

BANK OF ALBANIA

**THE BANK OF ALBANIA MEDIUM-TERM  
DEVELOPMENT PLAN  
(2003-2005)**

JANUARY 2003

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# CONTENTS

<b>CHAPTER I</b>	<b>7</b>
FOREWORD	7
<b>CHAPTER II</b>	
<b>OBSERVING TARGETS SET IN 1999-2002 STRATEGY.</b>	<b>9</b>
II.1. BANK OF ALBANIA INSTITUTIONAL MODEL.	9
II.2 BANK OF ALBANIA INSTITUTIONAL AUTONOMY.	9
II.3. COMPLETING AND IMPROVING LEGAL AND REGULATORY FRAMEWORK.	10
II.4. PUBLIC AWARENESS AND TRANSPARENCY.	11
II.5. MONETARY POLICY, BANKING SYSTEM AND FINANCIAL MARKETS.	12
II.6. BANK OF ALBANIA SPECIAL FACED EVENTS.	18
<b>CHAPTER III</b>	
<b>BANK OF ALBANIA OVERALL DEVELOPMENT.</b>	<b>21</b>
III.1. BANK OF ALBANIA DEVELOPMENT PRIORITIES.	21
III.2. BANK OF ALBANIA STRATEGIC TARGET- THE CONSUMER PRICE STABILITY.	22
III.3. MONETARY POLICY AND EXCHANGE RATE REGIME AND INSTRUMENTS.	26
III.4. BANK OF ALBANIA TRANSPARENCY, CREDIBILITY, ACCOUNTABILITY AND AUTONOMY.	31
III.5. PUBLIC EDUCATION AND RELATIONS TO IT.	33
III.6. FINANCIAL SYSTEM REFORMS.	35
III.7. INTEGRATION IN EU.	39
<b>CHAPTER IV</b>	
<b>BANK OF ALBANIA DEVELOPING CORE FUNCTIONS.</b>	<b>41</b>
IV.1. BANKING SUPERVISION.	41
IV.2. DEVELOPING STATISTICS.	46
IV.3. CURRENCY ISSUING.	51
IV.4. ACCOUNTING.	52
IV.5. PAYMENTS SYSTEM.	56
IV.6. HUMAN RESOURCES.	62
IV.7. BANK OF ALBANIA ORGANIZATIONAL STRUCTURE.	65

## **CHAPTER V**

<b>BANK OF ALBANIA SECONDARY FUNCTIONS</b>	<b>68</b>
V.1. INFORMATION TECHNOLOGY.	68
V.2. LEGAL FUNCTION.	70
V.3. BANK PROTECTION.	73
V.4. IMPROVING WORK CONDITIONS IN THE BANK.	74
V.5. STRENGTHENING INTERNAL AUDIT SKILLS.	75

## **CHAPTER VI**

<b>OTHER ISSUES.</b>	<b>78</b>
VI.1. BANK OF ALBANIA RELATIONS TO THIRD PARTIES.	78
VI.2. CONCLUSION.	79





# CHAPTER I

## FOREWORD

The document on “The Bank of Albania medium-term institutional development plan for 2003-2005” targets provision of a complete framework of the Bank of Albania institutional directives for the next three years. This document describes concrete steps to be taken to ensure the achievement of strategic targets. This document intends to be a helpful guide for the Bank staff on the medium term.

The Bank of Albania represents the Republic of Albania central bank, exercising activity pursuant to Article no. 161 of the Republic of Albania Constitution and Law no. 8269, dated 23.12.1997 changed by amendment dated 29.07.1998 (law no.8384) and 25.08.2002 (law no.8893).

Practically meeting duties assigned from this law and achieving targets require the Bank of Albania have an adequate and efficient management and organization, constantly improve, approve policies and undertake fair and optimal decisions and be farsighted. These requirements compel the Bank of Albania institutional plan be conceived for more than one-year<sup>1</sup>. Medium-term plans (3-year mainly) define the most important targets to be met over given period, main instruments to their achievement as well as set the basis for a number of longer-term targets, which attainment requests the preparation and implementation of such plans.

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<sup>1</sup> For the first time, this plan has been approved on the Bank of Albania Supervisory Board decision no.111, dated 17.11.1999.

A principal feature of these plans is that they form an axis around which are processed in detail short-term plans of every the Bank of Albania department or unit. The medium-term plan ensures compatibility on the whole institution activity. This plan is flexible permitting the intervention in case of urgent needs or in case of not reaching the achievement of a single or a number of targets.

The Bank of Albania strategy in the second decade is that of an institution attempting convergence with the most institutionally advanced central banks targeting final and long-term integration in the European monetary system.



## CHAPTER II

### OBSERVING TARGETS SET IN 1999-2002 STRATEGY.

#### II.1. BANK OF ALBANIA INSTITUTIONAL MODEL.

The Bank of Albania institutional development plan for 1999-2002 was an ambitious plan setting the European Central Bank as its institutional model. Such an ambitious objective was implemented in the situation when Albania's integration in EU represented a long process and ECB was a bank under construction, representative of a number of countries and not a single country only. There were taken prudential steps to this targeting the adoption of those ECB practices fit for the Albanian reality.

#### II.2 BANK OF ALBANIA INSTITUTIONAL AUTONOMY.

The period between the years 1999-2002 confirmed two issues: the importance of the central bank autonomy and the fragile support the external environment gave to the central bank autonomy in Albania.

Based on the relevance of the central bank autonomy, the Bank of Albania identified it as target of its overall strategy. The main conclusion<sup>2</sup> drawn from the studies has been that ***the Bank of Albania enjoys a wide legal autonomy, which is insufficient, in fact.***

<sup>2</sup> See: Cani, Sh., Baleta T., "Elements of a central bank independence. The Bank of Albania, how independent is it?" the Bank of Albania publication, September 1999.

Such definition sustained the analysis of the framework of measures to strengthen the autonomy, focusing the attention on the real strengthening of it. This would be possible through two main ways: achieving the main target and public awareness. The central bank managed to complete its legal targets, generally and inflation target, especially. This situation helped the central bank create an institutional profile of its own, characterized from: transparency, confidentiality, becoming a reference institution and consistency of its actions or own statements.

Public awareness served the central bank become public aware (media, political academic and professional environments and people in general) and attentive to the central bank operation.

### II.3. COMPLETING AND IMPROVING LEGAL AND REGULATORY FRAMEWORK.

Improving and completing the legal and regulatory framework intended clarification of clauses and further convergence with international standards. More specifically, it has been worked on and approved the law “On the prevention of money laundering”, the law “On deposit insurance” and amendments of the law “On the Bank of Albania”. As with the most relevant regulatory basis are presented guidelines prepared for the first time “On the custody and the liquidity”, “On the prevention of money laundering”, “On deposit certificates”, “On authorized accounting experts”, the regulation “On the licensing of loans and saving associations and their unions”, etc. There have been also approved some regulations on the new monetary policy instruments such as that “On the overnight deposits”, “On repurchase and reverse repurchase agreements” etc...

#### II.4. PUBLIC AWARENESS AND TRANSPARENCY.

Improving transparency and public awareness have been considered as key aspects to strengthen central bank transparency, expand its institutional accountability and improve the efficiency of its monetary policy.

With reference to these aspects, it might be said that the Bank of Albania has demonstrated a qualitative leap over 1999-2002. The first important step to transparency was the admission and the publication of IMF related assessment on the explication of its role, responsibilities and the targets it must meet. The Bank of Albania generally applies standards from the Code, whereas related to monetary policy formulation and reporting, the Bank of Albania partly implements these standards<sup>3</sup>.

As the most outstanding developments, we may mention the large number of publications and printed pages. The Bank of Albania published information ranking from the addition of statistical data to analysis and studies that have been broad and variable. This transformed the Bank of Albania into an important source of information and a reference institution either nationally or internationally. To facilitate communication with public, it has constructed a web site with a broad structure of headlines.

Another important step has been approving the regulation “On the Bank of Albania transparency and confidentiality” in June 2000. According to this regulation, the Bank of Albania

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<sup>3</sup>IMF related assessment on the Bank of Albania observing the “Code of the Best Practices on Transparency in Monetary and Financial Policies” The Bank of Albania “ Annual Report 2000”.

transparent operation is set at the basis of this regulation. Relative rules to confidentiality will be applicable in limited cases pursuant to the legislation in effect. Additionally to that, there were also set precise obligations regarding the enhancement of transparency.

## II.5. MONETARY POLICY, BANKING SYSTEM AND FINANCIAL MARKETS.

ESAF-2 arrangement (changed to PRGF agreement) signed with IMF set a number of targets regarding the framework the Albanian economy should be developed within. Targets relative to this agreement have been generally complete and the Bank of Albania has also contributed to their achievement. Unquestionable is its contribution in drafting a practical monetary policy in fine tune with the rest of economic policies especially with the fiscal policy. Moreover, the Bank of Albania has taken care to improve its monetary policy efficiency and implementing process through revising and processing monetary policy instruments.

Albanian economy, on the whole term, has been characterized from a rapid economic growth, a low inflation wavering at the average band of 0-3 percent, a declining budgetary deficit financed from foreign and domestic resources nearly at the same rates, a constant falling unemployment; domestic currency stability to both major market currencies, USD and EUR, increased income per capita of the population; a constant deficit of current account, etc. The main conclusion is that the Albanian economy managed to reset the lost balances after the 1997 unrest, generally. The main challenge stands to their consolidation and developing reforms to secure long-term growth and reduction of poverty on country basis.

For 1999-2002 inflation remained low, respectively at -1.0, 4.2 and 2.1 percent at the end of the years reducing from 42.1 and 8.7 percent in the years 1997 and 1998, meaning that inflation managed to keep low and positive rates and satisfy the medium-term quantitative target on it. The Bank of Albania challenge to maintain the achieved stability of prices especially in the situation when the country resulted as involved in a privatization program of strategic sectors faced a number of domestic and international policy upsets and was swept from power crisis without leaving aside other factors effect.

