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## **Effectiveness of Internal Audit in the Banking Sector in Macedonia**

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### **Abstract**

Internal audit, as an independent examination of the financial statements and those financial information related to specified financial entity, regardless of its size and legal form, is directed to examination of the level of functionality and financial performance of the company. Recent experience of the most companies, both non-financial and financial, speaks in favor of the fact that the progress of a national economy in each country, without good and efficient segmentation, collection, processing, analyzing and efficient use of information obtained in the framework of reviewing the financial performance of the enterprises and organizations, in contemporary changing environment, is less possible. Because of the importance of the effectiveness within the implementation of the financial audit in banks, as significant sector for the economic development of an economy, this research will be focused on the characteristics and effectiveness of the process of internal audit in the banking sector in Republic of Macedonia, as a country that's going through an economic transition.

**Keywords:** auditing; financial reporting; financial analysis; economy; banks

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## **1. Introduction**

The accounting standards and legal regulations require from the companies and organizations to present their current financial condition in a most possible objective way. Hence the process of publishing the annual financial results and reports are affecting a full range of requirements and conditions concerning the accounting and financial state, as well as the process of disclosure or publication of data of the prescribed company or organization. The main goal of the mentioned requirements is actually focused to create certain assumptions about moral and open financial reporting of numerous investors. In this context, in order to emphasize the importance of the function of the financial audit, it should be mentioned that a real possibility of discrepancy of interests of management within the companies that have a decisive impact on making the annual financial statements is always present, for instance, the interests of entrepreneurs, investors, whose property value thus may be exposed to losses. Taking into account the role of entrepreneurs in the overall national economy of the Republic of Macedonia, in this case, the importance of functioning for a financial audit in the process of insurance and providing confidence within the mechanism of the capital market is significantly prominent and obvious as well as the state included in this mechanism as a regulator and controller of the mechanism. Therefore, the effective financial audit has a huge impact in its process to enable a productive work environment and condition to the enterprise or sector, which in turn directly and indirectly affect the effectiveness of the national economy in the country. Regarding this, the below mentioned empirical research, the main and key scientific objective will be focused mainly on highlighting the link that connects the effectiveness of the operation with the productive and quality implementation of the financial audit and its significance as part of unquestioned functioning of enterprises, especially for the banking sector in Republic of Macedonia.

## **2. The significance and characteristics of the audit in the banking sector in the Republic Macedonia**

The process of audit is extremely important concept that is mostly tied to the tolerance and summary of errors, i.e. the accuracy which every auditor accepts within the audit implementation in a given case. The auditor carries his professional assessment of that which is important, and which is not, mainly on the basis of their knowledge and objective judgment. Accordingly, the information is considered significant if, its omission or misstatement affects the decision of users taken on the basis of the financial report [2]. Today with the development of information technology, the integration of various methods within the differentiation of the existing resources, is more common and effective within the audit implementation. Accordingly, the audit is actually part of the financial report, as a fragment of the process of supervision within the operation of the respective sector or company, which is treated as an instrument that fosters management process by offering support, implementing an effective accounting supervision. According to the Law on Banks and other financial institutions [9], as well as amendments to the given law, the following areas of internal control and audit:

- Internal Control
- Function control compatibility of the banking sector
- Internal Audit Function
- Supremacy of Internal Audit
- Annual report on the adequacy of the risk management and internal control

Therefore, the control of the correctness of the work of banking sector, as one of the most important financial sectors in Republic of Macedonia, in which the process of creating a productive working environment acts on the effective operation of the internal audit has. The main tasks of the organizational units of internal audit at the bank's board, is to provide an independent and objective consideration of the issues that are subject to the process of audit. Also it is of great importance for this mechanism to be able to implement an effective internal audit and advisory activity strictly aimed at improving the existing system of internal controls. Within the framework of this process, there is also a great support for the board of banks in order for them to achieve their goals, while implementing an effective and productive management in the organization. In addition, the internal audit perform these tasks, is using a systematic, disciplined and documented approach to the evaluation and improvement of the existing mode of the risk management, control and governance processes [1]. Hence, internal audit must be organized as an independent organizational quality individual banks in the Republic of Macedonia. The Banks are required, for the actions of the system of internal controls, to edit and implement effective approach that allows continuous monitoring and measurement of risk that may adversely affect the achievement of the established business objectives of the Bank, such as credit risk, country risk debtor foreign exchange risk, market risk, interest rate risk, liquidity risk, operational and other risks. Thus the organizational unit, in charge of controlling the matching operation of banks, is required at least once a year to identify and assess the main risks compatibility and propose plans of management, given the risks while implementing productive working environment in the banking sector whose work meets an objective and accurate report.

