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Report on the Observance of Standards
and Codes on Accounting and Auditing

Update

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Main Abbreviations and Acronyms

A&A	Accounting & Auditing
ACCA	Association of Chartered Certified Accountants
CAOA	Council for Advancement and Oversight of the Audit
CFRR	Centre for Financial Reporting Reform
CNCC	Compagnie Nationale des Commissaires aux Comptes
CPD	Continuing Professional Development
CPS	Country Partnership Strategy
CSOEC	Conseil Supérieur de l'Ordre des Experts Comptables
EC	European Commission
ECA	Europe and Central Asia
EU	European Union
GDP	Gross Domestic Product
GoM	Government of FYR Macedonia
IACA	Institute of Accountants and Certified Accountants
IASB	International Accounting Standards Board
IAESB	International Accounting Education Standards Board
IAASB	International Auditing and Assurance Standards Board
ICARM	Institute of Certified Auditors of the Republic of Macedonia
IES	International Education Standard
IESBA	The International Ethics Standards Board for Accountants
IFAC	International Federation of Accountants
IFRSs	International Financial Reporting Standards
InSA	Insurance Supervisory Agency
IPO	Initial Public Offering
ISAs	International Standards on Auditing
ISQC 1	International Standard on Quality Control 1
IT	Information Technology
JSC	Joint-Stock Company
LLC	Limited Liability Company
MOF	Ministry of Finance
NBM	National Bank of FYR Macedonia
MSE	FYR Macedonia Stock Exchange
PIE	Public Interest Entity
ROSC	Report on the Observance of Standards and Codes
SEC	Securities and Exchange Commission
SME	Small and Medium Sized Entities
SMO	Statement of Membership Obligations
QAR	Quality Assurance Review

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The review was conducted through a participatory process involving various in-country stakeholders with cooperation and assistance received from the staff of the Ministry of Finance, the National Bank, the Securities and Exchange Commission, the Insurance Supervisory Authority, the Agency for Supervision of Fully Funded Pension Insurance, the accounting and audit profession and their regulators and the academic and business communities.

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Executive Summary

- 1 **This assessment of accounting and auditing requirements and practices in the Former Yugoslav Republic of Macedonia is part of a joint initiative of the World Bank and the International Monetary Fund, to prepare Reports on the Observance of Standards and Codes (ROSCs).** The assessment focuses on the strengths and weaknesses of the accounting and auditing environment that influence the quality of corporate financial reporting, and includes a review of both statutory requirements and actual practice. The assessment uses international benchmarks and also considers the European Union (EU) body of law, the *acquis communautaire*¹, as FYR Macedonia defined firmly its commitment to a European perspective with the signing of the Stabilization and Association Agreement with the European Union in 2001. FYR Macedonia became a candidate for membership in 2005.
- 2 **The strategic objective of this report is to support the Government of FYR Macedonia (GoM) in its efforts to improve the business climate in FYR Macedonia, as well as the country's overarching goal of EU membership.** Actions regarding the areas for consideration in this report will support the Government's efforts to increase competitiveness and productivity across the economy through the provision by businesses of timely and reliable financial information, formulated according to internationally accepted standards, while also observing standards of governance that create confidence among local and foreign investors. By providing prioritised recommendations for improving financial transparency in the domestic corporate sector, and areas for strengthening accounting and audit requirements and practices in line with the international benchmarks and EU Directives, this ROSC Accounting and Audit (ROSC A&A) contributes directly to the country's progress toward economic integration with the EU.
- 3 **This report updates the first ROSC A&A, prepared in 2003 which had identified a number of areas for improvement.** Reflecting the status of FYR Macedonia as a potential candidate of the European Union, the 2003 report recommendations included the gradual adoption and implementation of the EU's corporate financial reporting and statutory audit policy framework. Issues identified for improvement included ineffective enforcement of the accounting standards, low quality of audits, the absence of an adequate professional organization, and lack of an oversight mechanism.
- 4 **FYR Macedonia received significant support to implement the recommendations on the first ROSC A&A.** A Country Strategy and Action Plan (CSAP) to implement the 2003 ROSC A&A recommendations was prepared. Actions included in the CSAP were implemented from 2007 to 2010 under the Road to Europe – Program of Accounting Reform and Institutional Strengthening (REPARIS).
- 5 **FYR Macedonia has made significant progress since 2003 in aligning the statutory and institutional framework with EU requirements.** The Government has carried out reforms consistent with good international practices and the *acquis communautaire*. Major changes in

¹ The entire body of EU law is known collectively as the *acquis communautaire*. Transposition and implementation of the *acquis* represents a requirement for EU member states and candidates. The *acquis* sets out specific requirements for countries under the Company Law chapters regarding financial reporting for companies and the statutory audit.

accounting since 2003 include: the enactment of a law on accounting services; the adoption of a relatively recent version of International Financial Reporting Standards (IFRS) (2009)²; the adoption of the IFRS for Small and Medium-sized Entities (SMEs), for smaller entities; improved filing mechanisms for financial statements; and improved transparency through the availability of data at the Central Registry. Additional reforms in auditing include: the enactment of a new law on auditing; the establishment of a professional institution for statutory auditors; the preparation of updated certification curricula; the replacement of outdated auditing standards with newer versions; and establishment of quality assurance and public oversight arrangements for the audit profession.

- 6 **The review of a sample of published financial statements found that the general quality of financial reporting for regulated companies has improved since the previous assessment but further efforts are needed to improve the quality of financial reporting for non-regulated, small and medium size companies, particularly regarding disclosures.** The ROSC team reviewed a sample of 37 financial statements to assess the extent to which companies and auditors comply with financial reporting and auditing standards, respectively.³ The review of a sample of financial statements by the ROSC team indicates different levels of compliance with relevant standards by different entities. The review found that the quality of the financial statement tends to be better for financial institutions and listed companies, as compared to that of SMEs. While banks, insurance companies and other entities of public interest (listed companies, companies operating investment or pension funds) generally publish financial statements of higher quality, some other entities, and especially enterprises of small and medium size, fail to meet relevant requirements and publish financial statements with limited or inadequate disclosures. Major issues noted in large company financial statements were mainly poor or no disclosure of important information such as related party transactions, events after the reporting date and segment reporting.
- 7 **The use of general-purpose financial statements by credit institutions and the demand by the market for improved financial reporting remain low.** Contributory factors include an insignificant securities market, an overreliance on collateral and other sources of information for bank financing, and only modest foreign investment. Better understanding of the role and value of financial information could increase the demand for good financial reporting. This can be achieved in the medium to long term with continued training and awareness raising efforts.
- 8 **FYR Macedonia adopted the international standards for accounting and auditing.** IFRS, the IFRS for SMEs, and the International Standards on Auditing (ISA) are currently of mandatory application. The standards in application date back to 2009 and thus they are not in full compliance with the current international standards. The delays in translating and publishing the accounting and auditing standards in the local language are mainly due to a lack of resources. There have been major changes in the IFRS since 2009, including to the standards on fair value measurement, financial instruments, and consolidated financial statements, and pronouncements on first time adoption on IFRS, disclosure of financial instruments, presentation of financial statements, and property, plant and equipment. These are important standards which can have a significant effect on corporate financial reporting. IFRS change

² For the banking sector, the most current version of the standards is applicable.

³ This is not a statistically representative sample for 71,209 active companies. The purpose of the financial statement review as per the ROSC methodology is to identify major difficulties in the application and enforcement of A&A regulations. The review was complemented with interviews as well as round-table discussions with relevant stakeholders.

often and therefore keeping the local language translations up-to-date will always remain a challenge. A wider application of the IFRS for SMEs could partly address this issue, as the IFRS for SMEs are changed less frequently.

- 9 **Some areas of the statutory framework, including quality assurance and the classification of companies, need further alignment with the *acquis*.** The thresholds used for defining SMEs are very low in FYR Macedonia as compared to EU thresholds. The recently amended definition for public interest entities also resulted in a larger pool of entities, which may be excessive considering the size of the national economy. At the same time, the EU requirements for large entities and PIEs in extractive industries are not covered. Finally, new EU requirements for quality assurance and oversight systems for PIE auditors are not yet reflected in national rules. These issues are further explained in the paragraphs below.
- 10 **Smaller companies in FYR Macedonia face greater financial reporting and audit requirements compared to their European peers.** The classification thresholds are significantly lower than those in the EU's Accounting Directive.⁴ As a result, smaller entities are subject to requirements that they might be exempt from in EU jurisdictions. The New Accounting Directive offers no flexibility to Member States for changing the thresholds.
- 11 **The IFRS for SMEs has been required for small companies since 2012. In addition, all companies, including micro enterprises, are required to prepare annual accounts comprising of the balance sheet, income statement and disclosures in the form and content prescribed in the Ministry of Finance-issued Rulebook.** The IFRS for SMEs is generally considered too complex for micro enterprises and is not consistent with Article 16 of the Accounting Directive regarding small undertakings. Indeed, the Accounting Directive simplified the requirements for small entities and allowed further simplification for micro enterprises, limiting the disclosures to those prescribed in the Directive. The current legislation has to be amended in accordance with the EU Accounting Directive and the IFRS for SMEs.
- 12 **Recent amendments to the Audit Law have broadened the definition of public interest entities (PIE) and some definitions would benefit from clarification.** In September 2014, the national legislation moved from a definition encompassing essentially listed companies and other companies regulated by the SEC to a broader one including trade companies for which statutory audit is required in "special" laws. Currently all companies that are subject to statutory audit by "special" laws are considered of public interest.⁵ The Macedonian legislation, however, does not define "general" and "special" laws. There is room for clarifying the definition of PIEs by specifying the types of enterprises that will be treated as such as designating companies as PIEs entails assigning higher obligations to them in terms of reporting and to their auditors as well. Following the recent reforms in the EU's A&A statutes, i.e. the 2003 Accounting Directive and the 2014 regulation on PIE audits, it is expected that EU member states will review the definition of PIEs to ensure they are not too broad given the new requirements adopted.

⁴ The current thresholds for classification of companies in FYR Macedonia is determined by the size of the national economy, and contribute to greater transparency in financial reporting of the entities. Acceptance of the thresholds for classification of companies regulated by the Directive will classify 99% of the companies to be classified as micro and small. FYR Macedonia intends to comply with the established EU thresholds for classification of companies during the negotiation process with the EU.

⁵ The term "special laws" should not be interpreted to include any company subject to statutory audit as a PIE, rather as any sector-specific law other than the Trade Companies Law requiring certain companies to be subject to external audit.

- 13 **The extent to which, and depth with which, regulators monitor and enforce financial reporting requirements, even though they remain uneven, have significantly increased since the previous ROSC A&A.** The National Bank supervises the quality of reporting in the banking sector intensively with a well-trained team of on-site and off-site inspectors. A more recently established regulator, the Insurance Supervision Agency, is also performing supervision and developing its capacity in corporate financial reporting. The Securities and Exchange Commission needs a broadened enforcement power and further capacity building for reviewing the financial statements of companies under its purview.
- 14 **In 2006, the Institute of Certified Auditors of the Republic of Macedonia (ICARM) was established, with a clear mandate and adequate organization.** The 2003 report highlighted issues with the profession including significant deficiencies in its organization, ineffective regulation, substantial lack of educational arrangements and non-compliance with independence requirements. These are largely resolved with the establishment and efforts of ICARM. ICARM has been an IFAC associate since 2010 and member of IFAC since 2013. A professional audit examination program, largely aligned with international benchmarks, has been developed; continuing professional development (CPD) requirements for auditors have been imposed; and a quality assurance mechanism has been established.
- 15 **ICARM has put in place a system of quality assurance over auditors which is fully functional and represents a very significant progress since the previous ROSC A&A.** The quality assurance reviews are conducted by two trained inspectors on a regular basis following a risk-based methodology. The process is overseen by a Quality Control Commission, the annual reports of which are published on ICARM's website. The reviews have revealed that the implementation of ISAs is a challenge, especially for small and medium-sized practices, and there are major issues related to proper documentation of the audit procedures and of compliance with the standards. The EU has addressed this by allowing Member States to simplify some requirements for the audits of small undertakings.
- 16 **However, ICARM faces significant resource constraints which could jeopardize the progress achieved over recent years.** The Institute is very modestly resourced to perform its entire mandate adequately. It needs technical and financial resources to undertake the translation of standards revisions and update the syllabus and exam materials for the auditing profession. Additional revenue streams, including donor support for technical assistance, need to be identified.
- 17 **A professional body for accountants, the Institute of Accountants and Certified Accountants (IACA), was established in 2012 with mandatory membership for chief accountants and accountants in public practice.** A Supervisory Board has been established but it has not appointed the members of the Managing Board since November 2012; this initial step is necessary for IACA's operationalization. In the interim, the Ministry of Finance has issued 12,000 certificates⁶ to the persons who meet the criteria for obtaining certificates as per

⁶ The MoF issued 9,000 temporary and 3,000 permanent certificates. Holders of temporary certificates will need to take the examinations organized by IACA.

the transitional provisions of the Law on Accounting Services. Currently, these accountants serve a market of approximately 71,000 commercial entities.⁷

- 18 **The Law on Accounting Services of 2012 requires accountants⁸ to be certified members of IACA.** This makes the position of chief accountant a reserved function of IACA members. The provision of accounting services or professional accountants in business is not regulated under EU statutes and only a few countries impose similar obligations on their businesses.
- 19 **Universities offering accountancy and audit education face difficulties in updating their curricula and providing an education that would better serve the market's needs.** International accounting and auditing methodology have been incorporated into curricula but there is a need to use of modern teaching practices and tools. Graduates lack practical experience of applying the A&A standards and require considerable training in the work place. Furthermore, the absence of joint degrees programs with international universities or dual degrees with professional associations (local or international) creates a lack of international visibility and attractiveness for students.
- 20 **Another positive development has been the creation of the Council for the Advancement and Oversight of Audit (CAOA), in accordance with the Audit Directive.** The Council was established pursuant to the Audit Law and started operating in 2012. So far it has focused its work on regulatory issues. The CAO A meets on a regular basis and is charged with overseeing all ICARM activities pertaining to auditing but their involvement in the quality assurance process of the profession has been limited so far.
- 21 **The CAO A needs additional staff and technical capacity to be able to properly oversee the audit profession.** The CAO A might leverage ICARM's experience in this area. Support could be obtained partly through the state budget and partly through the donor community based on a need assessment and strategy paper that the CAO A can prepare.
- 22 **The GoM recently amended certain provisions of the Audit Law to empower the CAO A to issue secondary legislation to carry out inspections of auditors and audit firms. This is a significant, positive step, although the current legislation needs further alignment with the EU Directive and Regulation regarding the PIEs.** The recent amendments demonstrate that the government is willing to move forward on a number of needed reforms. Specific mechanism relating to the oversight of PIE auditors and the adequate funding of the quality assurance system have yet to be reflected in the Audit Law. The fact that arrangements regarding the functioning of the oversight system are provided in the Law make it more difficult to adapt the system than would have been the case had they been set out in the secondary legislation.⁹

⁷ According to Central Registry there are 102,000 entities registered for business activity of any kind. However, only 71,290 entities declared their activity and submitted annual accounts to the Central Registry in 2013.