Banking system was characterized from progress and expansion in this period. The number of banks added from 10 to 14 and their activity expanded with 9.3 percent at annual average (real growth) bank deposits recorded the average growth of 28.2 percent annually; credit to economy accelerated and net outstanding credit from Lek 18.5 billion at the end of 1999 reached Lek 37.2 billion at the end of 2002. New credits rose from Lek 8 billion to 54.4 billion over the same period. Anyway, credit to economy keeps low rates yet. Banks recorded better financial results and bad credits discounted to 6.9 percent of the total credits as the second largest bank in the country namely the National Commercial Bank was privatized and there were taken steps to privatize the Savings Bank as well. Foreign capital in the banking system rose constantly from 63.6 percent to 95.2 percent (September 2002). Found in front of such situation, the Bank of Albania reacted through strengthening of its supervisory framework and further completion of the legal and regulatory framework.

The recorded situation in the banking system is as result of

implementing reform mainly focused in the privatization of both public banks and the largest of the Albanian banking system as well: namely the Savings Bank and the National Commercial Bank. Privatizing public banks was one of the main pillars of the undertaking reform. This process attended improving discipline in the financial market and transparency through founding institutions like the Bad Assets Resolution Trust (BART) or the Deposit Insurance Agency; revising, completing and strengthening the legal and the regulatory basis, improving the central bank transparency or strengthening its supervising skills.

However in these years additionally to the ever- growing activity of the banking system or its further expanding beyond Tirana, major aspects of the reform could not be totally complete. The Savings Bank failed to privatize due to the lack of a number of internal and external circumstances (not for the lack of willingness). Although privatized, the National Commercial Bank was not amid the major players of the banking market due to the problems with the new owner. BART could not manage completion of the function it was created for, becoming a harmful precedent for financial market discipline. Credit Registration Office comprised another unfinished project. Finally, the financial system in the latest three years and the Savings Bank especially was set under the pressure of political aggravations producing upsets.

Based on a more steady and balanced situation and quietness of the political situation; banking system development and the emergence of new players in the financial market, the Bank of Albania assessed as necessary undertaking the next two steps:

- Pass from the use of direct into indirect monetary policy instruments; and
- Target transition under a new monetary policy regime, that of inflation targeting in medium term.

### ***II.5.1. Monetary instruments.***

Using direct instruments instead of indirect ones was a gradual process targeting market familiarization with this change. The first to be revoked for banks was the credit ceiling and the next the minimum interest rate set on time deposits in Lek for public banks. Monetary policy signaling has been already achieved through fixed Repo rates in the weekly auctions organized from the Bank of Albania. The core interest rate has been approved from the Bank of Albania Supervisory Board. This Board regularly analyzes monetary policy monthly developments in the country.

The Bank of Albania current operating framework including outright purchase operations have been added to the framework of monetary policy instruments at the beginning of 2001.

Overnight deposits represent an already introduced instrument in February 2001 to help commercial banks manage the excessive liquidity through overnight deposits only in the Bank of Albania.

The most important changes with the required reserve instrument have been commercial banks using their own reserves held with the Bank of Albania at 5 percent. Another important change, occurring in the second half of 2000, was the remuneration of the required reserve.

### ***II.5.2. Markets.***

Undeveloped markets remain a weak point of the Albanian financial system impeding the efficient application of monetary policy and the reduction of informal market economy, limiting investment opportunity and disfiguring the mechanism of fixing market price efficiently. The main trouble for the existing markets was the weak competition through them.

Money market had an apparent development other markets compared. This was secured through motivating individuals to invest in the primary market of treasury bills to whatever the least added competition and organized Repo and reverse Repo auctions to it would be.

Foreign exchange market continued to show two aspects: the formal and informal market. The weight of each component element was considerable, however it remained the most competitive market on national basis. The informal market had a reducing weight due to the licensing of foreign exchange bureaus (the number of foreign exchange bureaus added with 48 in 1999-2002); the rising number of banks and their improving products; the enhancement of public confidence by foreign exchange formal market operators, the rising control of state organs targeting identification and minimization of informal market operations.

Capital market remains the least developed market in the country. Finally, Tirana Stock Exchange was permanently and administratively separated from the Bank of Albania body in June 2002. Throughout the entire period under scrutiny, Tirana Stock exchange recorded no listing, transaction or participation



in the privatization process. The Bank of Albania does not comprise not the supervisory authority of this market. Anyway, its development and progress is closely linked and affects interbank market development and other financial market operators'. Reverse from the banking system where the foreign capital is prevalent, the insurance market is typical for the significant presence of the domestic equity, the competitive market and the need for privatizing Albania's largest public institution as part of the financial reform in the country. Insurance market development in the latest years drives in the first plan the necessity for strengthening of its supervisory skills and its convergence to international standards.

### ***II.5.3. International reserve and management.***

The Bank of Albania gross international reserve over the period 1999-2002 had a rising trend from USD 520,8 to 840,6 million. International reserves expressed in months of imports changed from 6.1 at the end of 1999 to 6.9 at the end of September 2002. The Bank of Albania paid attention not merely to the structure of international reserves but also to their improving management. It was drafted and approved the policy of managing international reserve, which clearly defines the targets to evaluate this process.

Euro introduction as the legal tender for member countries in the EMU represented one of the most important developments to the completion of measures for establishing a broad European financial market comparable to that of the United States. For all investment institutions and the Bank of Albania as well, investment alternatives spread over the whole Euro area. International reserves can be actually invested in debt instruments

of all member countries of EMU at adequate liquidity terms and trading as well. At the same time, there have been created available possibilities on the decrease of fixed financial costs in the process of managing reserves as to the closure of superfluous accounts.

## **II.6. BANK OF ALBANIA SPECIAL FACED EVENTS.**

### ***II.6.1. Euro introduction.***

An important event for 12 member countries in EU was Euro introduction and the replacement of these countries circulating currencies. Such an event was also accompanied with activities over the rest of countries either directly or indirectly affected from this phenomenon. The Bank of Albania was committed in Euro introductory and preparatory campaign to be at any time sufficiently frontloaded with any required minting or printing of the new currency. Euro introduction in Albania did not encounter any problems generally. This process most straightforward effect was domestic currency appreciation (nearly 1.6 percent to USD and 1.8 percent to EUR) during December 2001 mainly resulted from the partly conversion of savings held in Euro component currencies outside the banking system. Consequently money supply and the currency outside banks recorded growth and the Bank of Albania was forced to purchase foreign exchange to disallow a strong artificial appreciation of Lek (at nearly USD 20,5 billion and EUR 25,72 million). Totally evaluated, there have been converted approximately EUR 131 million from these only 25 percent are physically exchanged at ATM's. Whether EUR will turn a major currency for the Albanian economy is something waiting for verification.

### ***II.6.2 Deposit retraction from the banking system.***

At the end of March 2002, both largest banks of the Albanian banking system witnessed the phenomenon of deposit retraction from public. This phenomenon initially emerged in restricted areas further spread over the rest of the country areas. This development took place when the Albanian banking system was experiencing its best term when was completed the legal framework to further strengthen its confidence in the banking system and economy developing with satisfactory rates. The fact that depositors showed unconfident to banks, mainly for this period, comprised a serious trouble as the banking system indicated as fragile and exposed to speculative and political crisis effects and the Albanian depositors had the propensity to react more energetically due to the bitter experience they had in 1997.

In this framework, the Bank of Albania reacted with a number of measures and decisions and adjusted its activity with other institutions mainly with the Ministry of Finance.

For the first time, the Bank of Albania gave short-term priority to another target that of maintaining stability of the banking system. This was materialized in resigning from the implementation of quantitative targets allowing deficit financing of government and the extension of limit from 5 to 8 percent, flowing liquidity mainly through practicing reverse Repo. Parallel to that, the Bank of Albania rose the interest to stimulate the return of currency in the system; developed a propagandistic and clarifying campaign for the harms conducted from the depositors behavior and the positive elements of the recently approved law on deposit insurance from the Parliament.

March 20- end of June 2002, total deposits withdrawn from the banking system were Lek 19.7 billion from these domestic and foreign currency denominated deposits comprised Lek 13,6 and 6,1 billion, respectively. The phenomenon of deposit retraction was considered as entirely ousted at the end of June 2002. However, the negative impacts of this phenomenon were disclosed in the extension of the currency outside banks; the addition of deficit financed from banks; the lack of liquidity in the banking system, the 0.1 percent depreciation of Lek to USD and rising inflation.

## **CHAPTER III**

### **BANK OF ALBANIA OVERALL DEVELOPMENT.**

#### **III.1. BANK OF ALBANIA DEVELOPMENT PRIORITIES.**

The Bank of Albania institutional development for the next three years aims offering a consolidated business plan to ensure the improving operating in all related aspects.

In the next three years apart from coping with the Bank of Albania related problems, it will be required a larger concentration in some aspects, comprising priorities of its institutional development.

Preparing a new monetary policy regime comprises one of the most important directions of its activity for the period 2003-2005. Over this term, it will strengthen its analyzing and forecasting skills that would be helping the assignment of realistic targets of monetary policy, its appropriate and right time decision-making. For this, it will be paid attention to improving data collection, processing and dissemination systems.

Strengthening and developing its supervisory skills comprises another important aspect of the central bank development in the circumstance when there is an added the number of operators or strengthened the competition between them, banking system is enhancing its role in domestic economy and new products are developed and it is expanding the activity.

The Bank of Albania shall pay attention to the enhancement of its institutional accountability and transparency of its activity.