### **3. Researching methodology**

The bellow mentioned research is covering all banks in the country, with the main objective to determine how the organization and objectives of internal audit. The research of the study implemented the quantitative - qualitative method, with the technique of instrument analysis - questionnaire. The Empirical research in this framework includes certain activities from the beginning of data collection through the questionnaire, the application of research results within the social and scientific practice. The research is also using a specific techniques for collecting the required data within the scientific observation methods, while implementing a research samples, analysis of the content i.e. a survey of the questionnaire. [5] The variables of the survey are the large, medium and small banks in the country, where the tasks of internal audit have been implemented within the bank sector that is divided in several groups, which together covered nine banks that fall within the banking sector in Macedonia.

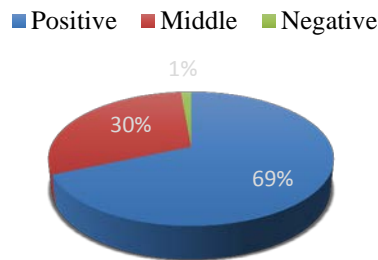
### **4. Results and discussion**

On the basis of the implemented questionnaire that is actually referring to the experts - auditors, within their experience of auditing the banking sector in the country, you can see how the process of the organization of internal audit in banks, was implemented, organized and realized, within which we've come to the following results:

Concerning the banks in the country, the internal audit is organized as an independent organizational unit and internal auditor as an independent entity, which is established by the legislative framework of state. Internal

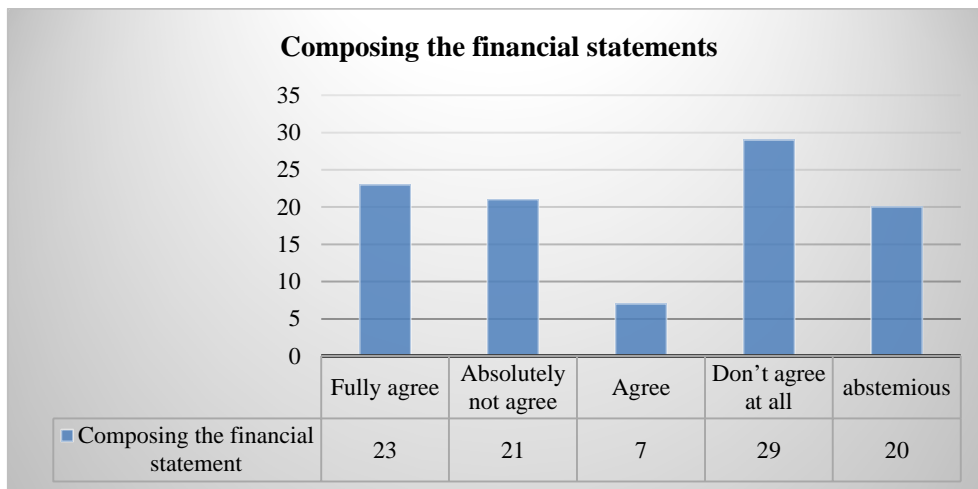
audit can be organized as a sector, department or service, depending on the size of the bank [4]. The audit is organized as a sector in the following banks: Commercial Bank, Industrial Bank, NLB Bank Tobacco, while the internal audit is organized as a department within the following banks – Societe General Bank, ProCredit, and UniBank, and the other - Sparkasse, Alpha Bank, Halk Bank, the internal audit is organized as a Service. In addition, based on the survey, by directly completing the questionnaire, the tasks of internal audit in banks, adds the following results: Within their opinion on the effectiveness of the work of internal audit quality and independence of working in the banking sector - 69.44% of the respondents completely agree that the evaluation is high for the quality of work of internal audit in the banking sector.

**Evaluating the work of the internal auditors**



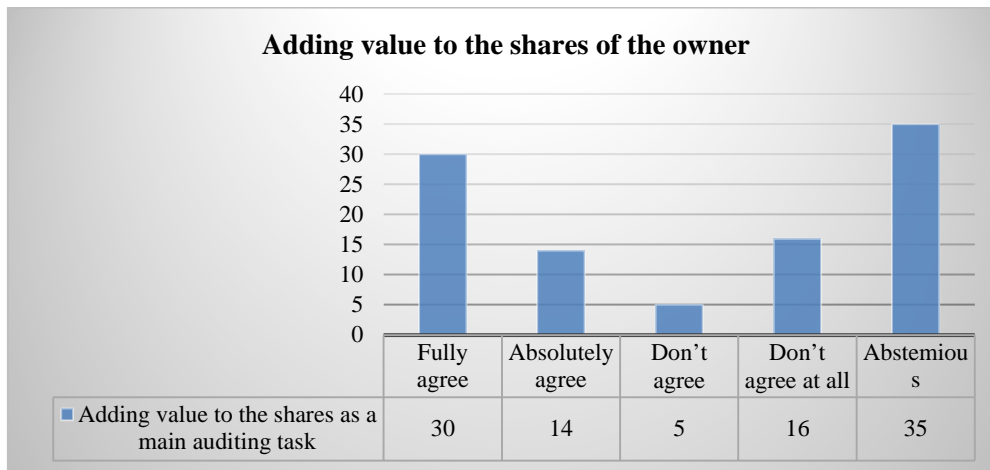
**Figure 1:** Assessment in the organization and effectiveness of the work of internal audit in banks