⁸ Accountants are required to be certified with IACA to be able to sign off the financial statements of companies regardless of size.

⁹ The Audit Law prescribes the requirements to be fulfilled by the quality inspectors as well as the process for appointment of inspectors to specific assignments, the components of quality inspections, procedures for distribution of QC reports, complaints and follow up. Ideally these should be regulated in a rulebook for enhanced flexibility with the Audit Law making a reference to the relevant rulebook.

Areas for Consideration

- 23 **This ROSC A&A aims to set forth broader areas for consideration as the basis for a dialogue with the government on the way forward**, rather than providing prescriptive recommendations. Significant progress has been achieved over the past decade, and the objective of this section is to identify a number of key areas that ought to be addressed in order to ensure that these gains are solidified and made sustainable over the medium and longer term.
- 24 **Align fully the statutory framework with the EU directives including simplifying requirements on SMEs.** The foundation of the statutory framework should be further developed, adapted and in some aspects simplified to align it fully with the EU *acquis*, and ensure it can be applied effectively. In particular efforts should be made to:
- *Clarify the definition of PIEs and align it with the main categories of EU Audit Directive*, namely listed companies, credit and insurance undertakings as well as the undertakings of significant public relevance because of the nature of their business, their size or the number of their employees;
 - *Simplify accounting and auditing requirements*, whenever possible, especially for small and medium size enterprises, to reduce the cost of doing business for SME businesses;
 - *Adopt simpler requirements of the EU Accounting Directive for micro-entities*;
 - *Foster cooperation between all institutions concerned with improving the quality of financial reporting* including universities, profession bodies, business organizations, regulators and key policymaking institutions;
 - *Further improve the Law on Accounting Services*, especially with regard to (i) easing the legal restriction allowing only IACA members to be chief accountants or professional accountants as this is not a regulated profession in the EU statutes, and (ii) balancing the need for improving the competence level of accountants and the impact on the cost of doing business particularly considering the compliance costs for accountants in terms of initial and continues professional development requirements. One way could be to regulate the public accounting service providers only, instead of all accountants employed in business¹⁰ as is currently specified in the Law.
- 25 **Revisit the organization of the accountancy profession to avoid duplication and ensure its long-term development.** Accounting and auditing are part of the same profession of accountancy and there are considerable overlaps in the professional and educational requirements for accountants and auditors. Given the size of the domestic market and resource constraints, close co-operation between ICARM and IACA from the outset may best suit the needs of FYR Macedonia. Merging both institutions may be considered as an option for the future. The report recommends that:
- IACA should function in accordance with IFAC's standards/benchmarks for professional accountancy organizations referred to as the Statements of Membership Obligations (SMOs) and should seek to join IFAC as an associate full member in the medium term, with a longer term goal of becoming a member.

¹⁰ Including bookkeepers and accountants working for accounting service providers willing to have the authority to sign off company financial statements.

- IACA and ICARM should collaborate; ICARM is already an IFAC member with an existing professional education and examination infrastructure. Providing services for accountants and certified accountants would also help ICARM broaden its revenue base.

- 26 **Continue modernizing accountancy education and training.** University education in accounting and auditing should include interactive elements using practical aspects where possible. This can be done by (i) providing opportunities to university faculties for the development of technical assistance projects with donors, and (ii) encouraging collaboration between universities and business to offer practical experience to students. Furthermore, universities and the profession could cooperate to attract more students to the profession by providing exemptions from certain aspects of certification requirements to A&A students, as also allowed in the EU.
- 27 **Streamline accounting and auditing standard setting.** There is a need to establish an effective, sustainable system for translating and publishing IFRS, IFRS for SMEs and ISAs. Compliance with the standards should be facilitated with the preparation of guidance materials and rulebooks, developed inclusively with the participation of all stakeholders.
- 28 **Strengthen mechanisms to ensure compliance with the standards.** Oversight roles, responsibilities and enforcement provisions in all sectors subject to financial reporting requirements should be clarified and/or improved. In addition there should be:
- Improved corporate financial reporting capacity within the relevant regulatory agencies;
 - Enhanced cooperation between the regulator agencies and ICARM; and
 - Increased involvement of the CAO in ICARM's Quality Assurance and Examination Committees.
- 29 **A modern corporate financial reporting environment will emerge in FYR Macedonia as progress is made in improving accounting and auditing practices in the country.** The commitment of Government, the regulatory agencies and the profession to address the issues raised in the Areas of Consideration section above will determine the pace of progress. Suggested next steps are for the Government to (i) discuss the diagnostic with the stakeholders, (ii) determine the priority areas for further reform or improvement (iii) assess the resources available and determine the corresponding allocations and remaining gaps. The World Bank is committed to continue supporting FYR Macedonia in this ongoing reform process.
- 30 The EU-REPARIS program, which FYR Macedonia participates in, will continue to provide a platform for knowledge sharing and peer exchange with other Western Balkan countries who face similar challenges and are on a common EU accession pathway.

I. Introduction

A. Objectives

- 1 **This assessment of accounting and auditing requirements and practices in FYR Macedonia is part of a joint initiative implemented by the World Bank and the International Monetary Fund to prepare Reports on the Observance of Standards and Codes (ROSC).** The assessment focuses on the strengths and weaknesses of the accounting and auditing environment that influences the quality of corporate financial reporting, and includes a review of both statutory requirements and actual practice. It uses International Financial Reporting Standards (IFRSs) and the International Standards on Auditing (ISAs) as benchmarks and draws on international experience and good practices.
- 2 **The assessment also considers the extent of compliance with European Union (EU) requirements under the *acquis communautaire*¹¹.** FYR Macedonia signed a Stabilization and Association Agreement with the EU in 2001. The country was given the status of EU candidate country in 2005 and the European Commission (EC) proposed starting negotiations on full EU membership in 2009. Progress was interrupted as a result of the dispute with Greece over the constitutional name of the country. Since March 2012 there has been high level accession dialogue with the EU - a platform for cooperation, aiming to modernize and reform the market economy, rule of law, public administration and other areas to bring FYR Macedonia closer to the EU.
- 3 **The strategic objective of this report is to support Government efforts to improve the business climate in FYR Macedonia, and achieve the country's overarching goal of EU integration.** The Government recognizes that timely and reliable financial information, formulated according to internationally accepted standards improve competitiveness and productivity across the economy, and that observing standards of governance creates confidence among local and foreign investors. This report provides policy recommendations to improve financial transparency in the domestic corporate sector and to strengthen accounting and audit practices in line with international benchmarks and EU Directives.
- 4 **The specific objective of this report is to help the Ministry of Finance and other stakeholders address continuing deficiencies in the institutional infrastructure required for relevant and reliable corporate financial reporting.** The three essential pillars of institutional infrastructure are: (i) adequate and appropriate legal requirements, (ii) capacity sufficient to implement those requirements, and (iii) effective enforcement mechanisms. Adoption of appropriate measures will enable companies, both large and small, to have greater access to finance, to invest, to increase productivity, and to support increasing the in-flow of foreign direct investments (FDI) and the deepening of the capital markets.
- 5 **This report updates the first ROSC A&A prepared in 2003.** The first report assessed FYR Macedonia's corporate financial reporting environment and identified a number of areas for improvement. Reflecting the status of FYR Macedonia as a potential candidate of the European

¹¹ The entire body of EU law is known collectively as the *acquis communautaire*. Transposition and implementation of the *acquis* represents a requirement for EU member states and candidates. The *acquis* sets out specific requirements for countries under the Company Law chapters regarding financial reporting for companies and statutory audit.

Union, the 2003 report recommendations included the gradual adoption and implementation of the EU's corporate financial reporting and statutory audit policy framework.

- 6 **FYR Macedonia received significant support to implement the recommendations on the first ROSC A&A.** A Country Strategy and Action Plan (CSAP) to enact the 2003 ROSC A&A recommendations was prepared. Actions included in the CSAP were implemented from 2007 to 2010 under the Road to Europe – Program for Accounting Reform and Institutional Strengthening (REPARIS). The stakeholders continued the reform process when REPARIS funding ended. Measures successfully implemented since 2003 include reforms to the accounting and auditing laws, the establishment of a public oversight agency, the adoption of IFRS for SMEs, and the establishment of a professional body which undertakes quality assurance.
- 7 **This 2014 update assessment contributes to the World Bank's Country Partnership Strategy (CPS) for FYR Macedonia.** The World Bank FY15-18 Country Partnership Strategy (CPS) is founded on two main pillars, 'Growth and Competitiveness' and 'Skills and Inclusion', with the cross-cutting theme of promoting the EU accession agenda. The CPS supports the growth and competitiveness through a sustained private sector-led growth, increased FDIs complemented with access to better jobs and efficient public services, while continuing to contribute to FYR Macedonia's agenda for EU accession. The ROSC A&A Update contributes towards in the objectives of the CPS through (a) assistance to support EU accession and (b) interventions to leverage financing and expertise from within the World Bank Group and across FYR Macedonia's development partners.
- 8 **A sound corporate financial reporting infrastructure is an important element for addressing the country's economic issues.** Improved corporate sector financial reporting and auditing, along with appropriate disclosure of financial information, contributes to economic development and growth and to improving access to finance, the investment climate, the overall business environment and thus to job creation. There are a number of ways in which it does this, including: (a) strengthening a country's financial architecture; (b) providing the pre-requisite information to facilitate foreign direct and portfolio investment; (c) helping to mobilize domestic savings; (d) improving companies' access to credit and finance; (e) increasing foreign and domestic investor confidence in local enterprises as a result of receiving timely and reliable financial information; (f) increasing lender and investor confidence which lowers the cost of capital; and (g) facilitating integration into global financial and capital markets. Improving accounting and auditing and financial reporting practices alone is not enough to solve the country's problems, but can significantly contribute to the economic stimulus and raising public confidence in financial reporting and mechanisms that protect the public interest.

B. Country Context

- 9 **FYR Macedonia is a small, open and developing economy closely integrated with Europe and with an overarching goal of joining the EU.** It is an upper middle-income country, with a population of 2 million, and GNI per capita of approximately US\$ 4,800 in 2013.¹² After peacefully declaring independence from the former Socialist Federal Republic of Yugoslavia

¹² <http://data.worldbank.org/country/macedonia-fyr>

in 1991, FYR Macedonia became a republic with a constitution that provides for a multiparty democracy. In 2009, the European Commission (EC) proposed starting negotiations on full EU membership, a conclusion that was repeated in all Annual Reports between 2010-2014, but progress has been blocked as a consequence of the name dispute with Greece.

- 10 **FYR Macedonia has made great strides in reforming its economy over the last decade, having mostly recovered from the 2008 global crisis.** Between 2002 and 2013, FYR Macedonia's GDP grew at an average of 3.1 percent in real terms annually and reached US\$10.2 billion in 2013.¹³ The following industries are the most significant to the Macedonian economy, as of 2013: Mining and Energy 17 percent, Financial and Real Estate Industry 16 percent, Trade 13 percent and Agriculture 9 percent.¹⁴ Recent growth has been driven largely by construction (largely due to public investment) and exports. Real GDP growth is expected to reach 3 percent in 2014.¹⁵
- 11 **However, the unemployment and poverty rates remain high despite recent improvements achieved by FYR Macedonia.** The overall unemployment rate was 27.9 percent in the third quarter of 2014¹⁶, one of the highest in Europe and Central Asia. Still, this represents an important decrease compared to 38.7 percent in the first quarter of 2005. The percentage of the population at risk of poverty is also relatively high. There are some data challenges in measuring poverty, yet the official statistic shows that 26.2 percent of the population was at risk of poverty in 2012.¹⁷
- 12 **Trade integration with the EU is well advanced.** In the period between January and September 2014, approximately 77 percent and 14 percent of exports were directed towards the EU-28 countries and the Western Balkan countries respectively. Similarly, imports from the EU-28 countries reached 64 percent in the first three quarters of 2014. The United Kingdom, Austria and Germany are the most important EU-based sources of FDI, and Switzerland and Turkey the most important non-EU sources of credit and investment for 2013.¹⁸
- 13 **Exports have become more diversified and accounted for 53.4 percent of GDP in 2012, a 6.6 percent increase over the previous year.** Growth was mostly driven by increased exports in sectors which have benefited from foreign direct investment, such as the automotive industry, and catalysts and electronic components. Iron, steel and textile products used to be traditional export goods but their importance has fallen recently. In 2008 six products represented 70 percent of total exports; in 2013, 12 products, including tobacco and fresh vegetables, represented the vast majority of exports.¹⁹
- 14 **The global financial crisis and the prolonged Eurozone crisis had spill-over effects on the national economy due to close trade ties with the EU.** Although the recovery is ongoing, the corporate sector and particularly the small and micro enterprises were affected by the reduced external demand for FYR Macedonian products, especially in 2012. Companies are still

¹³ <http://data.worldbank.org/country/macedonia-fyr>

¹⁴ http://nbrm.mk/WBStorage/Files/Statistika_Bilten_Q4_tabeli_raelen_sektor_2013_a.xlsx

¹⁵ <http://www.worldbank.org/en/country/macedonia/overview>

¹⁶ http://www.stat.gov.mk/OblastOpsto_en.aspx?id=14

¹⁷ More data available at http://www.stat.gov.mk/PrikaziSooopstenie_en.aspx?rbtxt=115.

¹⁸ http://nbrm.mk/WBStorage/Files/Statistika_DI_zemji_2013.xls

¹⁹ World Bank Group- FYR Macedonia Partnership, Country Program Snapshot, April 2014

struggling with low short-term liquidity, profitability and extended collection periods²⁰ that the GoM has been trying to address through reasonably priced credit lines since 2009. Small and micro size entities play a significant role in the economy in FYR Macedonia. They represent approximately 99 percent by number of some 102,000 registered enterprises²¹; they contribute 65 percent of the GDP and 82 percent of employment²² in the private sector.