Finally, not less important is that the Bank of Albania will be paying attention to the development of human resources and the creation of adequate work conditions as both of them comprise important elements regarding the completion of medium-term targets set in the Bank of Albania institutional development plan.

### III.2. BANK OF ALBANIA STRATEGIC TARGET- THE CONSUMER PRICE STABILITY.

A central bank law describes central bank strategic targets. The entire central bank activity is oriented from a legally established framework and aims the completion of strategic objectives. It represents those tasks delegated to the central bank institution on the side of Albanian government policy makers. In this framework, the Bank of Albania competence is to draft operating plans leading to the better and more efficient completion of legally established strategic objectives.

“Achieving and maintaining the consumer price stability “ comprises the Bank of Albania major and primary target. To serve this target, monetary policy is compiled, it is encouraged the development of the banking and lending market; it is prepared monetary programming; it is requested coordination with other institutions to harmonize policies; it undertaken communication with public etc.

In the daily and practical activity this target is materialized in keeping inflation at low and positive levels. For 2003-2005, the Bank of Albania will follow as main target of reaching inflation at the band of 2-4 percent.

While setting the quantitative aspect of the main target and drafting monetary policy to follow the completion of this target, the Bank of Albania will take into account to observe its own autonomy and

coordinate its monetary policy with economic growth and poverty reduction policies, fiscal policy, and efforts for fiscal consolidation, the policy of promoting employment etc. Acting in this way the Bank of Albania continues to contribute in the economic development of the country and specifies own targets and policies to this end.

Keeping a low and positive inflation has found most theoretical arguments on its convenience to a national economy. Apart from that these arguments are practically verified even in the case of Albania as well. In brief, low and positive inflation secures stable environment for taking investment decisions, increases the scale of their guaranty and forecasting profits; preserves the real value of savings and investments contributing in the support of economic growth. In other words, it reduces the uncertainty surrounding the economic environments and creates favorable conditions for a stable and real growth. On the other side, deflation created situations of unreasonable contraction with negative impacts on economic growth and employment.

Albania as a country aspiring membership in EU should ensure harmonization of inflation target as well. Euro area target on inflation is that it grows less than 2 percent. To this inflation, targeted at the band of 2-4 percent, is reasonable and in line with other integration targets as:

- It is a quantitative target classified under the low inflation group;
- It is close to the ECB target with a maximally relatively low deviation if compared to the levels of economy and market development;

- It is near target to Euro area inflation promoting stability of exchange rate in ratio to EUR. This stability is important in the conditions when the inflation in Albania is considerable affected from the exchange rate performance and most imports arriving from Euro area.

Anyway, the Bank of Albania target is higher as the economic and the financial market development in Albania is yet far off from that of Euro area. Still happening structural changes and developing reforms in Albania affect inflation in one way or another. In the situation that in the mid-term it is not expected a sharp reduction of imports and a significant growth of exports inflation shall continue to be influenced from imported inflation element. Albania's main trading partners, like Italy and Greece indicate an annual average inflation at 2.6 and 2.8 percent respectively (year 2002). Regional countries expected to invigorate trade transactions after signing the free trade agreements indicate a variable inflation from 1.5 to 41 percent. This affects maintaining inflation pressures as rather higher in Albania than in Euro area.

The above cited the Bank of Albania target is maintaining inflation at 3 percent annual average. Nevertheless such target is converted at the band of 2-4 percent taking into account the instability of the Albanian economy and the inefficient transmission of monetary policy decision in economy so that the central bank has a higher flexibility to operate and strengthen its public confidence, as institution as well. These measures are necessary to enhance autonomy and the accountability.

Inflation target is stated as annual growth of consumer prices. It is currently measured with the rate at the end of the year. Taking into



account that the annual change eliminates seasonal factors effect.

Inflation target expressed as annual growth of consumer prices is actually measured by the rate at the end of the year. Taking into account the annual change eliminates seasonal factors effect, but, only based on inflation rate at the end of the year, the result is not immune from casual factors effect adjusted or administered consumer price developments or indirect changes of taxes. This causes deviation from the target at the end of the year, although central ban actions have been compliant to monetary policy and served the target. Public awareness is the first important step to communicate such fact. However the repetition of such phenomena drives the central bank be corroded of its confidentiality. To minimize the reappearance of such events annual average inflation is regarded as the most appropriate approach to this. Using average rates diminishes the operation of casual factors but at the same time adds the pressure on the central bank to maintain inflation target throughout the whole year and not make adjustments at the end so that it might be alleged to that it observed inflation target at the end.

The Bank of Albania will broadly track observance of the target on annual average inflation declared at the end of the year. At the same time, the Bank of Albania will publish systematically the annual average inflation to get the public familiar with and prepared to its transition ahead. Parallel to this action the Bank of Albania will revise the methodology of accounting core inflation and shall consult it with international institutions of finance and INSTAT to finally conclude with a suitable rate within the first half of 2003. Core inflation will start publication in the second half of 2003. Through publicizing this kind of inflation, the Bank

of Albania shall enhance its level of transparency and accountability of its actions and influence on inflation. However, core inflation shall not instantly become a target. As core inflation is regularly obtained from the consumer basket emptied from high flexibility commodities as general rule, and in the case of Albanian nearly half of the basket is comprised from highly variable commodities, this category would reduce the central bank credibility or create the basis for less accountability. Adopting this category as target rate, the Bank of Albania will anticipate with a broad and intensive sensibility campaign of public opinion. Finally, the accurate measurement of inflation is also important. INSTAT survey in 2000 and the publication of inflation on a new basket base contributed considerably to the improvement of this indicator. However Albania's frequent and instant changes dictate the need for revision intending clarification of the consumer goods basket. For this the Bank of Albania would seek and assist INSTAT with performing the respective survey within 2004-2005 interval, aiming publication of the new inflation in 2006.

### **III.3. MONETARY POLICY AND EXCHANGE RATE REGIME AND INSTRUMENTS.**

The Bank of Albania defines the monetary policy and exchange rate regime in the country. Its legally recognized autonomy provides spaces to really state it through an entirely oriented monetary policy towards maintaining the consumer price stability. On the other hand, determining these regimes will be finely tuned with the overall economic development policy of the country due to the considerable impact these bear in economy.

In Albanian the applicable monetary policy is defined as

monetary targeting this regime having inflation as final target defines the annual growth of the money supply as intermediate target and subsequently sets three quantitative targets labeled: net domestic credit to government; the Bank of Albania net domestic assets and net international reserve. The three quantitative targets are obligatory to execution. Their kernel stands in the conceiving inflation as monetary phenomenon mainly on long terms and ensuring low inflation restricting the growth of money supply. This regime is applicable with the Bank of Albania system of indirect monetary policy instruments. The Bank of Albania has practically advanced rising the emphasis on inflation target completion.

However, inflation in countries like Albania is not purely a monetary phenomenon as in certain situations it is significantly influenced from other factors. Also exclusively concentrating in this indicator does not take into account a number of additional factors affecting the level of prices like fiscal and exchange rate indicators. Albania's large amount of currency in circulation reduces link between inflation and M3. In these conditions the Bank of Albania has assessed as most appropriate passing to another monetary policy regime underlining inflation. Inflation targeting is assessed as the most appropriate, eligible and highly used regime either by developed or transition economies. This regime takes into account a large number of factors affecting inflation moving parallel with the financial market development and the improvement of the Bank of Albania instruments.

The Bank of Albania has made its intention for changing the monetary policy public aware and has initiated the necessary preparations to this end. The Bank of Albania through its public

releases has also listed the reasons in favor of changing monetary policy regime as well as the terms to be complete for this step. In this framework, it has been nearly concluded that:

- The current monetary policy regime will be maintained throughout the medium-term period, 2003-2005;
- A new monetary policy regime will be prepared and
- Preparations will be intensified by the period 2005-2006;
- It will be ensured consensus on the new regime by year 2006;
- New regime will start application in year 2007.

The applicable exchange rate regime in the country is free and flexible. The current regime comprises an important prerequisite for inflation targeting, which means that the Bank of Albania will not be seeking to reach any assigned level of exchange rate of Lek to other foreign currencies. Also bank of Albania does not declare any concrete engagement related to foreign exchange market interventions. As to the foreign exchange transactions, the Bank of Albania shall continue to be present in cases when it is need to flatten the speculative movements in the domestic market as well as reorganize passive interventions (account transactions especially those held from the Ministry of Finance) to ensure adherence of its targets.

The Bank of Albania bases its operation on monetary policy indirect instruments, which is generally in accordance with the ECB framework of instruments. The Bank of Albania target related to these instruments will be their constantly improving their efficiency of use and total convergence with the ECB instruments.

The main instrument for signaling monetary policy shall remain repurchase agreement and its interest rate will play the role of

the core rate in economy. For an efficient using of repurchase instrument it is requested the complete knowledge on collateral and its value. The Bank of Albania medium term target is the estimation of collateral by its market value for any bank transaction where is needed its application. On the other hand it is required the securities market development in the Republic of Albania. Encouraging the trade of these securities comprises a medium-term target to be attained through:

- Creating the necessary required regulatory base for handing and the manner for fixing the value of collateral. For this it will be worked together with the Ministry of Finance to prolong the maturity of issued securities;
- Inciting the promotion of electronic swaps and the automation of issuing, processing accounting and maintaining data procedures. In this way, it shall be improved the processing capacities of the documentation and information from the primary market of Government securities and it will be aided the normal development of the secondary market for these securities.

Special attended aspects will be:

- The management of international reserve and
- The required reserve commercial banks hold in the Bank of Albania.

### ***III.3.1. International reserves.***

The main target regarding the management of international reserves is the addition of their net value ensuring a low investment

risk. The International reserve management framework contains the policy, investment committee, working rules for the committee and this framework is estimated as complete.