Considering the above mentioned graph, about 30.56% of the respondents, which includes directors and senior management of banks, assesses 3, from the highest 5 grades for the effective operation of the auditors, while less than 1% of respondents gave the assessment 2 as a negative assessment of the effectiveness of the work of internal audit in the control of the Bank's [6]. According to the above results, the quality of work of internal audit in the banking sector can certainly be reduced to a positive level. While in the context of the on-time constitution of quality financial statements, as a matter addressed to the auditors, banks also received these intriguing answers within the specified graph below:



**Figure 2:** Attitudes to prompt and effective implementing of quality financial reports

Within the aforementioned graph, it can be concluded that the auditors who have had experience with such activities, for 23% fully agree, while 7% who agree 90% are the banks, while 10% auditors are as respondents, 29% percent who do not agree where the 100% are the bank's management, while 20% in indefinite about the issue, 79% of the auditors, while 21% are banks. Thus from the standpoint of the bank's management, it can be concluded that most of them do not agree with the efficient assembly of quality financial reports by internal audit, while internal auditors believe that their financial statements are extremely quality made [7]. In the next issue, which is addressed strictly to the senior management of the banks - whether adding values of stake holders is an important task of the internal audit of banks, we have received the following answers:



**Figure 3:** Adding the values of the shares of the owner as an important task of the internal audit of the banking sector

Considering the above graph, it can be reliably determined that most of the senior management of banks fully agree that adding the value of the shares is completely important task of internal audit of which over 30% answered affirmatively to the issue, while only 16% of respondents said they do not agree at all. Abstemiou s on the issue is even 35%, while only 14% of respondents agree absolutely with the proposed issue.

### 5. Conclusion

Based on the above issues, rather the empirical research, we can conclude that internal audit in the banking sector in Macedonia, has an effectively vague concept in the context of their impact on the working environment in the banking sector. This result is mainly due to the fact that, as we can see from the above answers, most of the banks in Macedonia, still do not have enough time and resources to adapt the tasks of internal audit and fully understand them. Considering the given concluding observations obtained through empirical research, we can also add some suggestions for improvement of the internal audit function in the banking sector in Republic of Macedonia. In addition the tasks of internal audit should include examination of plans, programs, policies and procedures in order to make it possible to objectively evaluate their performance on tasks of all levels [8]. Also, the tasks of internal audit should include critical monitoring of the achievement of the overall plan and the individual plans, information management for deviations from the standards, and the process of establishing the main goals, giving advice and recommendations within the possible corrective actions that can add an effective

observation of the possible risks that could be suppressed. On the basis of the above research, we can unfailingly conclude that internal audit is organized as an independent organizational unit and sector in most of the surveyed banks. The decision on basic principles of organization and operation of the internal audit of banks stipulates that the internal audit should be organized as an independent unit. In addition, organizational unit should be directed to the continuous operation, monitoring, supervision, inspection and improvement of the work in the bank, identification and monitoring of risks to which banks are exposed, evaluation of the system of internal control, issuing recommendations for removing irregularities of operation, in order to cause and enable an efficient working environment. This kind of approach supports the achievement of the main goal of internal audit in the banking sector in Macedonia, it can also provide a protection of the solvency of banks and real expression of its financial results, which affects the national economy in the country [9]. Also, with the help of a little research, it could not be confirmed by the fact that the internal audit in banks in Macedonia, where the management of the banks in terms of the operation of auditors consider detecting and preventing errors and illegal activities, and assessment of the compatibility activities within legislation, policies and business practices of banks, which should be one of the most important tasks and focus on internal audit. This means that banks in Macedonia, as one of the most important financial sectors, consider other tasks such as assessing the effectiveness of the accounting system, untimely assembling a quality and effective financial reporting and internal control structure, taking into account that the banks management are not familiar enough with them. This means that in Macedonia has to pay more attention on educating the management of banks especially in the area of audit operations and functioning. According to this, it can be concluded also that internal audit acts as advisor to the management of the banks and that the activities of the internal audit is responsible and plays a crucial role, mostly because everything relating to the provision of support and assistance as well as proposals in the framework, must not and cannot be deprived of independence and competence. The audit of the functionality of the banking sector, therefore, should be more directed mainly to the anticipation of the possible risks in individual areas of functionality and operations of banks and advising management on the possibilities of implementing an effective management of the numerous risks within the shaping and monitoring of appropriate system of internal controls that can effectively reduce the risks. Thus, the subject of the examination of the internal auditor should become overall operation and functioning, which should be directed to the future not only of banking operations and productivity, but also to the growth and development of the national economy.

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