- 15 **The Government has implemented important structural reforms in recent years, which include reducing the regulatory burden and cutting red tape, improving customs administration, and introducing a flat tax rate on personal and corporate income.** These efforts have reaped substantial rewards. In 2013, FYR Macedonia was ranked fifth among the top Doing Business reformers worldwide, having improved from 92nd to 25th place in the overall ranking between 2006 and 2013. However, the changes that drove the improved rankings have, to a large extent, been due to the enactment of a number of legal and regulatory changes, which have not yet resulted in increased investment in practice. So, while the country has been successful in attracting a number of high-profile foreign investments, net FDI amounted to 4.4 percent of GDP between 2006 and 2013, still below the regional average of 6.4 percent.²³ Foreign investment is projected to gradually return to the pre-crisis levels, of 6 percent of GDP.²⁴ Investments in airport concessions, agro-processing and real estate have resumed. In addition, the pipeline for new investments appears strong and includes respectable global companies, most notably in the energy, car parts and electronics sectors.
- 16 **The private sector is seen as the driver of FYR Macedonia's future growth, the Government of Macedonia's Work Program for 2014-2018 therefore prioritizes improving the business climate and competitiveness agenda.**²⁵ FYR Macedonia's continued economic recovery will require supportive macroeconomic policies, continued structural reforms and their implementation, and accelerated progress on the EU accession agenda which will contribute to improved productivity of the corporate sector and attract FDI.

C. The Financial Sector

- 17 **The financial sector is dominated by commercial banks with a majority of foreign ownership; the banking sector is a significant proportion of the economy.** There were 16 banks and 4 savings houses operating in the country at the beginning of 2014. The banking system is highly concentrated, with two-thirds of total banking assets concentrated in the three largest banks. The aggregate share of foreign ownership has been increasing and reached 75.2 percent by the end of 2013. The share of state ownership remains low at about 6.5 percent. The banking sector is growing and is prudently regulated: in 2013, total banking sector assets represented 78.2 percent of GDP, and deposits had increased by 5.7 percent from 2012.²⁶ The

²⁰ According to the NBM's Report of Financial Stability, 36 percent of legal entities, particularly micro-enterprises, which submitted financial statements to the Central Registry, showed operating losses and 31& of registered enterprises had their accounts blocked in 2013.

²¹ State statistics disclosed 71,290 'active' enterprises providing information on turnover and number of employees for 2013.

²² Figures indicated by the Central Registry.

²³ http://www.nbrm.mk/WBStorage/Files/Istrazuvanje_WEB_Osnovni_makroek_indikatori_1993_2014.xls

²⁴ http://www.nbrm.mk/WBStorage/Files/Istrazuvanje_WEB_Osnovni_makroek_indikatori_1993_2014.xls

²⁵ <http://vlada.mk/?q=node/262&language=en-gb>

²⁶ http://www.nbrm.mk/WBStorage/Files/Regulativa_Godisen_BS_31_12_20130.pdf

capital adequacy ratio remains above 16 percent, and liquidity is strong while non-performing loans are 11.5 percent and almost fully provisioned.

- 18 **Even though the significance of the financial sector and its intermediation function has increased, access to finance by companies in FYR Macedonia remains limited.** The World Bank Enterprise Survey²⁷ identified two major obstacles to a favorable business environment: informality and access to finance. The survey indicates a significant burden imposed by loan requirements, indicated by very high collateral levels at around 275 percent, relative to the value of loans.
- 19 **Insurance companies are regulated by the Insurance Supervisory Authority (InSA), a relatively new regulatory agency established in 2009.** At the end of 2013, there were 15 insurance companies with annual premium income of around US\$ 160 million, or 1.52 percent of nominal GDP, up from seven insurance companies with approximately US\$ 67 million in premiums in 2002.²⁸ Foreign interests represent 88 percent of the total equity of the sector; there is only one domestic insurance undertaking in the market.
- 20 **Most other non-bank financial institutions are supervised by the Ministry of Finance; pension funds are supervised by the Agency for Supervision of Fully Funded Pension Insurance (MAPAS).** The Ministry of Finance is responsible for regulating leasing companies, and also companies that operate in lending, credit cards, factoring, and investment property including operating leases, guarantees, and financial advisory services. These non-bank financial institutions have a small market presence. The non-bank financial sector is in the development stage but is regulated prudently.²⁹ There are only two pension funds but the size of the assets they manage is significant. The mandatory pension contributions collected from employees are channelled to the state-operated Pension and Disability Insurance Fund³⁰ and to two private pension companies based on predetermined percentages. These two companies managed approximately EUR 440 million in assets³¹ at the end of 2013, corresponding to 5.65 percent of GDP. They are also allowed to operate voluntary pension schemes, but had only accumulated EUR 5 Million in these schemes from 18,500 members as at the end of 2013, corresponding to 0.07 percent of GDP. The majority (62 percent) of these funds are invested in government securities and only 4 percent in domestic listed companies.
- 21 **The capital market is shallow with declining activity levels.** There are 30 companies on the official market of the FYR Macedonian Stock Exchange (MSE), half of which have illiquid trading, providing limited investment opportunities for investors. In addition, there are 85 mandatorily listed companies (see the following paragraph). The market capitalization as of

²⁷ Based on data collected between November 2012 through May 2013.

<http://www.enterprisesurveys.org/Data/ExploreEconomies/2013/macedonia-fyr>

²⁸ FYR Macedonia Accounting and Auditing Report on Observance of Standards and Codes, World Bank, 2003.

²⁹ The Law on Financial Companies, passed in December 2010, regulates the credit activities of non-bank financial institutions, such as loans, credit cards, factoring and guarantees. It also introduces minimum capital criteria as well as reporting and oversight requirements for institutions providing those services. Similar prudential requirements were also contained in amendments to the Law on Leasing, which was adopted in March 2011.

³⁰ The fund is established at the Ministry of Labor and Social Security and operates as a current fund: contributions are not invested, but used to paid retirees. The funds are generally insufficient and funding gaps are filled from the Central Government budget.

³¹ Accumulated pension contributions of 350.000 members.

December 31, 2013 was around EUR 1.7 billion.³² Only the Government issues bonds, as companies choose to use traditional bank loans for their financing needs. The volume of trading at MSE was around EUR 52 Million³³, showing a decrease by 42 percent during 2013. IPOs in 2013 amounted to EUR 285,000. In an effort to attract more capital to the region and make trading more efficient, the stock exchanges of FYR Macedonia, Bulgaria and Croatia are reported to be considering linking together as a joint exchange based in Skopje.³⁴

- 22 **The Government has issued a mandatory listing requirement for companies above a certain size threshold for increased transparency and promotion of the growth of the stock market.** With this new requirement, the MSE introduced a new market segment of mandatorily listed companies. Accordingly, companies with at least EUR 1 million of issued shares, 50 shareholders and 1 percent public ownership are now made part of the mandatory listing. This legal requirement was introduced in 2013 and its impact on the growth of the stock exchange would be measurable only in the medium-term.

³² \$2.28 billion (\$2.18 billion in equity and \$99 million in bonds) as per Macedonian Stock Exchange, Annual Report 2013 <http://www.mse.mk/mk/content/4/2/2008/annual-reports>

³³ Equivalent to \$ 72 Million. This figure represents only 7.8 percent of the market peak in 2007, when the total volume of trade was \$ 926 Million.

³⁴ <http://www.ebrd.com/pages/news/press/2014/140707.shtml>

II. Institutional Framework

A. Statutory Framework

- 23 **Significant efforts have been undertaken since 2003 to reform the statutory framework for accounting and auditing.** The Government has carried out reforms consistent with good international practices and the *acquis communautaire*. Major changes in accounting since 2003 include: the enactment of a law on accounting services; the adoption of a relatively recent version of IFRS (2009)³⁵; for the introduction of IFRS for SMEs; improved filing mechanisms for financial statements; and improved transparency through the availability of data at the Central Registry. Additional reforms in auditing include: the enactment of a new law on auditing; the establishment of a professional institution for statutory auditors; the preparation of updated certification curricula; the replacement of outdated auditing standards with newer versions; and establishment of quality assurance and public oversight arrangements for the audit profession. Annex 1 provides detailed information on the 2003 ROSC recommendations and the progress achieved in the respective areas.

Legal forms and governance of companies

- 24 **The Trade Company Law³⁶ sets out the main company law requirements in FYR Macedonia.** It establishes the legal forms which commercial entities may take, and sets out the registration, operation, restructuring and cessation requirements for each type of enterprise. The two main legal corporate forms widely used for incorporation in FYR Macedonia are:
- Limited Liability Companies (LLC), which represent 89 percent of companies registered in FYR Macedonia. An LLC can be established with a minimum registered capital of 5,000 EUR and with at least one shareholder.
 - Joint Stock Companies (JSC), companies whose capital invested by the shareholders is divided into shares with given nominal value. A JSC can be established by at least one shareholder with a minimum capital of EUR 25,000 for non-listed and EUR 50,000 for listed companies.
- 25 **JSCs are subject to specific corporate governance requirements with respect to their management structure.** The JSCs may opt for either a two- or one-tier board structure; LLCs are not required to have a board of directors. JSCs may choose to have either a board of directors, comprising the executive and non-executive members, or a two-tiered board system with both a Management Board, comprising the executive officers of the company, and a Supervisory Board. In the two-tiered system, the Supervisory Board supervises the performance of the Management Board and is responsible for, inter alia, reviewing all financial statements of the company and preparing the Annual Report assessing the operations of the company, the performance of the Management Board, and the financial statements of the company.³⁷ JSCs appoint the statutory auditor and approve the company's financial statements at the Annual General Meeting of shareholders (AGM).

³⁵ For the banking sector, the most current version of the standards is applicable

³⁶ Enacted in 2004, latest amendment in December 2012.

- 26 **The vast majority of companies in FYR Macedonia are small or micro entities.** The Trade Company Law classifies companies according to size: micro, small, medium and large, based on the number of employees, total income, and total assets. Classification thresholds are significantly lower than the thresholds in the EU's New Accounting Directive³⁸. As of 2013, there are approximately 71,000 "active" entities out of some 102,000 registered entities. Of these, medium and large-sized companies (1,160) are obliged to have their financial statements audited. Regulated entities³⁹ constitute approximately 13 percent of the audited companies.

Table 1: Thresholds for MSMEs in FYR Macedonia [corresponding EU thresholds⁴⁰ given in brackets]

Entity size (No. of registered entities in 12/2013)	Number of employees	Total income [Net Turnover] ⁴¹	Average total assets
Micro (66,288)	< 10 [same]	< EUR 50,000 [EU: < EUR 700.000]	N/A [EU: < EUR 350,000]
Small (34,436)	< 50 [same]	< EUR 2 million [EU: < EUR 8 million]	< EUR 2 million [EU: < 4 million]
Medium (662)	< 250 [same]	< EUR 10 million [EU: < 40 million]	< EUR 11 million [EU: < 20 million]
Large (498)	> 250 [same]	> EUR 10 million [EU: > 40 million]	> EUR 11 million [EU: > 20 million]

* Two of the three criteria should be met.

- 27 **Recent amendments to the Audit Law have broadened the definition of public interest entities (PIE) and some definitions would benefit from clarification.** In September 2014, the national legislation moved from a definition encompassing essentially listed companies and other companies regulated by the SEC to a broader one including trade companies for which statutory audit is required in "special" laws.. Currently all companies that are subject to statutory audit by "special" laws are considered of public interest. The Macedonian legislation, however, does not define "general" and "special" laws. There is room for clarifying the definition of PIEs by specifying the types of enterprises that will be treated as such as designating companies as PIEs entails assigning higher obligations to them in terms of reporting and to their auditors as well. Following the recent reforms in the EU's A&A statutes, i.e. the 2003 Accounting Directive and the 2014 regulation on PIE audits, it is expected that

³⁸ A brief transposition of the national legislation with the New Accounting Directive is provided in Annex 2.

³⁹ This includes 16 banks, 4 saving houses, 30 companies listed by choice on the MSE, 85 mandatorily listed companies, 2 pension funds and 15 insurance companies.

⁴⁰ EU Accounting Directive (2013/34/EU)

⁴¹ The national legislation defines total income as all revenues earned or total inflow of economic benefits regardless of the source. In the EU, the net turnover indicates only revenues from core business activities.

EU member states will review the definition of PIEs to ensure they are not too broad given the new requirements adopted.

- 28 **Listed companies are not required to prepare a report on corporate governance as required in the EU's New Accounting Directive.** The Government prepared a handbook on corporate governance best practices and voluntary implementation through the IFC's *Corporate Governance Program* in *Southern Europe*. Despite the small number of transactions in the stock exchange, as a step to show commitment to the development of good governance arrangements in Macedonian companies, it is recommended to encourage the preparation of corporate governance reports and consider making it mandatory in the medium to long term. For instance, the Law on Banks and the NBM 'Decision on corporate governance' require banks to incorporate a report on corporate governance in their annual reports. A similar approach could be adopted for companies regulated by the SEC.

Accounting, Financial Reporting and Audit Requirements

- 29 **The Trade Companies Law establishes the essential financial reporting and audit requirements applicable to all companies in FYR Macedonia.** It sets out the accounting and financial reporting framework to be used; identifies responsible parties for the preparation, approval and distribution of financial statements; and sets thresholds for statutory audit and applicable reporting deadlines. Based on the Trade Companies Law, the MoF and financial sector regulators (e.g., NBM, InSA, etc.) developed by-laws, called "Rulebooks", which set forth additional requirements. Table 2 sets out the main financial reporting requirements in FYR Macedonia.

Table 2: Summary of accounting and auditing requirements by types of entities

	Regulatory Agency	Accounting Standards	Audit Requirement	Publication* and Other
Listed companies	Securities and Exchange Commission (SEC)	IFRS as issued by IASB, according to the Law on Securities, and the Rulebook-SEC (which refers to the IFRS 2009 version)	Yes. Audit partner rotation every 7 years. 2-year cooling off period for auditors.	<ul style="list-style-type: none"> • Full financial statements on MSE website • Abridged financial statements in newspaper.