The main target ahead remains the addition of returns from the investment of net international reserves and their valuation to quantitative targets set, the diversification of investment portfolio, to reduce the risk and the rising number of partner banks and applicable instruments applicable in investment operations.

The Bank of Albania will manage international reserves in medium term in view of its attained experience with this respect, the lack of such experiences from other institutions (inside the country); the organic relation that exists between international reserve management and the exchange rate effect on one hand and monetary policy targets on the other, and the required autonomy to reach the targets with this respect.

The policy for managing international reserve envisages that funds be partly managed from external administrators. Exercising this possibility will be able to realize when both technical and legal terms of any business contract possibly of this nature will be clearer for the Bank of Albania. Central banks experience having a better usage of this opportunity shall be applicable.

Changing the policy of managing reserves intending their constant improvement will be carried every year. First to be intended is the accurate definition of its role and responsibilities of all the staff dealing with such an activity and their changing operation into a measurable activity from the financial viewpoint. The second to be targeted is that the regulative framework be

enriched with risk and investment performance concepts and reflect them in an understandable and achievable way.

### ***III.3.2. Required reserve and the role of the lender of the last resort.***

The trend will be cutting the rate for required reserves held with the Bank of Albania at 2 percent initially at the third phase of BME. This will be gradually in accordance with the Bank of Albania applicable monetary policy and liquidity in the banking system.

For this, in the first half of 2003, it will terminate the study deciding the gradual compliance with ECB standard. On this basis, necessary changes will be secured either on medium- or long- term period.

The Bank of Albania will try to incite interbank market activity. The intention is that the commercial banks aim completion of their liquidity needs and not immediately resort to the Bank of Albania.

### **III.4. BANK OF ALBANIA TRANSPARENCY, CREDIBILITY, ACCOUNTABILITY AND AUTONOMY.**

The four elements are typical for any central bank and contribute in the achievement of its targets. Developing these features under inflation targeting regimes is ever more important.

Reverse from the 1999-2002, the Bank of Albania has a clearer vision regarding the development of these features because of the considerable care they got in the latest three years.

In the next three years it will be endeavored to reach:

- Increase of the Bank of Albania professionalism ensuring it more sustained decision-making;
- Extension of Bank of Albania accountability on its actions through the attentions to qualitatively report in Parliament and its work to actively participate in the discussion of national economic policies and projects; to harmonize its monetary policy with economic policies;
- Enhancement of transparency ensuring it a public support for own decisions. The most important target with this respect is ensuring the total completion of the standards of the code of transparency and best monetary policies drafted from IMF within 2004. Related to transparency the Bank of Albania will concentrate its attention in these major groups: broad public, businesses and media. This will help the establishment of appropriate lobes to support its monetary policy;
- Further explication of classifying confidential information not public available. For this it will for this, interim May 2003 it shall be revised the respective guideline to synchronize with the new regulation “On the Bank of Albania transparency and confidentiality” as well as to clearly and accurately interpret these classifications.
- Higher contribution in developing markets and banking system, strengthening the financial system through exercising banking supervision and helping the reinforcement of other supervisory authorities and the Deposit Insurance Agency creating the conditions from lessening to suspension of Government direct financing from the Bank of Albania.
- Maintaining central bank autonomy in decision-making to disallow their impact not only from executive decisions but



also from strong financial private economy group interests or the market expectancies;

- Improving the Bank of Albania transparency on its financial activity and building a platform within 2003 to maintain its institutional reputation through the explication of the main duties upon which basis is estimated the central bank activity are its contribution in preserving the consumer price stability and developing the banking system. This platform will serve to protect the reputation of the institution, any time it is set under the pressure of the political game.

- A higher public commitment of the Bank of Albania Governor to secure the clarification of central bank policies and decisions and transmission of important messages.

### III.5. PUBLIC EDUCATION AND RELATIONS TO IT.

Public education and relations to it will get the central role amongst the endeavors for enhancing transparency to win “popularity”. This element needs elaboration to add the degree of understanding problems and to also conquest even those groups hardly drawn on attention.

To attain this:

- The public will be offered a series of explanatory and educational editions in the form of pamphlets or leaflets;

- The quality of the publications will be improved either from contents supported from the gained experience in the area of publications but also on their visual aspect as well;

- It will be improved permissible environment for public to raise public convergence by the Bank more comfortable;

- A number of museums will be organized within the Bank environments or at the National Arts Gallery or the National Museum with the Bank of Albania available numismatic materials combined with simple means explaining the Bank of Albania current activity, offering more historical data for the public;
- It will be targeted the attention of new age groups of the populations like students of the entire system identified as the Bank of Albania future electorate to gradually improve its quality;
- It will be targeted re-conceiving relations with media in order to create group broadcasting its public stands without distortion of wrong interpretations;
- It will be strengthened the Bank of Albania role as analyst and government advisor on economy and financial issues.

The Bank of Albania web page is another way of communication with public. It is important that its accessibility be easier and enriched with new headings (i.e. Europe heading) in accordance with the Bank of Albania interests and needs in the future.

Additionally to these measures, attention shall be paid to the intensification of spokesman activity. The spokesman represents a certain position in the Bank of Albania. However, spokesman activity will get a special importance based on the ambitious targets on the enhancement of transparency and public communication. In this viewpoint, the spokesman will be the person presenting the Bank of Albania official attitude having under governance the Bank of Albania press conferences. The spokesman is the Bank of Albania point of contact with media, ensuring reciprocal communication with it.

### III.6. FINANCIAL SYSTEM REFORMS.

Developing financial system reforms represents one of the Bank of Albania most important targets requiring the commitment of various institutions, where the Bank of Albania is amongst the most interested in this process. Financial system reform will be targeted at establishing an effective financial and competitive market to support the economic development of the country. Financial system reform will be viewed under these aspects:

- **Savings Bank privatization** represents the most important step of the financial system reform for the dominant position this bank has in the Albanian banking system, the importance for implementing monetary and budgetary policy. The Bank of Albania has expressed that the Savings Bank privatization must ensure the attraction of reputable foreign investors promising the development of banking products, improvement of service quality, reduction service costs and the bank return into a safe and sound institution. The Bank of Albania insists that the savings bank privatization must ensure promotion of competition something that will improve the functioning of the banking system and enhance the efficiency of implementing monetary policy. For this, the Bank of Albania has always offered willingness to discuss and coordinate with the Ministry of Finance.
- **Practicing a prudential licensing policy of selective character** gives priority to those banks promising development of those products in those regions where these are actually deficient.
- **Strengthening the Bank of Albania regulatory and supervisory skills** through developing the Supervision Department, establishing and strengthening structures for

protection, inciting competition and the war against the abuse with the ruling position in the market and the respective legal and regulatory basis, improving analyzing and inspective skills;

- **Revising and improving the law “On banks in the Republic of Albania”** to reinforce the requirements on bank licensing and reporting their financial statement and the clearer definition of relations to persons related to the bank, etc.

- **Encouraging the creation of non-bank financial institutions** as an instrument to attract the domestic capital in the banking system and stimulate the creation of Albanian banks.

- **Establishing the Information Office on Credits and Transfers** shall enforce more discipline related to committed customers in these operations and will add Bank of Albania range of information to operate with safe customers.

- Promoting competition on the whole financial system as part of the common endeavors with the Ministry of Finance and the Ministry of Economy. Special care will be dedicated to measures to reduce the Savings Bank preponderance in the banking market.

- Strengthening supervisory authorities and reporting and transparency requirements from financial institutions not licensed from the Bank of Albania in cooperation with respective institutions and the Ministry of Finance mainly.

- Creating credit guarantee schemes as institutions that would help the incitement of credit to economy, the development of the banking system its close relationship to the rest of the economy and the improvement of transmission mechanism of interbank market.

- Strengthening the capacities of BART as part of the endeavors to strengthen the financial discipline in the market; the addition of requirement and opportunities to make it a forfeiting agency;

- Strengthening legal and institutional basis on such aspects as insolvency and the payment of debts; revising the law “On accounting” and the reinforcement of reporting requirements.
- Privatizing the public company of insurances will help the improvement of competition in this market and the expansion of active participation of this financial market segment in economy.
- Strengthening the skills of the authority of the fight against the money laundering and the close cooperation with the Bank of Albania. As the supervisory and regulatory authority the Bank of Albania is interested that banking system act in accordance with the effective rules and be immune from efforts of involving it in illegal activities.

The financial system is also strengthened through the implementation of international standards and codes drafted to this end. As part of the financial reform, it must be also considered the estimation on their observing scale and building programs to their completion. The system of codes and standards is pertinent to a number of institutions. However the Bank of Albania is committed to give its own contribution in the completion of codes and standards directly related to the monetary policy and provision of independent assessments on this basis of recommendations also for the rest of the codes as below:

- The code of Best Practices of Transparency in Monetary and Financial policies. The standards of this code will be assessed within 2005 and the Bank of Albania plans to be fully compliant to them.

- The Code of the Best Practices on the Fiscal Transparency, the Bank of Albania plan is to perform an independent assessment within March 2003.
- Principles and guidelines on the Real Insolvency and Systems of Creditor Entitlements, the Bank of Albania plans to perform an independent assessment within June 2003.
- International Audit Standards the Bank of Albania target is to perform an independent assessment within 2003; deciding an action plan to their completion in the framework of the central bank within 2004.
- Core Principles on the Payments Systems, the Bank of Albania plans to perform an independent assessment within September 2004.
- 40 recommendations on money laundering, the Bank of Albania plans to perform an independent assessment within December 2003.
- Core principles for an effective supervision the Bank of Albania is generally assessed as compliant to these principles. Their revaluation is yearly.
- Securities rule principles and targets related to them, the Bank of Albania plans to perform independent assessment within March 2004.
- Core Principles of Insurances, the Bank of Albania plans to perform an independent assessment within December 2003.

