurance that they are not inaccurate, as a result of errors or fraud. This provides the external auditor with a key role in maintaining the trust of financial markets and of the public in the financial statements of the Bank of Albania.

The Audit Committee reviews the effectiveness and appropriateness of the external audit function. Prior to submitting the opinion on the financial statements, the Committee meets with the external auditor, without the presence of the administrators, where the progress of the audit process is discussed.

ACCOUNTABILITY AND TRANSPARENCY

The Council has regularly complied with Bank of Albania's accountability obligations to the Assembly and its transparency obligations to the public, the financial system and the media.

The Council approves all reports and recommendations that are presented to the Assembly or the Council of Ministers, as well as the annual and financial reports of the Bank of Albania. These reports explain the decision-making at the Bank of Albania and its performance in light of achieving its legal objectives.

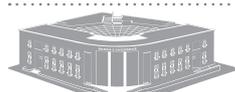
a. Approval of the Annual Report

In March, the Council approved the Annual Report 2016 and sent it to the Assembly and the Council of Ministers. The report describes the economy and financial situation in Albania and the activity of the Bank of Albania over the reporting period. The financial statements and the external auditor's opinion are an integral part of the Report. Information on the annual activity and results of the Audit Department for the period January-December 2016 was attached to the Annual Report. This document constitutes an additional instrument towards the accountability of the institution.

b. Approval of financial statements

An integral part of the annual report are also the financial statements verified and certified by the external auditor and his opinion. The financial statements were audited by KPMG Albania. Based on the review of the International Standard on Auditing 720 "The Auditor's Responsibilities Relating to Other Information", the auditor also used other information, from the Annual Report 2016, to consider whether this information was materially inconsistent with the financial statements.

In the opinion of KPMG Albania, the financial statements give a true and fair view of the Bank of Albania's financial position as at 31 December 2016, its financial performance and cash flows in accordance with IFRS.



c. Distribution of profit

In March, the Council approved the distribution of profit of the Bank of Albania for 2016 and the financial statements, in accordance with the International Financial Reporting Standards (IFRS). The value of net profit realised during 2016 was ALL 908,214,091.75 (calculated as difference between net income from the activity of the Bank of Albania, ALL 982,011,140.77, and net provisions, ALL 73,797,049.02).

The profit is approved by a separate decision from the one approving financial statements, which represent the value of the profit to be distributed. The value of profit is set in advance, in accordance with the organic law that provides for all possible deductions, subject to approval by the Council, before distribution.

d. Reporting to the Assembly and Council of Ministers

In accordance with the organic law, the Bank of Albania must publish: (i) a detailed opinion on the situation of the economy, every quarter; and (ii) a statement on the threat to the financial system stability, half yearly.

Monetary policy decisions in February, May, August and November are accompanied by the publication of the quarterly report of the monetary policy, which constitutes the main instrument of accountability and transparency in this field. These reports present a comprehensive description of the latest macroeconomic developments and factors that affect the performance of consumer prices in Albania.

In March and September, the Council discussed and approved the half-yearly reports of financial stability. These reports present Bank of Albania's assessment on the financial system developments in Albania, underline potential risks to financial stability and make recommendations in relation to the necessary measures for reducing risks.

The reports have been sent to the Assembly, the Council of Ministers and other central institutions of the Republic of Albania.