	Regulatory Agency	Accounting Standards	Audit Requirement	Publication* and Other
Banks	National Bank of Republic of Macedonia (NBM)	IFRS and Rulebook-NBM	Yes Audit firm rotation every 5 years.	<ul style="list-style-type: none"> • Primary financial statements (no notes) in newspaper. • NBM and bank websites
Insurance	Insurance Supervisory Authority (InSA)	IFRS (2009) and Rulebook-InSA	Yes Audit firm rotation every 5 years.	<ul style="list-style-type: none"> • Full financial statements on company website • Abridged financial statements in newspaper.
Other financial institutions	SEC regulates investment funds Supervision of Fully Funded Pension Insurance (MAPAS) regulates pension funds	IFRS (2009) for both; plus Rulebook-SEC for investment funds, and Rulebook-Pensions, for pension funds	Yes Investment funds: no rotation requirement Pension funds: audit firm rotation every 3 years.	Pension funds: <ul style="list-style-type: none"> • Full financial statements on company website • Abridged financial statements in newspaper. Investment funds: no publication
Large and medium companies	Ministry of Finance	IFRS (2009), plus Rulebook-MoF	Yes Audit firm rotation every 7 years for PIEs..	Some financial information is made publicly available by the Central Registry
Small companies and microenterprises	Ministry of Finance	IFRS for SMEs	No	Financial information submitted to Central Registry

*All entities file their unaudited and audited financial statements with the Central Registry.

- 30 **Most companies in FYR Macedonia face greater financial reporting requirements, relative to their size, than their EU peers.** The Trade Company Law requires all companies, regardless of size, to prepare legal entity financial statements on an annual basis, comprising a

balance sheet, income statement, and notes to the accounts⁴² (referred to as “Annual Accounts” in the national legislation⁴³). In addition,

- All small trade companies in FYR Macedonia, including micro enterprises, are required to apply IFRS for SMEs.⁴⁴ In practice, these enterprises prepare only annual accounts (balance sheet, income statement and notes) according to the MOF Rulebook, and IFRS for SMEs are used only as guidance for measurement or valuation purposes of specific elements of annual accounts; the practice balances the issue of complexity of the standards. However, even micro entities must include in their annual accounts information such as risk management which can be onerous. Member States in the EU are required to allow small entities to follow simplified accounting requirements.
- Medium and large size companies prepare two sets of financial statements: annual accounts and a complete set of financial statements in accordance with IFRS⁴⁵ i.e. with the inclusion of additional tables such as the statement of cash flows and changes in equity in addition to above. Medium sized companies should be allowed to use IFRS for SMEs where appropriate.

- 31 **Banks prepare their financial statements in accordance with IFRS; and must follow the Rulebook of the National Bank of FYR Macedonia (NBM) on the presentation of financial statements. Insurance companies prepare their financial statements in accordance with IFRS-2009 and the Rulebook of the Insurance Supervision Agency (InSA).** NBM also issues prudential rules, particularly relating to the types and the contents of financial statements, and the methodology for recording and valuation.⁴⁶ For listed banks, financial statements prepared in accordance with NBM requirements are accepted by the Securities and Exchange Commission (SEC). InSA does not issue reporting standards for prudential purposes but issues specific rules for the insurance sector, including requirements on the use of a special chart of accounts and specific valuation rules.⁴⁷
- 32 **Listed companies and companies with “special reporting obligations” face additional requirements, per the Law on Securities and the Rulebook-SEC, which are not fully consistent with IFRS.** The Law on Securities requires such companies to apply current IFRS, as issued by the IASB, for their legal entity as well as consolidated financial statements. The Rulebook-SEC, however, requires them to apply the officially published translated version of IFRS into Macedonian, i.e., the 2009 version of IFRS. In addition, the Rulebook-SEC requires that financial statements follow a presentation that is not consistent with that of IFRS. In

⁴² The disclosures in the annual accounts fall short of the disclosure requirements in the EU Accounting Directive in that they do not include topics such as commitments and guarantees, major agreements that may affect the financial statements, advances and credits granted to owners and managers, etc.

⁴³ The term “Annual accounts” differs from the terminology in the EU Accounting Directive in that it indicates the templates for balance sheet, income statement and disclosures as requested per the Ministry of Finance’s Rulebook. These are different than a complete set of IFRS financial statements.

⁴⁴ These are too complex for micro enterprises and this requirement might not comply with the Accounting Directive insofar as small undertakings are concerned. Implementation guidance for smaller size companies is not available, and the Rulebook currently offers little guidance or explanation to help them comply with the standards and it falls short of the disclosure requirements in the EU Accounting Directive.

⁴⁵ As effective from January, 1 2009, translated and enacted by the MoF in a separate Rulebook on Accounting.

⁴⁶ Including: NBM Decision 169/2010, as amended, on the types and contents of financial statements of banks; and NBM Methodology 169/2010 which gives IFRS guidance on recognition, measurement and disclosure.

⁴⁷ Benchmarking of the prudential rules against the EU Directives is not undertaken within the scope of this report.

practice, the vast majority of companies report under IFRS-2009 and the SEC accepts financial statements prepared under IFRS-2009 or current IFRS. Listed companies also submit unaudited semi-annual financial statements, which is aligned with the EU Transparency Directive.

- 33 **Non-bank financial institutions, including investment funds, pension funds, and leasing companies, are required to follow the accounting, audit, and reporting requirements in the Trade Company Law and Rulebook on Accounting, which requires the adoption of IFRS-2009.** Non-bank financial institutions must submit their full set of audited financial statements—comprising a balance sheet, income statement, statement of changes in equity, cash flow statement, and notes—to their regulatory body. They are also subject to additional prudential requirements, as stipulated by the regulatory body. Investment funds are required to prepare interim financial statements on semi-annual and quarterly bases.⁴⁸

Auditing requirements

- 34 **Companies, with the exception of small companies and micro-entities, must have their annual legal entity and consolidated financial statements audited by an external auditor.** 1,160 companies (out of a total of 102,000) were subject to statutory audits in 2013. Audits must be conducted in accordance with both the clarified International Standards on Auditing (ISA)⁴⁹, as translated and published in the Official Gazette, and the Code of Ethics for Professional Accountants issued by IESBA. The Trade Company Law sets out which companies are subject to statutory audit. Professional standards and provisions relating to the regulation of the profession, including the oversight system, are contained in the Audit Law.
- 35 **A new Audit Law was introduced in 2010 and has subsequently been amended to further align national legislation with the EU *acquis*.**⁵⁰ Further changes are required to fully transpose the EU audit regulatory framework. These include a need for the Audit Law to:
- introduce specific requirements regarding the internal organization of the statutory auditor and audit firm, and organization of work.
 - make reference to the proportionate application of auditing standards to the scale and complexity of the business entity.
 - differentiate between the quality assurance system for PIEs and for others, and specify that inspectors must be non-practicing auditors as there are currently no safeguards prohibiting practicing auditors from reviewing their peers.
 - provide adequate funding for the oversight system.

⁴⁸ Quarterly reports comprise reports on securities comprising assets of the fund traded during the period, cash deposit balance breakdown per holding bank, brokerage fees, fees for depository banks and other charges, value of investment fund assets, number of share units and the value of a share unit.

⁴⁹ Clarified ISAs 2009 were translated and published in the Official Gazette in 2010.

⁵⁰ The EU approved an audit policy reform in April 2014 and published the 2014 European Directive on Statutory Audits of Annual and Consolidated Accounts effectively amending the 2006 Statutory Audit Directive (2006/43/EC) in the Official Journal (OJ) on May 27, 2014. It is compulsory on Member States to enact the provisions contained therein by transposing them into their national legislation. The Commission has imposed a deadline of two years for the transposition, starting 20 days after the publication of the text in the OJ. In addition, the audit reform also comprises a new Regulation on Statutory Audit of Public Interest Entities, effective for EU member states 20 days after publication on May 27, 2014.

36 **In addition to the general requirements applicable to all companies, regulated entities face additional requirements with regard to audit:**

- **Firms auditing banks and insurance companies must have at least three years' audit experience**, and must not have provided consulting services to the financial institution over the previous two years or been subject to disciplinary measures by the Institute of Certified Auditors over the previous three years.
- **PIEs are subject to an audit firm/auditor rotation requirement.** Audit partner rotation is required every seven years, with a two-year cooling off period, for listed companies.⁵¹ Audit firm rotation is required every five years, with no cooling off period, for banks, insurance companies, and investment funds; and every three years with no cooling off period for pension funds. The EU Audit Regulation has not only a rotation requirement for key audit partners but also a rotation requirement for PIE auditors and audit firms every ten years with four years of cooling off.
- **Audit committees are required for PIEs.** For listed companies, the majority of audit committee members should come from the Supervisory Board, and there must be at least one independent member with an accounting and auditing background. For banks, all members of the audit committee are required to have expert knowledge in banking, finance, risk management, accounting, auditing or relevant fields and include at least one certified auditor as an independent member. The EU Directive requires the majority of the audit committee members to be independent of the entity.

37 **NBM has broad powers over auditors and supervises the auditor appointment process, as well as the content and quality of audit reports.** This is in line with the international good practice. Banks are required to notify the NBM of the appointment of an audit company, and NBM may reject the audit firm if it does not meet the criteria set forth in the Banking Law. Auditors must report to NBM on a number of issues. Auditors are required to notify NBM if they find that the bank has violated regulations, and must also provide explanations to NBM on the audit or audit report if requested to do so. In addition to the audit report, the auditor must submit to NBM a separate assessment covering issues such as: the accuracy of supervisory statements and reports submitted by the bank; the effectiveness of internal controls and internal audit; the security of the information system; the adequacy of accounting policies applied; and compliance with relevant laws and regulations. NBM may reject the audit reports of the external auditor if it finds they do not accurately reflect the bank's financial condition. In such a case, the auditor will be prohibited from auditing banks for three years.

38 **Additional or specific requirements for auditors of insurance companies are set by InSA and are broadly similar to the audit requirements of banks.** Audits of insurance undertakings are performed in accordance with International Standards on Auditing, and must also abide by the requirements of the Audit Law, Law on Insurance Supervision, and Rulebook-InSA, regarding the form and content of audit report, and the scope of audit. InSA must be informed of, and approve, an insurance company's appointment of an external auditor. InSA also has the right to dismiss an auditor if it finds that an audit was conducted improperly.⁵²

⁵¹ Article 39 of the Law on Auditing enacted in December 2010.

⁵² Art. 131a of the Law on Insurance Supervision.

Filing and publication requirements

- 39 **The Central Registry (CR) maintains various databases for company statistics and is the central depository for the annual accounts of all active companies as well as the audited financial statements of entities subject to external audit as per the statutory requirements.** All companies, including micro and small enterprises, file their financial statements within two months after the calendar year-end.⁵³ The CR extracts and stores basic tables such as the balance sheet and income statement for each company. An abridged set of financial statements excluding the disclosures is made available to the public upon request. Companies that are subject to statutory audit must also file their audited financial statements with the CR. 80 percent of audited financial statements were filed in 2012.
- 40 **Filing and publication deadlines set in laws and by various regulatory agencies could be better harmonized.** All companies submit their annual accounts to CR: medium and large companies are required to file electronically by March 15; small and micro enterprises can file manually by the end of February. Medium and large companies also submit their approved and audited financial statements by the end of June. Regulated entities are subject to additional, often burdensome, deadlines for submission of financial statements and audit reports. Banks must report separately to NBM, to CR and, if listed, also to SEC and MSE. Listed companies have different deadlines for the filing and publication of financial statements imposed by the MSE. Listed insurance companies are required to report, separately, to InSA, MSE, and CR. There is scope to coordinate requirements to make compliance easier.

B. The accounting and auditing profession

- 41 **Accountancy profession practices have improved since the 2003 A&A ROSC report.** Accountants and auditors serve a market of approximately 71,000 commercial entities⁵⁴ in FYR Macedonia of which 1,610 are subject to statutory audit. Issues with the profession highlighted in the 2003 report included significant deficiencies in the organization of the profession, ineffective regulation, substantial lack of educational arrangements and non-compliance with independence requirements.

The audit profession

- 42 **The audit profession is governed by the 2010 Audit Law, largely designed to align the audit framework of FYR Macedonia with the requirements of the EU Statutory Audit Directive.** The law provided for the creation of a public oversight system for the statutory audit function, in line with the EU Statutory Audit Directive, and clarified the respective roles of the oversight body (Council for Advancement and Oversight of Audit, CAO) and the Institute of Certified Auditors of the Republic of Macedonia (ICARM).
- 43 **ICARM is the professional body for statutory auditors.** Established in 2006, ICARM comprises 180 certified auditors, 26 audit firms, and 11 sole practitioners. It became an

⁵³ Companies with seasonal activities may request a different filling date.

⁵⁴ According to Central Registry there are 102,000 entities registered for business activity of any kind. However, only 71,290 entities declared their activity and submitted annual accounts to the Central Registry in 2013.

associate of the International Federation of Accountants (IFAC) in 2010 and a member of IFAC in 2013. Statutory auditors in FYR Macedonia are required to be members of ICARM and are required to apply ISAs, abide by the IESBA Code of Ethics, and participate to continuing professional development (CPD) programs. ICARM is the competent authority responsible for implementing key requirements of the 2010 Audit Law, these include organization of the professional examination program; quality control and quality assurance over audit firms; translation of ISAs and the IESBA Code of Ethics; and the development and delivery of CPD program for its members. A quality control and assurance system has been in place since 2009 within ICARM (discussed further in the Enforcement of Accounting and Auditing Standards section of this report).

- 44 **The audit qualification requirements are aligned with the examination and practical training requirements set out in the EU Statutory Audit Directive⁵⁵ and the International Accounting Education Standards Board (IAESB)'s International Education Standard (IES) 1.** To become a certified auditor in FYR Macedonia, a candidate must have a clean professional record; hold a bachelor degree in economics, law or other relevant degree⁵⁶; pass a professional examination program delivered by ICARM; and gain three years practical experience in audit, two of which must be under the supervision of a practicing auditor. Once certified, auditors are issued practicing licenses by the CAO and can become full members of ICARM and practice statutory or contractual audit and related assurance services in FYR Macedonia. 30 candidates have passed the examination program since its establishment in 2009, with 100 students currently enrolled at different levels. Despite a relatively narrow market, approximately one third of the certified are practicing auditors. Accordingly, there seems to be a need for further qualified auditors in the country.
- 45 **The professional examination program needs to be improved and incorporate legislative changes but faces resource and time constraints.** Established by ICARM in 2009, the program's syllabus, learning outcomes and reading materials substantially conform with the requirements of the EU Statutory Audit Directive and IAESB's IES 2, *Initial professional development- technical competence*⁵⁷, but need updating to include more complex IFRS topics and an information technology component. Furthermore, IAESB, as part of the IES Revision Project, revised IESs in an effort to improve clarity and to ensure consistent application of IESs by reducing ambiguity about the requirements imposed on IFAC members. These revised IESs will become effective by July 1, 2015 for the member bodies to better comply with the requirements. ICARM will have to reconsider the conformity of the professional examination program with these revised standards. Amendments to the Audit Law in 2013⁵⁸ require ICARM to establish a database of questions to conduct the professional examinations in electronic format. Changes, including to the exam's format, responsibilities for delivery and supervision, the minimum pass score, the availability of questions and other technical details, have been in place for new candidates starting from January 2014 but limited resources and tight deadlines restrict the ability to implement these. Concerns about the impact of the new examination format on the quality of the professional examination program raised by the ICARM President,

⁵⁵ Articles 6 to 12 of the Directive remain unchanged. The statement is valid for both the old and new versions of the Directive.

