

1<sup>st</sup> INTERNATIONAL CONFERENCE

South-East European Countries toward European Integration

20<sup>th</sup> October 2012

Elbasan – Albania

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## BENEFITS OF IMPROVING THE FINANCIAL REPORTING IN REPUBLIC OF MACEDONIA

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### *Abstract:*

*High-quality financial reporting is the foundation of a functioning market economy and the basis of a healthy financial system. Quality financial reporting in Republic of Macedonia depends on the adoption and application of a variety of benchmarks, standards, codes and practices. Improving the quality of financial reporting will have a significant and positive impact on the economy by: 1) reducing the risk of crisis in the financial market and related adverse economic impacts by strengthening the domestic financial architecture; 2) contributing to foreign direct and portfolio investment and helping to mobilize domestic savings; 3) helping the access of small enterprises to loans from the financial sector by reducing the high costs of information and borrowing; 4) enabling investors to properly assess business perspectives by informed investment and voting decisions, resulting in lower cost of capital and better allocation of resources; 5) allowing shareholders and public to assess the success of the management of enterprises, which promote active development of capital markets, and 6) supporting economic integration regionally and globally.*

*The priority goals of this paper are to mark the activities and actions necessary to achieve the previously mention benefits, such as: 1) improving the framework for financial reporting; 2) strengthening the key stakeholders in the framework for financial reporting; 3) supporting the auditing profession; and 4) supporting education, training and public awareness.*

**Keywords:** financial reporting, accounting, auditing, standards, framework,

**JEL Classification:** G19.

### **1. Improving the framework for financial reporting**

Achieving a consistent, predictable and practical framework for financial reporting is one of the key benchmarks for a healthy financial system. In developing the framework for financial reporting, primary goal is to provide a balanced approach between the financial reporting and audit requirements, that will meet the needs of the various users of financial information, will be consistent and predictable, and, what is more important, will not imposes unnecessary burdens on the corporate sector. Creating high quality regulatory and institutional framework for accounting and auditing, requires reform in Macedonian legal framework, institutions and accounting profession, as well as changes in its accounting, auditing and business culture. Strengthening the legal and institutional framework for financial reporting is guided by a primary benchmark, i.e. *acquis communautaire* of EU complemented with International Financial Reporting Standards (IFRS), International Standards on Auditing (ISA) and international good practice.

Alignment of current financial reporting requirements in laws and regulations with those of the *acquis communautaire* will encourage the development of a significantly improved financial reporting framework in Macedonia. The relevance of the *acquis communautaire* for Macedonia is bilayer. First, it is a high quality model for the regulation of accounting and auditing, which can be applied in countries with different characteristics. Second, the adoption of the *acquis communautaire* related to accounting and auditing, supports the strategy of Macedonia to become part of the European Union. This is of even greater importance after the EU granted Macedonia candidate status.<sup>81</sup>

<sup>81</sup> <http://ec.europa.eu/enlargement/candidate-countries>, accessed on August 2012

Chapter 6 of *acquis communautaire*, "Commercial Law", is particularly relevant for setting a solid framework for financial reporting.<sup>82</sup> Here we can make a distinction between "hard law" and "soft law". Regulations (obligatory in all EU Member States without the need for national implementation legislation) and Directives (binding in terms of the objectives to be achieved and the terms of it; however, they leave to the national authorities the choice of form and means to achieve such goals) are considered as "hard laws". Recommendations and Communications are considered "soft law". Soft laws are "rules of conduct which, in principle, are not legally binding, but which nevertheless may have practical effects". Taken together, these regulations, directives, recommendations and communications can be considered as a substantial body of the *acquis communautaire*, which is relevant to corporate accounting.

Environment for effective financial reporting is based on appropriate standards for financial reporting (Accounting Standards). Making financial standards that lead to transparent financial reporting will help preparers and users of financial statements. Relevant financial reporting standards should address the needs of different types of entities, such as public interest entities and small and medium enterprises. According to the Company Law<sup>83</sup> and the Law on accounting matters<sup>84</sup>, business entities are required to prepare and submit annual and consolidated accounts in accordance with the adopted International Accounting Standards, published in the Official Gazette. Macedonia has accepted International Financial Reporting Standards and published interpretations of IFRS. International Accounting Standards and International Financial Reporting Standards are updated on an annual basis, to be harmonized with current standards, as revised, amended or adopted by the International Accounting Standards Board (IASB). Regard to the fact that in application of standards there are two stages, i.e. their preparation and implementation, is inevitably activities to be directed to their application or implementation (training of employees in practice for their ease understanding, as well as preparation and issuing guidelines for accounting in accordance with the legislation) of technical assistance in financial reporting issues not specifically addressed by IFRS.