Concluding these assessments the Bank of Albania will take the initiative to apply for the assistance from IMF MAE Department, to provide its evaluation on these group codes in the second half of 2004.

### III.7. INTEGRATION IN EU.

EU integration has been declared as strategic target of the Albanian Government enjoying broad consensus amongst the ranks of the population and politics. The Bank of Albania joins process of integration through its membership in respective organizations founded in the country. The Bank of Albania has a special role in this process mainly focused on monetary and exchange rate policies and European directives on the banking supervision, legislation and statistics. In this framework, the Bank of Albania must be gradually developing its own activity in order to coordinate and converge with EU standard requirements.

The action plan on the Bank of Albania contribution in the process of integration is cleft in two phases. The first phase has been labeled “**What does it mean to be integrated in Europe**” and has preparatory and directive character regarding institutions, requirements, legislation and the steps to integration to understand how distant is Albania from this process. This phase will be accompanied with the foundation of a meeting hall for Europe with archives and documents on Europe and explanatory workshops. The first phase has already started implementing in the second half of 2002 and is expected to terminate within the first half 2003.

In this phase, there are also identified central banks of transition countries to be followed as base models of performance and similar troubles or traditions.

The second phase will be initial application of the concrete steps for European integration. To enter in the second phase, it will be prepared the long-term program to March 2003 after developing the introductory level of Europe amongst the bank staff. To the end of March 2003, it will terminate the arrangement of environment for Europe in the main hall of the Bank of Albania.

European integration also requires public familiarization with this process. The Bank of Albania in the introductory phase but with more intensity during the first and the second stage will develop an information campaign to the financial sector or public on the whole. Such campaign is deemed to be carried through the publishing a cycle of explanatory publications:

- Passport to Europe;
- And abridged and adopted summary of EU documents;
- A short summary of ECB publications on its monetary policy
- Facts and figures on EU countries;
- A vocabulary on various terms on Europe.

Another important step is also its orientation to EU directions in all legal basis and regulations drafted and revised from the Bank of Albania.



## CHAPTER IV

### BANK OF ALBANIA DEVELOPING CORE FUNCTIONS.

#### IV.1. BANKING SUPERVISION.

The Bank of Albania as many central banks all over the world also exercises the role of regulatory and supervisory authority for all banks in the country and financial non-bank institutions it deems as fit for inspection.

The Bank of Albania mission as regulatory authority is:

- To ensure the stability of the banking system and protect interests of depositors and the broad public;
- To ensure a safe and sound banking system with transparent and market-oriented activity;
- To enhance the investors and depositors credibility through developing banking industry and its efficiency.

This mission is publicized by means of the annual statement approved from the Bank of Albania Supervisory Board.

The Bank of Albania strategic target is that proclaimed from BIS Basle committee: ***“No unit will run away from bank supervision and the supervision will be adequate”*** and the observance of 25 core principles of this committee on a prudential bank supervision.

Banking supervision will be a component element of the Bank of Albania activity in the medium term<sup>4</sup>.

<sup>4</sup>For further details refer to the working paper “The Bank of Albania internal or external audits”.

### ***IV.1.1 Licensing.***

Related to licensing, main goals refer to the improving transparency of this process.

The main problem of licensing remains the amount of minimum capital required to be paid out from a bank. On one hand stands the obligation to converge this to EU standards and on the other is the need to not create bigger restrictions than the investors' capacity to open a bank or the need to have more banks in Albania.

Actually, the required minimum is at the level of the required amount for those countries expected to sign association agreement for integration in EU<sup>5</sup> or nearly the same with the average amount of the countries in the region<sup>6</sup>. For this reason and owing to the existence of a banking system with a risk profile and a limited range of activities this amount is estimated as adequate. Revising it may be done in 2004 following the changes to be carried in the group of the most advanced countries in the process of integration.

Another central element on the medium term is the licensing policy to be applied: will it be a prudential or restrictive. Based on the need to incite competition in the banking system, to expand the banking network and the range of products offered by the

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<sup>5</sup>Based on EU directive no.12 of year 2000, the required minimum is no less than EUR 5 million for the countries expected to sign association agreements. Consult: "Some considerations on the amount of minimally required capital" working paper, February 2002.

<sup>6</sup> The average amount for countries in the region is USD 5,5 billion: See "Some considerations on the amount of minimally required capital", working paper, February 2000.

banking system to clients, implementing a prudential licensing policy using selective elements results reasonable. The sense is that in the licensing process it should be given priority to approving licenses to those persons or related groups of persons promising incitement of competition, lending, introduction of new banking products, diversification of capital in view of origin or other similar elements. To support this, in June 2003, it will be drafted the licensing policy for banking entities.

Licensing foreign bank branches of EU in Albania is submitted to the same rules with as in the case of licensing a bank. This has been reasonable for the Albanian banking market needs to absorb foreign capitals in the form of investments in banks and, not simply branches as well as to provide more protection to the Albanian depositors. Building the scheme of deposit insurance and the authority for the prevention of money laundering establish the basis to walk head to the liberalization of these criterion. To reach this, the attention must be focused in studying steps taken from the more developed countries related to integration; the performance of foreign bank branches currently operating in Albania as well as the pressure for opening new banks or branches. There is room for in 2003 be studied the feasibility of adopting EU criterions with effect in 2004.

#### ***IV.1.2. Bank arrangement.***

On the medium-term period, 2003-2005, main attention will be focused on the convergence of EU standards, to the degree these can be adopted. To be tried is the reduction of the changing dynamics of supervision rules. To attain this, it will be added the

term of processing the draft regulation; it will be extended the basis of discussing the draft regulation and after being approved, it will be collected a sufficient number of cases before further changes are proposed.

To reach this goal, drafting “interpretative” documents for the current regulations or the new regulations to be approved will be very helpful.

The regulative framework will be completed with new rules, which drafting will arise from the need of developing and improving new banking products. To be mentioned as the most important herein will be the following:

- The group of rules related to e-banking;
- The group of rules relative to derivative products or future contracts or feasibilities etc;
- The group of rules related to incitement and protection of competition in the banking system and the disallowing abuse with the dominant position in the market;
- The preparation for the access of the new recommendations and principles of the New Agreement on Capital drafted from the Basel Committee on Banking Supervision. Apart that, the European Parliament is preparing the CAD III” directive on the capital adequacy, meaning that this will request the adoption of the new regulation to the New Agreement and CAD III in more details, the stress will be laid down on the closer link of capital requirements and the various risks (of lending, market and operating) or other additional elements. At

least, the adoption or implementing process are more closely linked with the work of Basel Committee according to which the final version will be ready to introduce in the last quarter of 2003 and the rest of the term until 2006 will serve for the adoptions and the proper implementation.

- Drafting rules to protect customers is related to their haphazard implementation and dealing with customer complaints.

#### ***IV.1.3. Off-site inspections (External examinations).***

The main goal of off-site inspections is the constant improving quality of analysis to ensure early signalizing for problems that might be arising in separate banks or the entire banking on the whole.

Medium-term targets will focus on:

- The improvement of the Early Signalizing System;
- Establishing an analyzing system based on the CAMELS system within the third quarter 2003;
- Revising bank groups, evidencing trends of indicators and consolidated analysis on the basis of bank groups, the banking system compared to countries of the region; Analyzing the activity of other non-bank institutions and the following/observance of supervisory rates.

#### ***IV.1.4. On-site inspections - the heart of banking supervision.***

The main goal of on-site inspections is improving the quality and efficiency of available human resources and the term of

exercising inspections. This will be ensured through:

- Introducing an improved quality within the first half of 2003;
- Raising an e-data system within the first half of 2003,
- Developing the policy of training inspectors in 2003;
- The constant following of analysis and bank performance intending familiarization with bank worries and the identification of deteriorating trends;
- Standardizing inspections and documents created from inspections;
- Inspecting banks available computer programs, their integrity of and the standard of security from non-authorized or deliberate ousting of information. This is an important element affecting the accurate evaluation of reporting in the Bank of Albania;
- Commercial banks inspected on the implementation of publication and reporting duties; advertisement of work conditions particularly the complete disclosure of operating costs before customers in order to secure a transparent banking in defense of customers;
- Drafting detailed programs on annual inspections and any special inspection separately;
- Inspecting cases upon which are submitted grievances from customers to the Bank of Albania;
- Building respective procedures on foreign bank inspection within 2003.

## **IV.2. DEVELOPING STATISTICS.**

Developing statistics on country basis and the Bank of Albania particularly over 1999-2002 aided the improving quality of analyzing function and the more practical decision- making. A notable achievement in this field has been the membership in the GDDS project and its starting implementation. Albania was chosen as a pilot country for this project and the Bank of Albania as a coordinator of this process. It has been managed that this project encounters successful implementation of some phases.

### **Expanding the spectrum of accumulated statistics**

- Expanding the basis entities reporting alongside with the savings and loan associations will be enriched with historical date reported from these units during 2003.
- Expanding the basis of the entities reporting alongside with other non-bank institutions the Bank of Albania licensed or not. In 2003, it is planed to terminate the preparation of the methodology started reporting from these entities.

### **Abbreviating the term of preparing reports and their dissemination**

This target is assessed of completion through reducing the term of banks reporting through the use of e reporting accelerating the process of data processing and publication. Improving the data dissemination electronically will be mainly through the web page.

### **Improving the quality of reporting**

- From banks and other institutions will be attained through improving the documentation related to them.
- Developing the technology of processing reports from commercial banks intending the application of e reporting from commercial banks. This will aim the improving quality of statistical data.
- Revising the legal and regulatory basis in order to facilitate the data collection more specifically the balance of payments and other financial non-bank institutions not licensed from the Bank of Albania.