⁵⁶ ICARM Examination Committee decides on the appropriateness of other relevant degrees presented by the candidate for the professional examination program. Any degree in a field close to economics and law (such as business, business and organization, business administration etc.) are generally considered as relevant.

⁵⁷ <https://www.ifac.org/sites/default/files/publications/files/ies-2-content-of-professi.pdf>

⁵⁸ Audit Law, Article 27a, 27b, and 27c.

the ICARM Examination Committee, members of the CAO A and auditors in practice need to be addressed.

- 46 **ICARM is receiving widespread recognition for its role, but it is poorly resourced and depends on donor support and the voluntary work of its members to fulfill its mandate.** ICARM is currently financed through membership fees (auditors pay 1 percent of their annual income from audit and related services), revenues from CPD and professional examination services. As required by the Audit Law, ICARM contributes the budget of CAO A⁵⁹. The available funding is not sufficient to carry out its mandate. Sustainable and adequate funding is crucial to build and maintain the regulatory and professional support system. Translated exam materials are currently purchased, at significant cost, from an international publisher. ICARM should explore alternative certification or training opportunities. With a staff of just four persons, and a relatively small operating budget, ICARM needs to broaden its revenue base.

Box 1: ICARM activities supported by development partners

- In 2009, the World Bank REPARIS project helped ICARM establish a quality assurance function, develop the professional examination and CPD programs, and financed the translation of ISA's, IFRS's and IESBA Code of Ethics into Macedonian. These translations have not been updated since, due to funding restrictions and the prioritization of other activities such as quality assurance, professional examinations and the CPD program.
- With the support of the REPARIS project, ICARM adopted a professional education curriculum and a CPD system for statutory auditors, based on the requirements of the EU Statutory Audit Directive.
- The quality control and assurance system was established in 2009 and subsequently developed in close cooperation with CNCC and CSOEC, the French professional bodies. The number of quality reviews completed in 2010, 2011 and 2012 were 11, 14 and 16 respectively.⁶⁰

- 47 **Certified auditors must be licensed by CAO A to practice in FYR Macedonia.** Individual and entity practicing licenses are issued by CAO A and have no renewal period. Professional indemnity insurance and evidence of non-employment with any other company are pre-conditions for obtaining the license. Licensed auditors are obliged to complete 120 hours of CPD in 3 years, at least 30 hours annually, to maintain the license. This is in compliance with IAESB's requirements. They must also adhere to standards of professional practice and ethics, and their professional behavior is subjected to disciplinary measures taken by ICARM or CAO A.

⁵⁹ With the September 2014 amendments to the Audit Law, ICARM contributions to the budget of CAO A are reduced from 25% of revenues generated from membership fees to 15% of ICARM's total revenue. This change in the basis for calculation did not create an effective change in the contributions of ICARM to CAO A despite reduced contribution percentage.

⁶⁰ No sanctions were imposed on audit firms or auditors at this initial stage of quality inspections. There was rather a constructive and educative approach to familiarize the firms with the quality assurance process. Therefore, the recommendations were generally made for the purpose of achieving a greater compliance with the ISQC 1 for internal control systems and with the audit methodology and documentation requirements stipulated in ISAs.

- 48 **Foreign audit qualifications are recognized if they meet standards equal to or higher than the local audit qualification.** Responding to previous criticism of a lack of inclusivity for auditors qualified abroad, most of whom are working as audit professionals, ICARM operates an effective recognition procedure through its committees since 2012. Auditors qualified abroad complete a recognition procedure with ICARM, sit the professional exam on national taxation and business law, and apply for a license with the Audit Oversight Council. This is in line with the EU directive. Only holders of ACCA and US-CPA licenses have been recognized so far.
- 49 **The amount of the auditor's liability insurance to safeguard the interests of auditors and those who may place reliance on their audit reports and opinions is determined in the Audit Law.** The current liability insurance amount is set at a minimum of EUR 30,000 that can be escalated to EUR 400,000 in proportion to the revenues of the audit client.

The accounting profession

- 50 **FYR Macedonia changed the regulatory framework and institutional arrangements for accounting with the enactment of the Law on Accounting Services in July 2012.** This introduced regulation of accounting in Macedonia. The titles of 'accountant' and 'certified accountant' were established for accountants both in public practice and employed in enterprises. Accountants, entitled to prepare and sign the financial statements of sole proprietors and non-profit organizations, must have completed secondary education. Certified accountants, entitled to prepare and sign the financial statements of any legal entity, are required to have a university degree and at least 3 years of experience in accounting. The Law also introduced the concept of "shared responsibility" for the content and format of financial statements. The accountant or certified accountant and the owner or chief executives of the company are equally responsible for compliance with relevant laws, regulations and standards. In addition, the Law introduces fines for accountants not preparing financial statements in accordance with IFRS or IFRS for SME's. In the EU Law, the financial statements are collective responsibility of the administrative, management and supervisory bodies of companies..
- 51 **A professional body for accountants, the Institute of Accountants and Certified Accountants (IACA), was established in 2012 with mandatory membership for chief accountants and accountants in public practice.** A Supervisory Board has been established but it has not appointed the members of the Managing Board since November 2012; this initial step is necessary for IACA's operationalization. IACA membership has been made obligatory for accountants. Certification is undertaken in the interim by the Ministry of Finance, which has issued certificates to some 12,000 accountants and certified accountants, of which 9,000 are temporary certificates. Currently, the Ministry of Finance has an important role in IACA in that the Minister has the authority to endorse or reject the appointment of board members, including its President. This is an interim and temporary solution; the authorities indicated that the oversight responsibilities of the Ministry of Finance over the accounting profession will be transferred to another institution in the future.
- 52 **The 2012 Law on Accounting Services improves regulation and the knowledge and skills level of accountants in FYR Macedonia, however some aspects may benefit from further debate.** In its current form only IACA members are allowed to be an accountant in business authorized to sign off financial statements. This is not a profession regulated at EU level. As

the value of the accounting profession to business increases, demand for qualified accountants will rise.⁶¹ The Law currently covers all accountants employed in business, including bookkeepers as well as accountants working for accounting service provider companies. One area of consideration could be to regulate only public accounting service providers.

- 53 **ICARM and IACA should cooperate.** There are considerable overlaps in the professional and educational requirements for accountants and auditors. Given the size of the domestic market and resource constraints, there seems potential benefit in developing close co-operation between ICARM and IACA from the outset. ICARM has an existing professional education and examination infrastructure and such collaboration could help ICARM broaden its revenue base by providing services for accountants and certified accountants. Merging both institutions into one body or merging overlapping activities could be another option for the medium-term.
- 54 **IACA should work towards IFAC membership.** Establishing itself in accordance with IFAC's standards/benchmarks for professional accountancy organizations, referred to as the Statements of Membership Obligations (SMOs), would bring greater recognition and make it easier to join IFAC as an associate member in the medium term with a longer term goal of becoming a member. IACA should collaborate with ICARM, already an IFAC member, in its establishment.
- 55 **There is also potential to develop a strategic partnership between ICARM, IACA and the Association of Accountants of Macedonia⁶².** The Association, which is not a professional body but rather a loose federation, comprises 36 community associations of accountants established in large cities, with approximately 300 active members. It offers continuing training and learning support for its members through conferences and seminars, without having a formal professional qualification or CPD programs as a prerequisite for membership. The Association recently renewed its existence as a non-profit entity with a voluntary membership of accounting practitioners which seeks to articulate and promote members' interests and to enter into policy dialogue with the regulators.

C. Academic Education, Professional Education, and Training

- 56 **Universities offer basic accountancy and audit education as part of economics and business administration degrees, as well as dedicated accounting degrees.** Three public universities⁶³ offer undergraduate and graduate programs in accounting, finance and audit at the Faculties of Economics in Skopje, Prilep and Stip. The majority of courses in the programs relate to accounting, financial reporting, international accounting, auditing, internal auditing and other accounting related matters. Collaboration among universities is limited.

⁶¹ A report on the "Economic impact of regulation in the field of liberal professions in different Member States – regulation of professional services" provides arguments both for and against regulation and addresses accounting services, arguing that regarding the provision of public goods and consumer protection, a case can be made for some form of regulation, or supervised self-regulation, but warns of regulatory capture and highlights the potential costs to Europe and member states of unnecessary regulation and the impact on the single market of barriers to entry that ensue:

http://ec.europa.eu/competition/sectors/professional_services/studies/prof_services_ihs_part_1.pdf

⁶² Former Association of Accountants, Financial Workers and Auditors of FYR Macedonia.

⁶³ University Ss Cyril and Methodius in Skopje, University of Ss Kliment Ohridski in Bitola and University of Goce Delcev.

- 57 **Syllabuses incorporate topics such as IFRS and ISA and the IESBA Code of Ethics, but the course materials need strengthening to familiarize students with the practical implementation of these standards.** The teaching process could benefit from the inclusion of case studies, practical examples of IFRS reporting or simulation of an audit engagement. Lecturers often lack practical experience in financial reporting and auditing, and their quality of delivery can be quite varied. Practitioners are engaged on a visiting basis, but primarily only in private universities.
- 58 **Universities, regulators and the profession should collaborate further on the design and delivery of accounting and auditing education to better serve the needs of the market and in light of the IAESB's International Education Standards.** Recognizing that the strong theoretical background is not supported with practical education, universities encourage students to undertake internships but these are hard to find. Financial sector companies, regulators and enterprises would benefit from an organized pool of human resources with a structured mechanism to support internships and the educative process. Furthermore, the universities could take the IES 3 on Professional Skills and General Education in particular for designing their programs.
- 59 **University faculties are constrained from developing projects and accessing additional resources.** The 2009 Law on High Education introduced the concept of the “integrated university”, restricting faculties from establishing external liaisons. Faculties must wait for the university management to prioritize issues and establish relationships, but this takes time and sometimes causes them to lose opportunities, for example in accessing further training for professors, the translation of international materials, and the updating of textbooks and course materials.
- 60 **Professional certification credits or exemptions are not currently available for accounting or auditing graduates.** The EU Statutory Audit Directive allows universities to design accountancy degree programs which give graduates exemption from certain aspects of certification requirements. In some countries universities obtain international accreditation and exemptions by internationally recognized and reputable professional organizations (such as ACCA, etc.) for their accounting and auditing degrees. This would involve revision and improvement of curricula and examination papers in line with the selected international certificate.
- 61 **ICARM members must complete 120 hours of CPD in three years, with at least 30 hours per year, to maintain their competencies. This is in line with the input-based approach set out in IAESB's IES 7.** If the CPD requirement is not fulfilled by a statutory auditor, who is a member of ICARM, the Audit Oversight Council withdraws the practicing license and temporarily bans the auditor from practice. The program for continuing professional development is organized and delivered by ICARM with the help of local and international experts. It is a mixture of accounting and auditing related technical aspects and issues training, as well as other regulatory or soft skills updates. ICARM announces the CPD events publicly and verifies the attendance of members to record the CPD training hours.⁶⁴
- 62 **ICARM is the only domestic CPD provider; CPD provided abroad by other accredited institutions is also recognized.** This ensures revenue for the professional body, but is inflexible in not allowing credits to members for relevant professional training and

⁶⁴ The input base approach as per IAESB International Education Standard 7.

development outside ICARM's CPD program. ICARM is investigating redesigning its entire CPD system.

- 63 **ICARM and IACA, when it becomes active, should collaborate on educational matters.** This is especially important with respect to initial education of professionals.

D. Setting Accounting and Auditing Standards

- 64 **The Trade Company Law requires use of IFRS as accounting standards but compliance is compromised by an ineffective system for translating them into Macedonian.** Medium and large size entities are obliged to use Macedonian translations of IFRS, and small and micro entities IFRS for SMEs. The standards must be translated and published in the Official Gazette of FYR Macedonia to be officially valid for application and updated annually to reflect changes in the standards as published by IASB. The current translations date from 2009 and are in need of urgent updating. Previously the responsibility of ICARM, which lacked the necessary resources, IFRS translation is now the responsibility of the not yet functional IACA⁶⁵. IFRS compliance may be compromised because of this delay caused by inadequate funding and a lack of technical resources.
- 65 **Translated audit standards are similarly out of date and a continuous standard-setting process for accounting and auditing standards is needed.** The Law on Auditing requires IAASB's International Standards on Auditing, as translated and published in the Official Gazette, to be used in statutory and contractual audits performed in the country. The standards are required to be updated on an annual basis by ICARM. The most recent translation is of the ISAs as presented in the IAASB Handbook 2009, published in June 2010. No translation of amendments to the ISAs has been made since.

E. Ensuring Compliance with Accounting and Auditing Standards

Ensuring compliance with accounting standards

- 66 **The level of enforcement of the accounting standards is uneven.** The Central Registry only monitors compliance with filing requirements. Enforcement in the banking and insurance sector is adequate. There is little or no mechanism in practice for effectively enforcing accounting and financial reporting requirements for other companies. The Law on Accounting Services mandates IACA to perform certain quality control activities over its members. However, this is yet to be put into effect as IACA is currently inactive. The Trade Company Law defines possible fines and penalties for non-compliance with the requirements to prepare and distribute annual accounts or financial statements, and the Central registry has an authority to implement misdemeanor procedures against companies which fail to meet the requirements. The law lacks enforcing provisions and does not specify which authority is responsible for

⁶⁵ The Law on Auditing assigns this responsibility to the Institute of Certified Auditors of the Republic of Macedonia (ICARM); however, the more recent 2012 Law on Accounting Services transferred the responsibility to IACA.

monitoring compliance with the accounting standards for companies that are not subject to statutory audit.