The accounting in Macedonia is regulated by the Companies Act, Law on accounting matters, the Law on Accounting of budget and budget users and Accounting Guide. Companies Act determines that the following companies have to prepare annual / consolidated accounts in accordance with IFRS which is published in the "Official Gazette": large enterprises; medium-sized enterprises; banks; insurance companies; companies listed on the stock exchange; companies that are part of the consolidated accounts of some of the above types of companies. Provisions of this law determine bookkeeping, classifying traders, trade books, annual accounts and financial statements. The Law on accounting matters regulates the conditions of doing accounting work, subjects who perform accounting work, the conditions for acquiring the status of a bookkeeper and accountant, organization and operation of the Institute of Accountants and Certified Accountants of the Republic of Macedonia, as well as other issues concerning performing accounting work. Law on Accounting of budget and budget users<sup>85</sup> regulates the performing of accounting, business books, accounting documents and data processing, recognition income and expenditure, balance sheet items assessing, revaluation, financial statements, delivery and financial reports and other matters related to accounting budget of Republic of Macedonia, the budgets of local government units, budgets and funds, consumers and individual users of funds, and other legal entities for which funds to perform operating activities are primarily provided from the budgets. Accounting Guide contains directions of conducting accounting in accordance with international accounting standards, which are published in the "Official Gazette".<sup>86</sup>

## 2. Strengthening the key stakeholders in the framework for financial reporting

Successful financial reporting should be implemented and enforced in practice by institutions with adequate resources. The purpose of this activity is to introduce a system that works together with appropriate financial reporting framework and which result will be a high quality financial reporting.

Banking sector as a whole represents a significant segment for preparers and users of financial reporting and, therefore, is a key area for the establishment of expectation and preparation of financial reporting quality. National Bank of the Republic of Macedonia<sup>87</sup> shall ensure the harmonization of the legal framework with the relevant parts of the *acquis communautaire* in order to provide consistency of banking legislation with other relevant domestic legislation. This determines the role of the Supervision Department of the Bank in strengthening the institutional capacity to supervise, monitor and enforce the implementation of IFRS in the banking financial reporting. Resources which are used to build capacity in the Association for commercial banking in the long run will allow its development in the direction of a key partner for the Central Bank, which will create a culture of compliance and, ultimately, better financial reporting in the sector.

<sup>82</sup> [www.eurofound.europa.eu/areas/.../acquiscommunautaire.htm](http://www.eurofound.europa.eu/areas/.../acquiscommunautaire.htm), accessed on August 2012.

<sup>83</sup> Company Law, Official Gazette of the Republic of Macedonia, No. 28/2004.

<sup>84</sup> Law on accounting matters, Official Gazette of the Republic of Macedonia, No. 95/2012

<sup>85</sup> Law on Accounting of budget and budget users, Official Gazette of the Republic of Macedonia, No. 81/2005

<sup>86</sup> Accounting Guide, Official Gazette of the Republic of Macedonia, No. 28/2004

<sup>87</sup> [www.nbrm.gov.mk](http://www.nbrm.gov.mk), accessed on August 2012.



Tax reporting in Macedonia currently absorbs a significant portion of the country's accounting facilities. Resources which are used for clarification and coordination of the environment for tax reporting on one hand and financial reporting on the other hand will contribute significantly to the overall significance of financial reporting in Macedonia, and in the long run this will lead to better quality financial reporting. Public Revenue Office (PRO)<sup>88</sup> should support the establishment of a legal framework that provides predictable tax base, as well as the construction of an efficient process for determining taxes which would reduce compliance costs imposed on companies. Moreover, they should encourage the establishment of institutional framework to implement an effective process for determining income tax, which would result in effective assessment and collection of taxes.

Development of key specialized financial sectors in the areas, which also cover the insurance and pensions, is a strategic goal for any country that seeks to develop a healthy and growing economy. This specialize areas require specialized financial reporting and supervision. For this, there is a need to develop a consistent legislative and regulatory framework that supports the modernized reporting environment for the insurance companies in line with the *acquis communautaire*. Moreover, it should support the development of capacity for monitoring and ensuring compliance with financial reporting legislation and regulations for insurance companies in Macedonia.

The establishment of a strong, effective and sophisticated capital market is the foundation of a successful economy in any part of the world. Strong, effective and sophisticated capital markets require appropriate regulations (including financial reporting requirements) and institutionalized mechanisms for their implementation in practice. This includes responsibility for Securities Commission<sup>89</sup> to support the development of legislative and regulatory framework for the listed entities.

Institutional and legal strengthening programs should assist in the preparation of high quality financial reporting that will meet the needs of a wide range of users, such as investors, lenders and other creditors. Such high quality financial reporting is a prerequisite for raising funds in the capital markets and the banking sector, which are essential for economic growth. This high quality annual accounts and consolidated accounts are useful only if the public can get them quickly and easily. Central Registry shall ensure the harmonization of national legislation and regulations with the relevant parts of the *acquis communautaire* related to: the publication and submission of financial information, including the principle of mandatory disclosure, minimum requirements for transparency, and their consistency with other relevant domestic legislation; significantly improve public access to quality financial information through a program of operational hardware and software support. These activities will enable stakeholders for fast and easy access to electronic annual accounts and consolidated accounts of the relevant companies.