### **Enhancing and developing the unit of statistical surveys.**

- The increasing volume of statistical surveys by the respective unit through expanding the role and the level of this unit.
- The increasing cooperation of the institution with other of institutions like universities, institutes, and private companies trained in the data collection or that contain an established database.
- Developing the human resources of the survey unit intending the rise of professionalism.
- Increasing the band of performed surveys.



## **Improving methodology**

- In this framework, it has been terminated the methodology of monetary and financial statistics, which bases on the “Manual of monetary and financial statistics IMF 2001”. The methodology will be a methodical reflection of the mode of reflecting monetary and financial indicators.
- Revising the methodology of evaluating data of real economy. For the balance of payments it is assessed to revise the methodology of evaluating indicators not dealing with official resources.

## **The contribution in developing statistics on country basis**

Such contribution will be given in:

- National projects at the public or Albanian authority sensitivity on the significance of statistics generally;
- Concrete projects with clear effect in developing the level of statistics either for the actuality or the future;
- The support from major statistical institutions like INSTAT, the Ministry of Finance and common enterprising of this area;
- Cooperation with academic and scientific institutions operating in the area of statistics like universities, academies; research institutes etc to attract the most advanced scientific attention in institutional or national initiatives.

It will generally view with enthusiasm any project, a cooperation driving development of national culture in these areas.

## **Europe convergence and familiarity**

This comprises one of the most important goals of statistical developments. The main directions of the entire institutional framework consist in the following:

- Getting aware of EU information standards;
- Training staff related to these standards;
- Drafting action plans related to the adoption of these standards.

As assessed this will be attainable within 2004.

## **Implementing GDDS project and preparing to adopt SDDS**

- The level of three institutions increasing the role of the group of coordinators with some respects as coordinators: the Bank of Albania INSTAT the Ministry of Finance, arranging regular meetings and workshops.
- Strengthening the institutional cooperation to improve the quality of implementing project. ■

## **Related to SDDS laid as duties are:**

- Raising a group of specialists to study the SDDS standards in the second half of 2003.
- Completing a working paper on the needs and the degree of difficulty for implementing this project in Albania during the first half of 2004.
- Adopting in pilot form separate metadata to check the possibility and the concrete difficulties during the second half of 2004.

### IV.3. CURRENCY ISSUING.

The improving structure of currency in circulation to an appropriate and acceptable form from the broad public will be the main target for the next three years. The main development in structure will be the rising weight of Lek 5 000 denomination and a slight decrease in Lek 1000, 500, 200 and 100 denominations while metallic coins will record growth. The structure of the currency in circulation in value for 2005 is expected to be:

**Table 1. Structure in %.**

<i><b>Lek denomination</b></i>	<i><b>In %</b></i>
<b>Bank notes</b>	
<b>5000</b>	30.0
<b>1000</b>	42.5
<b>500</b>	22.1
<b>200</b>	3.1
<b>100</b>	1.3
<b>Coins</b>	1.0
<b>Totali</b>	100.0

Related to new printed notes and reprints as well as the replacement of those harmed it is anticipated:

- The Bank of Albania available cash is for more than one-two year needs. Subsequently it results unnecessary printing the new currency printing to end of 2004. If needed the bank note printing it will be regarded the possibility of issuing a denomination with a higher nominal value (Lek 10 thousand) as well as the maintaining an acceptable ratio between the currency in circulation and the reserve stock.

- Evaluating the possibility of the partially substituted banknotes for special denominations issued ahead 1996.

Albanian bank note and coin marketing will be a special attended activity on the mid-term through:

- Developing issues for numismatic purposes;
- Enriching the catalogue of metallic coins and banknotes in circulation and those historical;
- Opening the numismatic museum.

This program intends the further developing activity in this area.

On the whole, currency issuing will also request the logistical and technological support to further enhance the level of processing and control of banknotes and metallic coins; ensuring necessary indicators through computer accounting (within year 2003) for the management of currency and the improvement of respective regulations. For the period included in this developing plan it will be enriched the current technology of counting and processing cash so that it be also distributed from the Bank of Albania branches, as well.

Finally, it will be paid attention to the standardization of precious metals to make them more feasible to investment.

#### IV.4. ACCOUNTING.

The final target of accounting system is the Bank of Albania estimation of financial statements not only for the important data

they carry to decision making but also to increase the transparency for the Bank of Albania outside users.

### **ATM project**

ATM system will ensure the establishment of an integrated accounting system in the Bank of Albania according to international accounting standards (IAS) and the generally accepted accounting principles (GAAP).

The new data system in the Bank of Albania consists of two base modules (Informed and Oracle General Ledger) and some other five sub-modules for special activities (Loro, CBR, SML, Account payable, Fixed assets). An integrated accounting system shall contain the sub-systems of Subsidiary Ledger and the Large Ledger.

The new integrated system conditions the short-term undertaking of measures for drafting procedures of internal audit.

Accounting and Payment system department drafting internal audit procedures will be completed in the first half of 2003.

In the first half of 2003 it will be revised the regulative and accounting framework (manuals methodologies and guidelines) to be adjusted with the new system and the generally accepted accounting principles. (GAAP).

### **Bank of Albania financial statements**

Based on the overall objective on which basis the EU has adopted the appropriate decisions in own forums and has created the

appropriate organizations for member countries apply the IAS starting from the January 1, 2005, the Bank of Albania plans to precede the completion of this target focusing in directions:

- Getting familiar with International accounting standards generally and that bank- related especially.
- Revising the form and contents of the current financial statements; types of information to be reflected by modern central bank models.
- Getting familiar with international organizations documents on the central bank transparency of financial statements. Evaluating the code of transparency and the adoption of its requirements in the Bank of Albania financial statements.
- Revising the Bank of Albania accounting policy to serve the adjustment according to the developments deriving from the complete implementation of international accounting standards.
- Drafting new accounting procedures pursuant to the Bank of Albania policies on the use of new money market instruments and that of capitals.
- Revising the Bank of Albania law in accounting area as result of the new obligations emerged from the complete application of international accounting standards and the ne law ‘on accounting” which project anticipates the complete implementation of international accounting standards from the banking system.

Getting through with the above targets will be carried according to this time line:

- Listing all standard requirements for which the Bank of Albania has deviations in 2003.
- Proposals for changing the law “On the Bank of Albania” to reflect the evasions from international standards during the first quarter 2004.
- The constant training of accounting staff with international accounting standards (IAS).

### **Bank of Albania household budget**

The Bank of Albania household budget is an effective instrument for exercising activity, delegating responsibilities or reducing costs. It regulates the expenditure regime for the normal exercise of activity ensuring an important means for monitoring expenditures. Household budget increases transparency and accountability on the Bank of Albania financial activity in the terms when it enjoys a financial autonomy.

The Bank of Albania strategic targets in budget field consist in:

- In the first phase it will terminate the application of accounting system for interdepartmental costs (center costs) or other costs by the Bank of Albania functions. This phase will end in the first quarter 2003.
- In the second phase, it will be completed the construction of special budgets for interdepartmental projects of special importance for the Bank of Albania. This phase will terminate in the first quarter 2003.

- In the second phase the Bank of Albania will draft the policy for compiling medium- term budget (3-year). This target will be completed in the first quarter 2004 in cooperation with the Ministry of Finance.
- The Bank of Albania will ensure transparency on its household budget. To attain this the Bank of Albania in first half of 2003:
  - Will draft its budget ledger;
  - Will include in its financial statements the consolidated statement of service costs.

#### IV.5. PAYMENTS SYSTEM.

The Bank of Albania vision on the payments system is reaching a modern efficient and safe payment system. The payment system must ensure a platform and operational capacities adequate for a safe and efficient exchange of values and make Albanian or foreign customers feel more confident about the Albanian banking system capacities or safety.

The Bank of Albania mission with the payment system is playing the role of the leader in the process of reforming and modernization of this system.

The Bank of Albania strategic target on the payment system over the period, 2003-2005 will be the following:



- **Completing core principles** on important payments system defined from CPSS/BIS<sup>7</sup> as well as the terms and rates to be included in the European payment system target<sup>8</sup>. Closely related to this target, the Bank of Albania has defined two concrete targets:
- **Completing the RTGS system** (Real-Time Gross Settlement) for the settlement of gross international payments within 2003.
- **Completing ACH** (Automated Clearing House) for clearing and the settlement of interbank payments of small amount within 2004.

#### ***IV.5.1. Meeting core principles of payment system.***

Core principles for important payment systems are admitted as standards for national payment system from all central banks. The Bank of Albania targets their completion within the next three years. For this, it will terminate an independent assessment of payment system related to the application of the 10 most important principles within 2004.

Meeting RTGS and ACH systems will bring the completion of requirements for part of these core principles like:

- The reduction of systemic risks,
- The final settlement within the date of the foreign exchange,
- Safety and confidentiality,
- Settlement in multiparty systems.

<sup>7</sup> Committee on Payment and Settlement Systems / Bank for International Settlement

<sup>8</sup> EURO gross payment system.

To complete other principles the Bank of Albania will focus in:

- The improving legislation,
- Supervision of the payment system,
- Coordination and transparency.

Completing legislation and documentation of the payment system

A target with this respect will be the convergence with the European legal framework and the adoption of the best international practices.

To achieve this target it will be used the financial and the technical assistance offered from World Bank, the International Monetary Fund and other international organizations. Establishing bilateral relationships with other central banks will be helpful with this respect. Our country will be oriented to EU member countries and candidate countries aspiring assess in EU.

Concrete steps to reach compatibility with the core principles and international standards will be the following:

- Identifying deficiencies or contradictions within the entire legal framework regarding the payment system within the first half of 2003.
- Completing the regulative basis for membership and functioning of RTGS and ACH systems within 2004.
- Preparing proposals for possible changes in the Albanian legislations within 2004.