- 67 **The Central Registry investigates companies that have failed to submit financial reports for three consecutive years; it is adequately resourced and capable of enforcing the filing requirements.** Enforcement mechanisms have been strengthened with several new legal amendments ⁶⁶to the Trade Company Law, applicable from 2015, allowing the CR to initiate bankruptcy procedures for companies that fail to file reports despite additional deadlines.
- 68 **The NBM enforces accounting and financial reporting standards, as well as prudential requirements, in the banking sector.** It conducts onsite and off-site inspections. 12 professionals work in the onsite supervision department and 33 in the off-site supervision department. The audited financial statements of all banks are reviewed systematically to determine their compliance with accounting and financial reporting regulations, as well as their consistency with accounting records and other reports. Banks are notified of the findings and asked to explain or resolve any discrepancies. There are cases of audit reports and audited financial statements being revised after review by NBM.
- 69 **InSA conducts on-site and off-site inspections of insurance companies to verify their compliance with prudential and accounting regulations.** InSA's off-site supervision department reviews financial statements for timeliness, completeness and appropriateness of content. Audited financial statements submitted by companies are used to analyze compliance with capital adequacy and solvency requirements. Further, each insurance company is fully inspected on-site on an annual basis to verify their compliance with prudential as well as financial reporting regulations. InSA has the right to impose fines and penalties to enforce regulations including the financial reporting framework applicable to insurance companies, but so far has refrained from doing so and rather provided constructive feedback to allow the insurance companies to build capacity.⁶⁷
- 70 **The SEC and MSE have no enforcement role.** The supervisory function within the SEC, namely the Corporate Finance Department and the Capital Market Supervision Department, focuses on the timeliness and completeness of financial information to provide general assessments of the financial performance and condition of supervised entities. The Law on Securities assigns no responsibility to the SEC to review the qualifications of auditors of listed companies or the quality of reports and the SEC, lacks sufficient accounting expertise to perform any monitoring or enforcing function of financial reporting and auditing issues. Similarly, the MSE is also concerned with timely disclosure of financial information by listed entities, but the monitoring of the quality of financial reporting and auditing is left to the ICARM.

⁶⁶ With these amendments to the Trade Company Law, Article 477 and 477-a from 24.2.2014 applicable 1 Jan 2015, failure to submit financial reports by the end of the following calendar year would trigger additional procedures by CR and Public Revenue Office that may end up with the declaration of bankruptcy of the entity.

⁶⁷ InSA refrained from imposing penalties; instead InSA asked for the correction of errors noted during supervision. Although there are no specific statistics for measures taken by InSA relating to corporate financial reporting, InSA issued 96 orders in 2013 for correction of errors in the implementation of regulations.

Ensuring compliance with auditing standards

Quality Assurance Reviews by the Profession

- 71 **ICARM has put in place a system of quality assurance over auditors which is fully functional and represents a notable progress.** ICARM performs quality assurance reviews (QAR) of all audit firms and sole practitioners at least once every three years.⁶⁸ This is consistent with the EC Statutory Audit Directive (SAD). ICARM initiated the QAR process as part of a twinning project with the French institutes CNCC and CSOEC, begun in 2010 with the support of the World Bank REPARIS initiative and which continues to the current date. The CNCC will complete an external independent evaluation of the quality assurance system during 2014 which can be used as a basis for ICARM and CAO A to further strengthen the enforcement of auditing standards.
- 72 **The QAR process is overseen by the ICARM's Quality Control Commission (QCC) which is responsible for approving the annual quality review plan, as well as the individual results and conclusions of the QARs.** The QCC comprises five members, three of which must be practicing auditors. The Commission publishes annual reports providing information on its methodology and a summary of the results of the quality reviews. The latest such report published on the ICARM website is for the 2012 reviews. The QCC also reports regularly to the CAO A. Five audit firms were given public warnings (disciplinary measure) in January 2014 following the results of the second cycle of quality reviews performed by QCC.
- 73 **With the recently amended Audit Law, ICARM is now required to publish all individual quality review reports on its website, which would require careful safeguarding of sensitive and confidential information.** Through this requirement, which goes beyond the provisions of the new EU Audit Directive or Audit Regulation, policymakers have sought to provide more transparency on the outcome of audit inspections. Recognizing that this is not a universal practice⁶⁹ and that it may involve certain sensitivities and reputational risks, the authorities will need to monitor carefully the application of this requirement to ensure that disclosure of information pertaining to individual firm inspections does not cause undue harm to the firms' reputation.
- 74 **ICARM follows a risk-based QAR methodology consistent with ISQC 1 and ISA 220, *Quality Control for an Audit of Financial Statements*, which is made available on ICARM web site.**⁷⁰ Two suitably qualified inspectors⁷¹, staff of ICARM, perform the quality reviews which are sufficient given the size of the audit market. ICARM requires annual returns from all audit firms and sole practitioners on their activities, including details of audits and other engagements performed, hours and fees incurred per engagement, type of opinion issued and other relevant information. Previous period QAR results and the statistical data compiled are used to determine the engagements and audit firms or sole practitioners that will be subject to

⁶⁸ More frequent QAR can be performed in cases when: (i) there is doubt about the quality of a particular audit expressed by the ICARM Quality Control Committee, (ii) on specific request by the ICARM Ethics Committee or (iii) the QAR in the prior period has noted unsatisfactory assessment.

⁶⁹ Currently applied only in the United Kingdom and Netherlands.

⁷⁰ http://www.iorm.org.mk/kontrola_na_kvalitet.html.

⁷¹ International experts assist in the QAR of audits in sectors requiring specialized knowledge and complex engagements; ICARM inspectors benefit from experience and interchange with QAR teams of other European professional accountancy bodies.

QAR. The first 2010-2012 cycle of on-site control reviews was used to identify constraints in implementation of quality assurance requirements, build-up additional implementation guidance, provide recommendations for improvement of audit practice and design and deliver appropriate quality assurance training to member firms and auditors.

- 75 **The QAR results indicate that the implementation of ISA remains a challenge for local small and medium sized practices.** Nineteen audit firms were subject to QAR during the period September 2013 – February 2014, twelve of which had been subject to QAR in the past cycles.⁷² Frequent issues related to deficiencies in audit methodology, internal quality control mechanisms, limited use of experts with appropriate specialized knowledge and inappropriate document handling procedures.⁷³

Public Oversight

- 76 **The Council for Advancement and Oversight of the Audit (CAOA) was established by the Law on Auditing and became operational in 2012.** The CAO A is charged with overseeing all the activities of ICARM relating to auditing⁷⁴ and is a requirement of the EU Statutory Audit Directive. It provides working licenses to audit firms and publishes annual reports which give a good overview of CAO A activities.⁷⁵ The majority of CAO A members are non-practitioners, including representatives from industry and other regulatory bodies.⁷⁶ Under the New Audit Directive, practitioners are not allowed to be in the governing boards of competent authorities.
- 77 **The CAO A should oversee the QCC and have ultimate authority over the system of recurring audit quality inspections for auditors of PIEs, but CAO A involvement in the QAR process has been limited so far, making the oversight system ineffective.** CAO A oversight has been limited to imposing disciplinary measures on audit firms following ICARM committee decisions. CAO A's effectiveness should be enhanced to meet the requirements of the EU's Audit Directive and to meet membership requirements of the International Forum of Independent Audit Regulators (IFIAR), which sets the standards for best practice in this area. One way of addressing this issue would be for ICARM to invite one or two representatives from the CAO A to take part in the Quality Control Committee (QCC). This would also strengthen the QAR process within ICARM vis-a-vis the CAO A, the regulators and the general public about the independence and reliability of the process. The CAO A is not yet an IFIAR member. A major barrier is the membership fees to IFIAR. Regular contact with other peer organizations under the IFIAR umbrella could contribute to the capacity building efforts of the CAO A.

⁷² Summary Report on the Quality Control Reviews, 2014, Quality Control Commission.

⁷³ The ICARM Quality Control Commission filed with the ICARM Ethics Committee eight unsatisfactory QAR files for further disciplinary measures; public warnings were issued on the grounds of detected quality deficiencies for five of them.

⁷⁴ The Council approves all acts passed by ICARM, monitors its operations in terms of compliance with the Audit Law and issues one-time licenses statutory audit firms and sole practitioners. CAO A is empowered to take disciplinary measures against audit firms and sole practitioners, independently.

⁷⁵ <http://www.sunr.mk/>

⁷⁶ The CAO A employs four permanent staff, including the President, and is managed by an Expert Council composed of six representatives and the President. The President of the Council is appointed by the Government on the proposal of the Minister of Finance, while the six members are nominated by the following institutions: NBM (1), SEC (1), InSA (1), large trade associations (1) and ICARM (2).

- 78 **In the context of the new Audit Directive, the CAO A would be expected to develop an in-house capacity to undertake the quality reviews of PIE auditors.** The system should be independent from the profession, i.e. the inspectors should be non-practitioner auditors and have no conflict of interest with statutory auditors⁷⁷. An intermediate solution may be that inspectors of CAO A cooperate jointly with the QAR performed by ICARM in order to build on the already existing capacity and exchange knowledge and experience. A more radical solution would be to transfer the ICARM's QAR capacity to the CAO A. This would maintain the QAR expertise already established and avoid duplication of review tasks.
- 79 **The CAO A is modestly funded.** 80 percent of the CAO A budget is financed from the state budget and the remaining 20 percent comes from ICARM, licensing fees, and other income arising from operations.⁷⁸ There is a need to revisit the funding and expenditures of CAO A, particularly considering the technical staffing and training needs to align with the EU's 2014 Audit Directive and the need for the CAO A to establish capacity for direct inspection of statutory audit firms of PIEs as well as overseeing the activities of ICARM. The system, in its current form, does not appear to be financially sustainable. The CAO A and GoM should broaden the sources of the CAO A's income; this might include imposing additional levies on the public interest entities and their auditors.
- 80 **The GoM recently amended certain provisions of the Audit Law to address some of the challenges of the oversight system, namely empowering the CAO A to issue secondary legislation and to initiate quality inspections of auditors.** The Law now includes provisions that (i) allow the CAO A to adopt rules of procedures and request specific quality assurance inspections to be performed by ICARM (ii) describe the qualification criteria of QA inspectors that will be appointed by ICARM starting from 2017 and (iii) require additional transparency requirements such as the publication of individual QA inspection reports on the website.
- 81 **While these amendments improve the system, the following shortcomings remain:**
- Deviation from the new Audit Directive and Regulation: (i) the CAO A should have direct inspection authority to conduct quality assurance reviews of PIE auditors; the Law gives the CAO A delegated authority for QA in general and lacks specific provisions on PIE auditor inspections. (ii).the new pool of qualified QA inspectors is likely to be composed of practitioner auditors, which may create a conflict of interest for QARs of PIEs; EU law requires that non-practitioner inspectors undertake quality reviews of PIE auditors.
 - Rigidity in operational matters: organizational arrangements and operational procedures that could be addressed through secondary legislation are now embedded in the Law, meaning adjustments to, for example the professional examination program, require lengthy procedures for parliamentary approval.

⁷⁷ Directive 2006/EC of 17 May 2006, amended by Directive 2008/30/EC and Directive 2014/56/EU of 16 April 2014.

⁷⁸ The Audit Law mandates that 15 percent of the income of ICARM arising from fees paid by audit firms and sole practitioners to be transferred to CAO A. Licenses are not subject to periodic renewal and cannot be considered as a regular source of revenue

III. Accounting standards as designed and practiced

A. The standards gap

- 82 **IFRS (as issued by IASB)⁷⁹ as translated in 2009, and IFRS for SMEs represent the set of accounting standards to be applied by all entities preparing general purpose financial information.** The latest translation of IFRS was conducted in December 2009 for application by all medium and large size entities, banks⁸⁰, non-bank financial institutions and insurance companies. IFRS for SMEs were published in August 2011 for mandatory use by all small and micro entities from 2012 onwards. The translations were published without any changes or amendments.
- 83 **Updates to IFRS made since 2009 are not translated.** Major changes include the newly issued financial reporting standards on financial instruments, consolidated financial statements, and fair value measurement. There are also new pronouncements such as first time adoption of IFRS, financial instrument disclosures, presentation of financial statements, income taxes, employee benefits, and property, plant and equipment that may be relevant for companies. A comprehensive list of changes in IFRS after January 1, 2009 is presented in Annex 2 of this report.
- 84 **Discrepancies in which set of standards apply should be addressed by the SEC.** As mentioned earlier in this report, there is discrepancy between the Law on Securities - which requires listed companies to apply current IFRS as issued by IASB for legal entity and consolidated financial statements - and the Rulebook-SEC - which requires them to apply the 2009 translated version as published in the Official Gazette. The SEC should ensure that the financial statements of listed companies are comparable by making specific and consistent references to the applicable standards in the law and by-laws.

B. The Compliance Gap

- 85 **The ROSC team reviewed a selection of financial statements to assess the extent of any compliance gaps with nationally enacted IFRS, IFRS and IFRS for SMEs. The review was performed in two rounds, in 2012 and 2014.** In the first round, the selected sample of financial statements included 27 companies including 5 banks, 5 listed, 4 insurance, 11 randomly selected companies including 6 from the list of top 200 companies in the country. Nine companies in the sample prepared their financial statements in accordance with full IFRS. The annual accounts of two small companies were also reviewed to assess the quality of financial information presented. In the second round, an additional sample of 10 financial statements was selected from 2013. This additional sample included two banks, two listed, one insurance, three medium size and two small companies.
- 86 **The review results are summarized below.** However, the conclusions should be regarded with a degree of caution given the limited sample size, as well as inherent problems in examining the compliance gap as the reviewer of financial statements cannot be certain that

⁷⁹ The IFRS as issued by IASB differ from the IFRS as endorsed by the EU.

⁸⁰ For the banking sector, the most current version of the standards is applicable.

everything that should have been disclosed was indeed disclosed. Furthermore, financial statements of entities in similar economic sectors could reasonably be expected to have similar formats and disclosures and therefore it is reasonably easy for those preparing financial statements to make them appear good simply by conforming to a “standard” format without regard to the entity’s underlying financial transactions and position.

- The quality of the financial statements varied according to the size, industry and the listing status of the company.
- The quality of the financial statements in the financial sector, i.e. banks and insurance companies, are of better quality than those from other industries.
- There was no observed difference in the quality of financial statements prepared in accordance with full IFRS and those prepared in accordance with nationally accepted IFRS (i.e. IFRS from 2009). Some of the disclosures provided in the notes relating to the accounting policies adopted were lengthy and could benefit from some increased focus to make them more entity-specific. Also, some of the IFRS preparers reviewed omitted relevant disclosures on segmental reporting and reporting on post-balance sheet date events.
- Small entities used the layouts set out in the MOF Rulebook for their balance sheets and income statements. However, the disclosures in some reports were of poor quality - too short, insufficient or incomplete. This raises the issue of insufficient enforcement mechanisms. Furthermore, IFRS for SMEs were adopted to be used by small and micro entities as guidance for recognition and measurement. However, compliance with IFRS for SMEs recognition and measurement principles could not be assessed.
- The quality of financial statements was influenced by the nature of the statutory auditor employed. Companies that were audited by international networks were more compliant with IFRS requirements than others.
- General-purpose financial statements are often influenced by taxation rules and regulations. To satisfy the requirements of taxation authorities regarding the recognition of revenues and expenses, the preparers of general-purpose financial statements often tend to deviate from applicable financial reporting standards and follow tax rules in choosing the method of accounting treatment. For example, companies do not provide for bad debts until the debtor is sued, or the receivable is uncollectable due to debtor bankruptcy. Audit opinions on financial statements of 4 reviewed preparers were qualified with respect to such inappropriate accounting policy.

87 The financial statements of selected banks and insurance companies were of good quality. All of the banks and half of the whole sample were audited by international networks. The financial statements complied with the requirements of nationally enacted IFRS and the Rulebooks of NBM and InSA. However, the clarity of disclosures and readability of financial statements could be improved if:

- Fair value disclosures are improved to provide for an appropriate comparison with amortized cost and to describe the basis and method used to arrive at fair value when an active market doesn’t exist;
- Disposal plans for assets acquired through foreclosure are disclosed;
- Empty movement schedules in the notes are deleted⁸¹; and

⁸¹ NBM indicated they request this specifically to ensure that nothing is omitted.

- Lengthy disclosures of accounting policies related to non-significant transactions are simplified.

88 **The review identified some common deficiencies in financial statements, even setting aside the fact that some of the financial statements were prepared using IFRS as of 2009.** These include:

- Non-financial companies' statutory financial statements lacked appropriate disclosures on adoption of new and revised accounting standards;
- Some companies provided inadequate disclosures with respect to related party transactions and balances as well as segment reporting information where relevant;
- Almost all preparers showed limited focus on disclosing sufficient information on events after the reporting date;
- In a few instances the accounting policy notes included topics irrelevant with the companies' financial statements, e.g. goodwill and intangible assets;
- Reporting on financial instruments and the risks associated with financial instruments seem to be a challenge for a wide range of companies;
- Some preparers could address the issue of completeness in the financial reporting by use of a checklist.

IV. Auditing Standards as Designed and as Practiced

A. The standards gap

- 89 **The applicable auditing standards at the national level are the ISAs and other IAASB handbook pronouncements that have been translated and published in the Official Gazette.** The ISAs as published by the IAASB in their 2009 Handbook part I were translated and published in 2010. IAASB has since revised two auditing standards, ISA 610 and ISA 315, and made changes to standards on assurance engagements and related services but these have not been translated or published.

B. The Compliance Gap

- 90 **The audit reports conducted in accordance with ISA were found to be of adequate quality, but the limited sample means no general conclusions can be drawn.** The selection included reports with unmodified opinion, unmodified opinions with emphasis of matter paragraph, and qualified opinion. All audit reports were structured in accordance with ISA 700 *Forming an Opinion and Reporting on Financial Statements* requirements, without noticeable deficiencies in the content or presentation. In the reviewed reports all auditors reported that their audits were performed in compliance with ISA, but did not specify whether they were the ISA as translated and enacted by MoF (i.e. from 2008) or current ISA.
- 91 **The implementation of ISA, especially for local small and medium-sized practices, is a challenge.** ICARM's quality assurance reviews revealed that many audit firms were lacking important audit documentation evidencing compliance with ISA. Discussions revealed that auditors are facing difficulties in applying the international quality control standard (ISQC1) and only very few auditors have audit methodologies in full compliance with ISA.⁸²
- 92 **Auditors are concerned about the declining audit market and increasing expectations.** Statutory auditors revealed their concerns about the negative trends and major challenges imposed by the declining audit market and constant increase in expectations and the required levels of audit procedures and documentation.
- 93 **According to the ICARM Report on annual quality control reviews for 2012, the following compliance deficiencies were common among audit firms and sole practitioners. These indicate actual deviations from the ISAs in implementation by auditors:**
- Lack of documented audit methodology to describe mandatory or consistent audit procedures;
 - Lack of documentation of internal policies and procedures for quality control;
 - Lack of documentation of the results of monitoring activities undertaken as part of quality control procedures;

⁸² Conclusion taken from the analysis of ICARM Quality Control Committee Annual report for Quality Reviews in 2012.

- Lack of appropriate training and deficiency in documentation of CPD activities of employed personnel;
- Limited or no use of work of external experts with specialized knowledge during audits of specific entities;
- Lack of formal confirmation of the independence of employed auditors in accordance with IESBA's Code of Ethics; and
- Incomplete audit files in terms of audit documentation and its organization.

94 **There remains a general lack of understanding of the audit process and the value it offers to business.** Representatives of audit firms indicated that company owners often lack the financial literacy to use the audited financial statements as a management tool. Some companies seemed more concerned with survival than accounting and auditing, which may also reflect financial illiteracy. A gap was obvious between some entities, such as banks and insurance companies, where the audits are found useful and important, and others who are legally obliged to be audited but see little value in it. Employees and managers of the latter are said to have significant training and learning needs in preparing financial statements.

V. Perception of the Quality of Financial Reporting

- 95 **The 2003 A&A ROSC concluded that the legislative framework and the quality of financial reporting needed improvement.** The report argued that investors, lenders and other users placed little reliance on information contained in public financial statements. Tax evasion practices were noted as a prevailing factor behind inappropriate accounting practices. Banks, as key users of financial statements and with an interest in quality reporting by entities seeking financing, considered that audit and reporting enforcement mechanisms were important factors determining the quality of financial information, and that they were in need of improvement. There was a strong view that the quality of financial reporting would improve with a better regulatory regime and effective enforcement mechanisms to ensure compliance with accounting and auditing standards.
- 96 **In 2014, the quality of financial reporting has improved for companies subject to full IFRS reporting requirements and statutory audit.** The adopted standards were updated in 2009. The implementation of international standards, albeit not the very latest versions, during the last decade has raised the domestic benchmark for financial reporting. The quality of statutory audit improved as a result of the establishment of ICARM in 2006 and the introduction of the quality control and assurance function within the Institute.
- 97 **Small and micro entities report via their annual accounts but have issues with quality and compliance with the requirements of IFRS for SMEs.** The layouts prescribed in the Rulebook on the form and content of annual accounts are also used for statistical purposes thus they apply to all companies irrespective of their size without any option to provide abridged accounts. Although IFRS for SMEs should be followed in recognition of the elements of annual accounts, the full set of financial statements, including applicable disclosures in the notes, are not mandatory because the requirements of the Rulebook-MoF supersede those of IFRS for SMEs.
- 98 **Although the general quality of financial reporting practices has improved, there remains divergence of reporting by entities of different size and sector.** ROSC team investigations of compliance with IFRS disclosure requirements show better reporting quality for entities audited by firms from international audit networks. Also, bigger entities seem to prepare financial statements of better quality. Banks are generally preparing acceptable general purpose financial information, appropriately enforced by NBM.
- 99 **The use of general purpose financial statements and the demand for improved quality of financial reporting is still low.** Entities are financed predominantly through bank loans, where banks rely heavily on collateral and use the close relationship built with their clients to gather financial or other information, often from other sources than the published financial statements. Due to competition concerns, the majority of companies are reluctant to disclose information, and focus on the tax consequences of accounting practices. Interviewees indicated that, in addition to better enforcement mechanisms by the State, demand from domestic and foreign investors for quality accounting and auditing would drive more companies to build capacity in these areas.
- 100 **Tax implications may contribute to some accounting improprieties.** One contributing reason to low market demand for financial statements could be the perception that for some

companies accounting policies have been shaped by tax legislation. Accountants are perceived to pay more attention to the impact of the accounting treatment of transactions on the calculated tax charge than on compliance with IFRS,⁸³ and may therefore be reluctant to follow IFRS requirements for the measurement of financial assets and the recognition of bad debts or impairment, resulting in a deviation from implementation of the standards.

⁸³ In 2011 the tax policy changed, where companies' duty to pay 10% corporate income tax was postponed until dividends are paid out of realized profit. In addition, companies are required to pay corporate income tax on non-deductible expenses recognized in financial statements, among which is the provision for bad debts (unless the customer has filed for bankruptcy).

VI. Areas for Consideration

- 101 **The areas assessed in this ROSC are interrelated and mutually supportive; suggestions for improvements are made to collectively enhance the financial reporting environment in FYR Macedonia with high-level Government leadership.** Areas for consideration are presented below along the major pillars of the corporate financial reporting framework i.e. (i) Statutory Framework; (ii) Accounting and Auditing Standards; (iii) Monitoring and Enforcement; (iv) the Profession; and (v) Education and Training. These five pillars are mutually reinforcing and ideally many of these reforms should be addressed in parallel in order that the weakest aspects of the corporate financial reporting framework do not undermine the framework as a whole.
- 102 **Reform efforts by FYR Macedonia stakeholders should take into account the economic and human resource constraints facing the country and seek to:** (i) strengthen and build upon existing mechanisms that work adequately; (ii) simplify accounting and auditing obligations whenever possible, especially for small businesses; and (iii) establish synergies between institutions to avoid duplication of efforts.
- 103 **Further progress in the corporate financial reporting environment could be attained by discussing the results of the diagnostic as well as the availability and allocation of resources to address the issues through a multi-stakeholder approach.** Moreover, as FYR Macedonia continues developing its corporate financial reporting framework, the EU-REPARIS program will provide a platform to continue the knowledge sharing and peer exchange with other Western Balkan countries that face similar challenges and are on a common EU accession pathway

A. Statutory Framework

- 104 **The definition of PIEs in the Law on Auditing should be clarified in line with the new EU Audit Directive.** The scope of the definition could be too broad depending on the interpretation of the definition. PIEs should include the types of undertakings listed in the Directive and those that are of significance to the public.⁸⁴
- 105 **The Government should revisit the existing threshold for SMEs taking into consideration the European Union's approach to SMEs.** The current thresholds in FYR Macedonia are well below the EU requirement. The Member States are required to adopt the thresholds in the Directive and have no flexibility for national adaptation.
- 106 **The Government should ease the accounting and financial reporting requirements for micro and small entities in line with the EU Accounting Directive as much as possible.** An option could be the integration of the requirements of the Accounting Directive regarding micro entities into the MOF Rulebook and making the implementation of the IFRS for SMEs

⁸⁴ The EU definition includes a reference to “other “entities of significant relevance. These “other” entities are defined by member states in line with the country context and include different entities in different EU member countries (non-profit enterprises raising significant funds from public, pension funds and investment companies, large non-listed companies meeting certain criteria, State Owned Enterprises, energy companies, etc.)

mandatory for the small and medium-sized companies after harmonization of the categorization thresholds for the company sizes with the EU directives.

- 107 **The filing and publication deadlines for companies should be harmonized.** Regulated entities in particular often have multiple filing and reporting requirements, harmonization would help economize efforts and avoid multiple versions of financial statements being officially submitted by companies. Electronic reporting could also be a good approach to addressing some of the issues.
- 108 **Accounting requirements between primary laws and rulebooks need to be reviewed for consistency.** One example is the discrepancy between the Law on Securities and the Rulebook-SEC referring to current IFRS versus IFRS 2009. Furthermore, the financial reporting templates prescribed by MOF or regulatory institutions are not always fully consistent with applicable IFRS.
- 109 **The Law on Auditing needs to be amended to align further with the New EU Audit Directive.** Major issues to consider would be the role of the oversight authority and proportionate application of the standards relative to the scale and complexity of the operations of the statutory auditor and the audited entity.
- 110 **PIEs could publish corporate governance reports and reports on payments to governments in line with international good practice and the EU *acquis*.** This would not only align the national legislation with the EU's 2013 Accounting Directive, but also help raise the awareness in the market for better quality corporate information and improve transparency practices in the medium-term.

B. Accounting and Auditing Standard Setting

- 111 **There is a need to establish an effective, sustainable system for translating and publishing IFRS, IFRS for SMEs and ISAs.** Although responsibilities for translations are included in the laws, and a requirement for annual updates of standards, the legislation does not address resources and procedures, which caused significant delays. The translations in force in FYR Macedonia date back to 2009 and do not include the changes to date, which, in practice, means that the standards in force are significantly different than the standards of reference in their current form. IFRS change often and therefore keeping the local language translations up-to-date will always remain a challenge. A wider application of IFRS for SMEs could partly address this issue as this particular standard is subject to less frequent changes. Furthermore, compliance with the standards could be facilitated by providing guidance materials and rulebooks, developed inclusively with the participation of all stakeholders.

C. Monitoring and Enforcement

- 112 **Clarification is needed of the mechanism for enforcing accounting and financial reporting requirements applicable to companies, set out in the Trade Company Law.** Although the Law sets out fines and penalties for non-compliance by general companies, it does not identify a responsible monitoring authority. NBM and InSA have legal enforcement powers, but such

authority is not clear regarding other regulators. The Central Registry only monitors compliance with filing requirements. Enforcement should be risk-based and proportionate; given resource constraints, public interest entities should be the primary focus of the efforts.