## **Supervising the system**

So as to get a normal functioning of the payment system, the Bank of Albania targets achieving a balance rate between the system security and efficiency.

Bank commitment will be focused in identifying potential risks related to the functioning of the system in order to get the reduction and management of risks and be given the appropriate relevance and care either from operators or participants.

Some of the concrete steps, the Bank of Albania will undertake to eliminate or manage risks to be attained within its operational role, are the following:

- Offering the use of its Lek liabilities considered as free risk liquid assets,
- Offering intraday credit facilities.

To help real time settlement of payments it will start offering intraday credit facilities during 2003.

Completing the book entry on securities comprises a term to meet one of the payment system core principles. The Bank of Albania will target the completion within 2005.

## **Cooperation and transparency**

The Bank of Albania will improve its coordinating and catalyst role inciting the transparency and facilitating the relationship between the payment system participants.

- Running the direction of the National Committee of Payments and the publication of its activity in a web page.
- Founding the Committee for the Coordination of Projects that will be functioning by the Bank of Albania with the participation of bank representatives charged with RTGS and ACH projects.
- The stimulation of the private initiatives for e- payments and the coordination of efforts to raise a common infrastructure on them.
- The policy for pricing the RTGS system will be based on the principle of “covering costs” and will be fixed in coordination with commercial banks.
- The constant collection of statistical and periodical data on payments intending the publication of the Albanian Book Payment System according to the “Red Book” standard in 2005.

#### ***IV.5.2. Concluding the RTGS system.***

The Bank of Albania target in the medium term plan shall remain concluding the implementation of RTGS project.

The Bank of Albania plans final implementation of the RTGS system to the end of 2003.

The successful termination of this project is critical for the payments system. The Bank of Albania will finalize this project with financial and the technical assistance from the World Bank. Independent advisors participating in setting requirements and the designing system will assist in further steps of the project.

- Choosing the concrete framework of RTGS within January 2003,
- Implementing process – until December 2003,
- Completing the regulative framework of the system within the first quarter 2004.

#### ***IV.5.3. The system of interbank payments at small value.***

Interbank system for payments at small value is mainly initiated from commercial bank customers. The Bank of Albania assessment is that the efficiency of this system is very advantageous for banking system. For this, it offers not only the settlement but also the clearing of these payments.

The provided clearing for customer payments comprises a central bank function governed from another interbank institution. Transferring this function to a private institution comprises a long-term target to be completed after the standardization and automation process.

Subsequent to this process the Bank of Albania will conclude the implementation of automated clearing system for processing interbank payments at small value. This system will be fully integrated with the RTGS system comprising a rational continuation of it.

- Designing the system will terminate within 2003 based on the financial and technical; assistance from the World Bank.
- Implementing the ACH system will terminate within 2004, finding international donors or with the Bank of Albania funds.

It will be targeted to implement an efficient envisaging the possibility of detachment from the Bank of Albania governance versus a minimal cost.

#### **IV.6. HUMAN RESOURCES.**

Developing human resources at the Bank of Albania is considered an important function ensuring optimal relations between the employer and employees, improving profitability and work efficiency.

However establishing some core elements to develop this function yet the Bank of Albania encounters many troubles in this field, requiring a bigger commitment in 2003-2005.

##### ***IV.6.1. Staff motivating policies to work.***

The main target is motivating staff to work and improve the work efficiency. The basic element of motivating staff policies to work is material rewards received in the form of salary or bonuses.

The Bank of Albania based on its institutional and financial autonomy especially will adjust the level of salaries to ensure a relative competition with the private banking in order to retain the trained staff in the bank. It is important to simplify salary component elements, which complicate the accounting system, maintain straight hierarchic ratios in salaries and provide parallel spaces for differentiation on specialist basis. The current system is actually permissive of three ranks of specialists: assistant,

specialist and senior specialist allowing the construction of the hierarchy, professional career accompanied with the differentiation in salary. Stretching out the summit of this pyramid adding the number of categories rank from 1 to 5 allows more possibilities for professional career, flexibility in performance evaluation and at the same time offers the differentiation between the specialists at the advantage of inciting competition between the staff.

Monetary reward is the second element of staff incentive policies. This element may be knitted of social or performance evaluation policies.

Monetary incentives are limited and the increase of salaries and bonus cannot be infinite. That's why the Bank of Albania will be using non-monetary forms of rewards

#### ***IV.6.2. Staff training policies.***

Staff training though work is a constant process aiming the transmission of constant knowledge to ensure the continuation of work and not its monopoly. This is attained through applying the principle that at least two persons know the same process; organizing work in groups as well as combining highly trained with the recently recruited staff. To have an efficient training will request a greater commitment and a fair performance evaluation for more than one employee on the behalf of superiors.

Staff training will be attained through three major forms:

- In the working process
- Through short-term training inside or abroad the country,
- Long-term training inside or abroad the country

Short-term training aims offering basic knowledge on different central bank activities. These trainings are automatically offered to the new recruits who need to know the central bank nature or other categories to be adjourned with economic or central banking developments.

Long- term training target offering more advanced knowledge on the central banking.

Long- term trainings relate to projects, studies or improvements in the working process, actually concrete. This will help the measurement of training efficiency.

#### ***IV.6.3. Staff recruiting policies.***

Recruiting staff directly affects profitability and work efficiency. Special care in staff recruiting process will be attached to:

- Professional skills,
- Communication skills,
- Personal qualities helping the recruitment of skillful persons but be also willing and devoted and respect the institution.



The core element of recruitment will be the competition developed in two classic forms: in written and oral interview. Both forms allow the assessment of three elements as above described.

New recruits influence the Bank of Albania staff structure from every viewpoint: age, education, sex-related etc. To help this it will be drafted the Bank of Albania staff recruiting policy.

- Analyzing the Bank of Albania staff structure and their year on year evolution especially those taken on in the recent two or three years.
- Evidenced structures will be analyzed in combination with attained results

In this way, there will be evidenced groups with the best efficiency, visionary proposals and initiative. Setting these models aids us easily identify persons we want to take on in accordance with Bank needs to improve the work by certain sectors of it.

#### **IV.7. BANK OF ALBANIA ORGANIZATIONAL STRUCTURE.**

Meeting duties and achieving targets is ensured from the work of the Bank of Albania staff distributed according to an organizing structure approved from the Bank of Albania Supervisory Council.

The Bank of Albania current organizational structure on the whole is introduced, as appropriate covering all functions the Bank of Albania must perform. On the whole this structure is finely tuned with other central bank structures. This structure is not expected to be fully identical with any other central bank structure as:

- It does not exist a uniform structure,
- Banks have special features and requirements compatible with the country they operate,

Main targets with this respect consist in:

- The Bank of Albania improving structural stability by reducing the major changes in it which adds confusion in functioning, insecurity in drafting and implementing plans or individual investments. The Bank of Albania structure needs changing mainly to adjust to the new tasks eliminate temporary enforced structures to allow the distribution of competences in decision-making.
- Preparation to cut out a part of bank structures releasing it from functions that might be gained from the thirds,
- The increasing number of central bankers to qualitatively improve the work and its functioning to allow their training to afford a higher activity in the next three years due to additional tasks forecasted,
- The addition of the central bank staff giving priority to its major functions.

Central bankers are planned to be at an optional number ensuring the qualitatively exercise of its functions without weighing on the cost. The medium- term trend will be adding the number of central bank staff and this will be attributive to some reasons:

- The Bank of Albania added or expanded tasks.
- The number of the Bank of Albania licensed entities is ever growing,
- Bank computerization and automation is yet an

unfinished process, which termination will bring about the reduction of its staff,

- It still exercises functions to be cut out in medium term.

The Bank of Albania adding the number of staff is compliant to the general trend of the central banks all over the world which tracks a strong rising curve in the first years, reaches the peak and further moves down from reduction its functions and the rise of endeavors to economize costs. The entire process requires a cycle of 15-20 years. The Bank of Albania staff number is under the rising curve and has not reached the peak yet. In the medium term, its related staff number is expected to increase at almost 400 employed.

## CHAPTER V

### BANK OF ALBANIA SECONDARY FUNCTIONS

#### V.1. INFORMATION TECHNOLOGY.

The Bank as an institution that offers services and products to clients is also oriented to research, collection, analysis and distribution of information. On one side, it targets the extension of communication and information from/ to the external environment and the development of internal and external transparency on the other it seeks to be fanatic in keeping and preserving confidentiality and reliability for a part of information or its activity. From this viewpoint, it is necessary to carefully combine both policies with inverse procedures as that of opening and transparency or keeping confidentiality.

The Bank is a central institution unprofitable with legally assigned duties. The central position logs it off from the direct competitions, however its needs to develop have at the basis the efficient completion of legal duties, the constant support and opportunity of growth to the Albanian banking system. In this context, the Bank seeks to reach following vision in the area of Information Technology (IT):

**“IT will enable any time communication of personnel, clients and the Bank public with efficiently reliable and safe domestic means and information to alleviate the differences between internal and external communication”.**

For reaching vision in area of IT, the Bank identifies four major targets:

- **Improving/ developing knowledge and governance of information:** The Bank already owns a large number of data (documents, economic data, different studies, operating data related to its daily activity), which on one side are as a result of a preliminary activity and comprise the basis for further processing and analysis, on the other. The ever rising demand for fast and reliable information requires the acceleration of broadcasting and searching information, on one side, and the development of human resources, on the other. The bank will be committed to either revise or improve the current manner of communication and broadcasting information targeting its continuous automation.

- **Improving the range of information security, the secondary infrastructure and administration:** the bank is already owner of a number of information system of national relevance and their systematic or partial non-functioning is not only grave for the banking system but even broader. The rapid growth of information systems in the Bank as well as the few experience regarding the administration of security comprise a risk and the management of this risk makes up one of the Bank priorities. Keeping the confidentiality on these data also based on the Bank's need for transparency comprises a challenge. Generally based on the rapid developments in IT, their protection is not considered as static but it needs to be adjourned at any time and moreover have a preventive behavior.