- 113 **Regulatory institutions would welcome and benefit from further technical assistance on accounting and auditing.** The SEC indicated an interest in training on IFRS methodologies to better understand how to read and understand IFRS reports and to assess issues raised in audit reports. InSA expressed a need for a sector-specific IFRS training; fair value measurement, technical reserves, reporting and recognition of claims and recording of premiums are particular areas of difficulty.
- 114 **Collaboration between ICARM and regulatory institutions could be enhanced.** For example, InSA could benefit from employing ICARM-qualified staff, especially given anticipated changes to the EU–Solvency II regime which will require revisions to i) corporate governance, ii) financial reporting, and iii) the solvency capital requirement (the most challenging). The Law on Insurance Supervision will need to be amended and InSA is likely to need technical assistance.
- 115 **The requirement for ICARM to publish all quality review inspection reports on their webpage could be reviewed.** This requirement was introduced in the Audit Law as amended in September 2014 in order to achieve greater transparency in the operations of companies that are subject to audit. This new amendment to the Audit Law is not a requirement of the EU *acquis* and this is not a universal practice. It should be carefully designed to contain reputational and confidentiality risks. The authorities should agree on the template and content of such disclosure to protect the reputation of the audit firm and the anonymity of the audited entity.
- 116 **CAOA’s oversight would be improved if CAO staff participated in ICARM’s QA and Examination Committees.** This would also help enhance the reliability of the existing systems established by ICARM among regulators and other stakeholders.
- 117 **The technical and human resource capacity of CAO regarding quality inspections should be enhanced.** This is especially important with regards to the 2014 EU Audit Regulation which requires oversight authorities to establish independent quality assurance systems for PIE auditors. ICARM’s capacity and experience in quality assurance reviews could be used as a basis for cooperation between the two bodies if CAO were to develop similar capacity in relation to quality review of PIE auditors.
- 118 **The oversight system should be better resourced for sustainability.** The financial needs of CAO should be estimated taking technical staffing needs as well as training needs into consideration.
- 119 **Some aspects of the recently amended Audit Law should be reconsidered in light of the new EU Audit Regulation.** First, the CAO will need to develop in-house capacity for inspections of PIE auditors, which under the 2014 EU Audit Regulation cannot be delegated. Second, QA inspectors for PIE auditors will need to be independent from the profession. As the Audit Law envisages that a pool of QA inspectors, to be established by 2017, composed of practicing auditors, it conflicts with the Audit Regulation.

- 120 **The Audit Law, as recently amended, contains detailed provisions that could cause bottlenecks in implementation, and would better be addressed through secondary legislation.** Matters that could have been addressed in a more flexible manner through secondary legislations, including organizational arrangements, communication between ICARM and CAO, methodologies for technical matters, and procedures for disciplinary measures, are now embedded in the Law. Adjustments will require lengthy procedures for parliamentary approval.

D. The Profession

- 121 **Funding and additional resources should be agreed for ICARM, to take account of its expanded mandate.** The funds currently available to ICARM are not sufficient for its increased responsibilities: the translation of relevant standards; the preparation of an updated examination syllabus to reflect the changes since 2009; adapting the examination program to the new central examination system; performing quality assurance reviews; and further developing high quality CPD programs for the auditors.
- 122 **The IACA needs to be activated, and the cooperation of IACA and ICARM clarified.** Although established in law the IACA is not yet functional. It should be developed, in accordance with IFAC's Statements of Membership Obligations (SMOs), and in close cooperation with ICARM. Formal separation of institutes for the accounting and auditing professions can be a drain on available resources in a country of FYR Macedonia's size. There is considerable scope for collaboration in areas such as education, examination and organizational matters, or even to merge the activities of the two institutes
- 123 **Certification of accountants in entities is not an EU requirement and could be limited to accountants working in accounting service providers, large enterprises and PIEs; or solely to accountants in practice.** The Law on Accounting Services requirement for all accountants in the country to be certified, even bookkeepers in small firms, seems to be overregulation and will increase the cost of doing business, particularly if it becomes costly for accountants to comply with initial and continued professional development requirements.

E. Education and Training

- 124 **Universities need further resources to improve their curricula and materials, and to update the knowledge of professors.** Syllabuses incorporate all the relevant topics but they fall short in providing the necessary materials to familiarize the students with the practical implementation of the applicable standards.
- 125 **Universities need more flexibility to draw on additional resources, such as donor-funded projects or twinning projects.** Currently, faculties seem to be somewhat restrained, by the Law on High Education, from initiating such liaisons in a timely manner.
- 126 **ICARM and universities should cooperate in promoting the profession among students.** Currently, the holders of accounting and auditing degrees do not have any advantage in ICARM's qualification examinations. Exemptions from certain examinations for certification

could increase the interest in A&A faculties and also stimulate interest in the professional qualification, which seems currently to have little demand. ICARM could play a more prominent role in the design of the undergraduate and graduate courses proposed by universities and accredited by the Ministry of Education. Furthermore, ICARM and universities could collaborate on the design and delivery of CPD programs.

- 127 **Collaboration between universities and businesses should be enhanced to create an A&A workforce that will better meet the needs of the market in the medium term.** This could be enhanced through incentive mechanisms offered by the Government. More internships or part-time work opportunities should be made available to students. Professionals from the corporate sector could also be invited to familiarize students with daily implementation challenges.

Annex 1. Status of Recommendations from ROSC Report 2003 and Implementation of Country Strategy and Action Plan (CSAP) 2006

Following the 2003 ROSC A&A report, a Country Strategy and Action Plan (CSAP) was prepared in 2006 by the Ministry of Finance and other stakeholder to address the recommendations of the report. The execution of the CSAP was financed by a technical assistance grant provided to FYR Macedonia for 2007-2010 as part of the Road to Europe- Program for accounting Reform and Institutional Strengthening Program (REPARIS). The following table presents the status of implementation of the ROSC recommendations under six themes:

2003 ROSC A&A Recommendations	Country Strategy and Action Plan	National REPARIS Sub-Projects/Activities	Way Forward
1. Amending the Accounting and Auditing Laws and Regulations			
Align primary and secondary A&A legislation with the <i>acquis communautaire</i>	<ul style="list-style-type: none"> Align financial reporting framework Implement financial reporting framework Improve financial reporting for listed entities Support SEC 	<ul style="list-style-type: none"> Technical assistance on the alignment of financial reporting framework (completed in 2009) Technical assistance on listed companies reporting and supervision (completed in 2009) 	Better adapt the financial reporting requirements to the size of entities. IFRS for medium sized, IFRS for SMEs for small and micro size entities seem to impose burden.
Provide SMEs and micro entities with a reporting framework adapted to their size			Review changes in the EU A&A Directives in 2013 and 2014 and reach a policy decision on how to incorporate them in the relevant laws, namely the Trade Company Law, Law on Auditing and corresponding by-laws.
Require PIEs to apply IFRS and be audited in accordance with ISA and related IFAC pronouncements			Clarify the PIE definition in the light of the EU definition.

2003 ROSC A&A Recommendations	Country Strategy and Action Plan	National REPARIS Sub-Projects/Activities	Way Forward
2. Enhancing A&A Standard Setting			
Establish a sustainable and transparent standard setting in FYR Macedonia, including timely translation with a clear distinction between prudential and general-purpose financial reporting	<ul style="list-style-type: none">• Establish the IFRS and ISA translation process• Support the IFRS and ISA translation• Align financial reporting requirements for banks	<ul style="list-style-type: none">• Translation of IFRS, ISAs and IESBA Code of Ethics (completed in 2010)• No activities were planned for bank financial reporting under REPARIS. These were achieved by NBM separately.	Update the translation of A&A standards, unchanged since REPARIS, through mobilization of resources to responsible authorities.
3. Strengthen Filing of and Access to Legal Entity Financial Statements			
Improve timely publication and electronic availability of PIE financial statements	<ul style="list-style-type: none">• Improve statutory requirements for the publication and filing of financial information• Support the filing of statements at the Central Registry	REPARIS activity on “Publication and Filing of Financial Information” aborted. However, the recommendation implemented by amending laws and regulations on filing and publication.	Not applicable. Publication and availability requirements are met for regulated entities.
Introduce better enforcement mechanisms to avoid publication of abridged financial statements under normal circumstances			
4. Ensuring Proper Regulation of the Auditing Profession			
Establish a professional organization responsible for the organization of professional examinations, maintenance of a registry of auditors, organization of training and CPD programs for auditors, monitoring of compliance with professional and ethical standards,	<ul style="list-style-type: none">• Establish ICARM and build operational capacity• Design and implement educational programs for auditors	<ul style="list-style-type: none">• Technical assistance programs for the education, training and examination of auditors as well as the CPD (completed in 2009)	ICARM needs to update its examination and CPD programs and requires important resources

2003 ROSC A&A Recommendations	Country Strategy and Action Plan	National REPARIS Sub-Projects/Activities	Way Forward
development and implementation of a quality assurance system for auditors	<ul style="list-style-type: none">• Design and implement CPD programs for auditors• Design , implement and build capacity to develop a quality assurance system• Support ICARM in designing and implementing the disciplinary program for auditors• Support ICARM in establishing the registry for auditors• Support ICARM in its liaison with the relevant international institutions• Establish, develop and build capacity of the oversight	<ul style="list-style-type: none">• Technical assistance for the development of the quality assurance system (completed in 2009)• Technical assistance for disciplinary measures (completed in 2009)• ICARM member of IFAC (2009)• Technical assistance for oversight (not completed despite selection of consultant)• Public registry for certified auditors (not completed under REPARIS but completed by ICARM)	CAOA is established as the oversight authority but needs legislative improvements and technical assistance and resources to build technical capacity to fulfill its mandate
Establish an adequate public oversight over the audit profession			
5. Strengthen Enforcement of Compliance with A&A Standards			
Amend regulatory framework to enable regulator to monitor compliance with A&A standards	<ul style="list-style-type: none">• Support the banking regulator• Support the insurance regulator• Support SEC	<ul style="list-style-type: none">• Technical assistance for listed companies reporting and supervision (completed in 2009)	<ul style="list-style-type: none">• Regulators established monitoring mechanisms at varying levels and there is still need for further and continuous
Establish monitoring and enforcement procedures at regulator level			

2003 ROSC A&A Recommendations	Country Strategy and Action Plan	National REPARIS Sub-Projects/Activities	Way Forward
Enable effective and realistic administrative, civil and criminal penalties for non-compliance ⁸⁵	<ul style="list-style-type: none"> • Support Central Registry • Design and build capacity for implementation of a quality assurance program for auditors 	<ul style="list-style-type: none"> • Technical assistance for insurance sector reporting and supervision (completed in 2009) • Technical assistance for the QA Program for auditors (completed in 2009) • Activities for the Central Registry not performed under REPARIS 	<p>training of their technical staff on IFRS and ISA</p> <ul style="list-style-type: none"> • The QA Program for auditors is adequately put in place and functional • Filing requirements are enforced by the Central Registry but without any enforcement mechanism for the application of standards
6. Improve the A&A Education and Training			
Improve the A&A education especially with respect to practical application including updates of curricula in universities	<ul style="list-style-type: none"> • Design and implement an educational program for auditors • Design and implement a sustainable continuous development program for auditors • Support the preparation and implementation of the third level curriculum 	<ul style="list-style-type: none"> • Design and implementation of the education, training, examination and CPD program for auditors (completed in 2009) • The update of the university curriculum could not be supported under REPARIS 	<ul style="list-style-type: none"> • There is a need to update and renew the training, examination and CPD programs for auditors • There is room for improvement in the university A&A education to better serve the needs of the real sector and further develop the practical training at undergraduate and graduate levels and also to establish stronger links with the businesses.
Establish professional examination and continuous development programs for auditors			
Establish separate programs for regulators and corporate accountants			

⁸⁵ The EU accounting Directive sets out that penalties shall be effective, proportionate and dissuasive.

Annex 2: Changes in IFRS with effective date after January 1, 2009

The following table provides a list of IASB pronouncements that need to be considered to update the official translations in Macedonian language:

#	Name of the Pronouncement	Scope	Effective date
IFRS 9	Financial Instruments	Deals with recognition and measurement, de-recognition and hedge accounting.	Still to be determined, later than January 1, 2017
IFRS 10	Consolidated Financial Statements	Outlines the requirements for the preparation and presentation of consolidated financial statements.	January 1, 2013
IFRS 11	Joint Arrangements	Prescribes the accounting for entities that jointly control an arrangement.	January 1, 2013
IFRS 12	Disclosure of Interests in Other Entities	Requirements for wide range disclosures related to interests in subsidiaries, joint arrangements, associates etc.	January 1, 2013
IFRS 13	Fair value measurement	Provides single framework for measuring and disclosing fair value.	January 1, 2013
IFRIC 18	Transfers of Assets from Customers	Related to IAS 18 and deals with arrangements when entity receives from a customer property, plant and equipment.	July 1, 2009
IFRIC 19	Extinguishing Financial Liabilities with Equity Instruments	Deals with debtor accounting when equity instruments are issued to extinguish financial liabilities.	July 1, 2010
IFRIC 20	Stripping Costs in the Production Phase of a Surface Mine	How to account for the benefits when mine waste is removed in order to gain access to mineral ore deposits.	January 1, 2013
IFRIC 21	Levies	When to recognize liability when levy is imposed by the government.	January 1, 2013

IASB has also made the following major changes to IFRS and related pronouncements since 2009, which are not yet introduced into Macedonian translated version of IFRS:

#	Name of the Pronouncement	Issue date	Effective date
	Conceptual framework for financial reporting	September 2010	As of date of issue
IFRS 1	First-time adoption of IFRS	July 2009-May 2012	January 1, 2010 - January 1, 2013
IFRS 2	Share-based Payment	April and June 2009	July 1, 2009 - January 1, 2010
IFRS 3	Business Combinations	November 2008 and May 2010	July 1, 2009 - July 1, 2010
IFRS 7	Financial instruments: Disclosures	May 2010 - December 2011	January 1, 2011 - January 1, 2013
IAS 1	Presentation of Financial Statements	April 2009-May 2012	January 1, 2010 - January 1, 2013
IAS 12	Income taxes	December 2010	January 1, 2012
IAS 16	Property, Plant and Equipment	May 2012	January 1, 2013
IAS 17	Leases	April 2009	January 1, 2010
IAS 19	Employee benefits	June 2011	January 1, 2013
IAS 24	Related parties	November 2009	January 1, 2011
IAS 27	Separate Financial Statements (as amended in 2011)	May 2011	January 1, 2013
IAS 28	Investments in Associates and Joint Ventures (as amended in 2011)	May 2011	January 1, 2013
IAS 32	Financial instruments: Presentation	September 2009-May 2012	February 1, 2010-January 1, 2013
IAS 34	Interim Financial Reporting	May 2010 and May 2012	January 1, 2010 - January 1, 2013
IAS 38	Intangible assets	April 2009	July 1, 2009
IAS 39	Financial Instruments: Recognition and Measurement	July 2008 – April 2009	June 30, 2009 – January 1, 2010

#	Name of the Pronouncement	Issue date	Effective date
IFRIC 8	Scope of IFRS 2		Withdrawn as of January 1, 2010
IFRIC 11	IFRS 2: Group and Treasury Share Transactions		Withdrawn as of January 1, 2010
IFRIC 13	Customer Loyalty Programs	May 2010	January 1, 2011
IFRIC 14	IAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction	November 2009	January 1, 2011

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