- **Improvement and operational development:** Improving efficiency and standardization is attained through the constant improving of Bank executive and operational activity particularly related to: (1) the introduction of new systems and a number of

operational activities (2) improving and replacing the current system, (3) establishing the “Help desk” office to improve the level of support related to time and quality of executive and operating systems in the Bank. The new systems will (1) stretch out the band of IT in Bank operations, (2) complete the replacement and integration between the covered functions from special systems, which frequently double each other activities, (3) improve range of automated operations reducing the risk of errors and enhancing staff orientation to main tasks.

■ **Strengthening and improving communication and the technical administration:** the main target of this program is the Bank constant improving and increasing its technical infrastructure. To attain a general IT development in the Bank this infrastructure must be developed and supported in terms of security, stability, confidentiality, and universality of usage, the flexibility of adoption to introduce new developments in the field of IT.

The complete implementing of IT strategy will bring improvements in the daily activity of the Bank and its provided services to customers (the Albanian banking system and broader). Priorities can be divided in two main groups: the improving productivity and the increase of operating efficiency in all activities.

## V.2. LEGAL FUNCTION.

The Bank of Albania entire activity is based on a legal and regulative framework, which might be generally considered as complete and comparable to homologue central banks in the rest

of the world. The Bank of Albania legal and regulatory framework is drafted in compliance with the financial and banking system developments in Albania and the legal framework on the whole. In the mid term in view of the need to be supported the banking system and the Bank of Albania developments with rules and laws it will be targeted:

- The expansion and the completion of the legal framework through drafting and compilation of new legal acts or laws.
- The improvement of the legal and regulatory basis targeting the establishment on international standard basis and the coordination with respective laws and regulations of EU.
- The reinforcement of the interpretative element to unify stands related to various laws and regulation and their implementation.

These goals will be attained through:

- Setting clear programs for 2003 and ahead in the field of the nearing the Bank of Albania legislation to that of European Central Bank also based on the principles of *Acqui Communautaire*<sup>9</sup> as well.
- Approving the Special Part of the General Terms of Work in the Bank of Albania, February 2003.
- Drafting the project on the “Code of ethics of the Bank of Albania Supervisory Board members”, April 2003.
- Revising the regulations on the classification of the confidential information in the Bank of Albania, May 2003.

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<sup>9</sup> EU complete legal and regulatory framework.

- Revising the regulatory framework on the Bank of Albania transparency, September 2003

Amongst the mid-term targets for improving the legal and regulatory framework we may mention:

- Revising the law “On banks in the Republic of Albania” also based on the World Bank assessments, April 2004.
- Drafting the law “On the foreign exchange market and regime” within June 2004.
- Establishing the regulative basis on the Credit and transfers information office within January 2005.

Additionally to the above projects where the Bank of Albania shall take the role of the initiative institution for drafting laws, the economic development of the country and especially the financial sector requests from the Bank of Albania the Bank of Albania to actively participate in the process of drafting different laws. So, the Bank of Albania will join the process of:

- Drafting changes and amendments on the civil Code in the Republic of Albania initiated from the Ministry of Justice particularly for the part directly related to banks.
- Drafting changes on the law “On the prevention of money laundering”<sup>10</sup> in 2003.
- Drafting amendments on the legal system of duty- tax especially for the part related to the financial system or the financial area, generally, be sent for opinion or requested of cooperation.
- Potential changes of the law “On accounting”.

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<sup>10</sup> These changes have been prepared from the Department of Coordinating Fight against Money Laundering and the Bank of Albania has been an active participant in drafting these changes.



### V.3. BANK PROTECTION.

Central bank normal developing functions are not only attained through exercising core functions but also through establishing a safe and protected work environment.

On the medium term, the Bank shall continue to cover police escort expenditures used for performing monetary operations. The political and order situation and the country range of criminality condition the entire the Bank of Albania head office environment be protected from police troops set up for the protection of highly important State office buildings. The Bank of Albania shall request these expenditures be covered from government budget within the first quarter 2003.

To be prepared for the next three years is also the study on the establishment of the banking police as a trained force for the protection of financial institutions in the country.

The better regime of movements helps the improvement of the security standard. The Bank of Albania environments are classified as free moving areas (allowing public entrance) restricted and security areas.

In compliance with these areas, it will be improved the circulation system in the main office building within the first half of 2003 and supervision system within 2003.

In 2003, it will be adopted the same system, classifying the head office building and other Bank of Albania related buildings in the districts recently reconstructed be installed check entry systems.

Within the first quarter 2003, it will be reviewed the regulation on the entrance of non-bank persons so that their circulation be safer in the head office building.

#### V.4. IMPROVING WORK CONDITIONS IN THE BANK.

Work conditions and institution environments must be as such as to offer a normal situation allowing the staff to have a quiet and comfortable operation. Creating comfortable environments is important as it adds work concentration and efficiency. As important tasks to be resolved within the period 2003-2005 with regard of improving environments are specified the following:

- Reconstruction of the current building,
- The addition of available work environments for the staff with adequate work areas and additional environments for other activities. This can be ensured with the construction of the new the Bank of Albania building. For the new building, there must be submitted maximum requirements for considerable spaces and environments per work posts for 400 employees and other additional activities;
- The Bank of Albania must be studying the feasibility (within 2003) to become a protective institution of national culture. For this there must be assigned special funds every year. The intention is to protect the history of the Albanian culture. To select them it is set up an ad-hog commission of artists and famous art critics under and the care of the Ministry of Culture.
- The modernization of archives and keeping it in an e-format to make it more suitable for use.

## V.5. STRENGTHENING INTERNAL AUDIT SKILLS.

The internal audit department can play an important role in governing the institution helping a more efficient management especially with the identification and the correction of faults found with the institution.

Medium-term targets will be aimed at:

1. **Exercising an internal audit function according to the international standards.** To achieve this target:
  - Audits must be compliant to internal audit professional practice standards.
  - It must be kept constant contact with internal audit organizations to recognize the respective changes and adoptions of standards.
  
2. **Changing the internal audit function from aftereffect to preventive.** To reach this target it has be:
  - Reevaluated the risk of audit for all bank functions adjusted to the new work conditions, the application of new accounting systems and recommendations given for the improvement of found faults from the external auditors, international organizations and Supreme Audit Commission. To analyze deficiencies found in the activity of various bank sectors to disallow their repetition.  
(within 2003)

- To be prepared the presentation of establishing the internal audit system, according to the Bank's specific functions as well as the constant supervision of changes in it in order to reduce the risk of committing mistakes or increase the possibility to their fast discovery.

(Within 2003)

- Prepare the terms for installing contemporary audit programs in compliance with the types structure and the Bank's operational activity.

(Within 2004)

- Create the history of risk assessed by functions according to the computed audits making in rational basis be given priority to high risk area for keeping risks at acceptable levels.

- Be completed the operational procedures on computed work documentation according to international standards and national legislation.

**3. The improving efficiency and productivity of internal audit activity.** To attain this, the department staff must be:

- Familiar with the contemporary techniques to assess the efficiency and productivity of operational and managerial actions to give appropriate recommendations on how to improve indicators in the future.

(Constantly)

- Improving the professionalism of staff assigned with audit tasks through getting constantly aware of the progress made by other central banks and by respective training.

**4. The improving transparency and autonomy of internal audit department to attain this:**

- There must be established links with the Albanian Parliament for the delivery of periodical and annual reports on Bank of Albania exercised internal audits as well as on new findings and recommendations given.  
(Within 2003)
- The Supervisory Board be constantly informed on the exercised audits on Bank structures, the given recommendation and their execution be quarterly
- All bank units get aware of on internal audit conclusions and special exercised functions related to it.  
(The first quarter 2003 and constantly beyond regularly)
- Be studied the reorganizing structure of internal audit with the goal establishing the Audit Committee, proposing the respective amendments on the law “On the Bank of Albania”. Their completion will be possible after the Albanian Parliament approves special laws on internal audit and control, actually under discussion.  
(Within 2005)

## CHAPTER VI

### OTHER ISSUES.

#### VI.1. BANK OF ALBANIA RELATIONS TO THIRD PARTIES.

The Bank of Albania relationship to other institutions allow it to be integrated in the surrounding environment to transmit its work results to it and secure the adequate support to improve the quality of its work.

The Bank of Albania target is expanding these relations to foreign or national institutions as well as setting them on a more compatible basis so as to get no clashing experiences.

For this there will be studied the features of any central bank or other institution offering assistance as well as there will be made apart those issues the Bank of Albania can take advantage of. On the basis of this study to be completed during the first half of 2003 it will be designed the map of relations to the end of the year. Foreign embassies in Albania will get an important place in this endeavor.

The Bank of Albania will be constantly seeking the rise of the cooperation with other national institutions to exchange information and discuss important country projects and programs in economy and finance. Cooperation with other supervisory authorities to strengthen the financial market discipline assumes a special importance. In this framework the Bank of Albania considers the relationships with the Ministry of Finance and INSTAT of the highest priority.

## VI.2. CONCLUSION.

The Bank of Albania institutional development 3-year plan shall be:

- Reflected in further details in the Bank of Albania Supervisory Board and relative Departments annual development plans,
- Be constantly yearly reported the completion of respective steps and forwarded needs on the required steps to the Governor in June.
- Be reported to the Supervisory Board each year in December regarding its implementation and respective proposals to its review,
- Be maximally respected to limit deviations and in the cases it is indispensable there will be made the corrections so that the implementation of the plan be natural and be no additional burden to that might be leading to reduction of its implementing quality.
- Be accompanied with the uniform implementation from the entire Bank structures.