Accountants and certificated accountants in the territory of the Republic of Macedonia, according to the Law on accounting matters adopted in June 2012, should be organized in the Institute of Accountants and Certified Accountants of the Republic of Macedonia. The Institute should perform the following tasks: 1) maintain a register of accountants; 2) control the operation of accounting workers; 3) organize and conduct exam for accountant or certified public accountant; 4) issue a certificate for accountant and certified public accountant; 5) issue and revoke licenses of sole proprietors - accountants, sole proprietors - chartered Accountants and companies performing accounting work; 6) determine applications for approval of the accountant or public accountant qualification acquired abroad; 7) organize and conduct exam for accountant or public accountant qualification acquired abroad; 8) organizes and conducts training for continuous professional development; 9) monitors the application of the Code of Ethics for Professional Accountants brought by IFAC; 10) translates IFRS and IFRS for IAS; 11) cooperate with other relevant professional bodies in the Republic of Macedonia and abroad and 12) perform other duties stipulated by this law.

### 3. Supporting the auditing profession

Adoption of improved financial reporting framework will be effective only if the companies comply with it. Strengthening key actors responsible for regulation is one of the methods to ensure companies comply with financial reporting requirements. Statutory audit of selected annual accounts and consolidated accounts (e.g. annual accounts of company of public interest) is another effective method to encourage compliance with the financial reporting standards. Essential pillar for ensuring quality and consistency in financial reporting is the presence of a reliable and independent auditing profession loyal to the creditors, shareholders and other stakeholders of the company.

Support and development of the auditing profession in Macedonia have been identified as essential goals, so there is a need to develop internal regulations and procedures for conducting it. This become especially important after the international accounting scandals ("Enron", "Parmalat" etc.), and taking into account legislation of the European Union (Eighth Directive in the field of commercial law on statutory audit). Macedonia should implement a system to an external and independent public oversight of the audit profession. In addition, effective public oversight of the audit profession is a vital element in maintaining and increasing the confidence in the audit function.

<sup>88</sup> [www.ujp.gov.mk](http://www.ujp.gov.mk), accessed on August 2012

<sup>89</sup> [www.sec.gov.mk](http://www.sec.gov.mk), accessed on August 2012

Audit Act<sup>90</sup> supports the creation and development of the Council for advancement and audit oversight to help assuring regulators, investors and the public that the audited annual accounts and consolidated accounts give a realistic picture of the financial condition of the revised companies. Council is required to be developed into effective and efficient professional body that will be able to fulfill its legal duty to fortify the regulatory structure of the auditing profession in Macedonia in the long run. Preparation of structured processes and procedures, as well as the construction of sufficient capacity for efficient and effective implementation of the same is one of the basic tasks of the Institute of Certified Auditors<sup>91</sup>, as a professional body which brings together the statutory auditors in the Republic of Macedonia. Effective audit procedures are implemented through adherence to relevant international benchmarks, in particular International Standards on Auditing (ISA). Continuous availability and implementation of these standards is essential. Translation of ISA and the constant updating of the translated text are under the control of the ICA.

Fully functional audit profession requires the development of accounting education and training program that will create competent auditors capable during their working life to make a positive contribution to the profession in which they operate and the country in which they exist. Preparation, implementation and continued development of such an educational program are also under the control of the ICA. It also means ensuring the continuing competence of statutory auditors and their permanently acquiring new skills and experience to remain effective in the workplace and career. Such an approach will improve the qualitative attributes of the members of ICA and their reputation among employers, clients and the public. ICA is responsible for preparation, implementation and permanent development program for continuous professional development. Transparent display to the public that the activities of statutory audit follow, check (quality assurance) and implement appropriate measures (sanctions and discipline) is a key method in building public confidence in statutory audit. Acquisition of public confidence in the auditing profession in turn will increase the use and credibility of the audited annual accounts and consolidated accounts. Quality assurance is a major asset of the audit profession to show the public and regulators that auditors work at a level that meets the established auditing standards and ethical rules.

The ICA also perform the following tasks: 1) maintain a register of certificate auditors and firms; 2) control the operation of auditors; 3) organize and conduct exam for auditors; 4) issue a certificate for auditor; 5) issue and revoke licenses; 6) determine applications for approval of the audit qualification acquired abroad; 7) cooperate with other relevant professional bodies in the Republic of Macedonia and abroad and 8) perform other duties stipulated by the Audit Act.

The Law on Internal Audit in the Public Sector<sup>92</sup> regulates internal audit system based in accordance with international internal audit standards, objectives, principles, organization, functioning and responsibilities of the internal audit in public sector entities in the Republic of Macedonia. The aim is to help public entities to meet their objectives by bringing a systematic, discipline approach to evaluate and improve the effectiveness of management with risk, control and governance. The provisions of this law shall apply to the following entities in the public: users of funds from the State Budget, the Pension and Disability Insurance Fund, Health Insurance, Fund for National and Regional roads, the Employment Agency, municipalities, agencies and other institutions established by law, public enterprises, as well as legal entities in which the state is the dominant shareholder. Performance of public enterprises in meeting these goals determined by internal audit is controlled by external state audit. The Law on State Audit<sup>93</sup> regulates the conditions and manner of performance of the audit of Budget of the Republic of Macedonia, the budgets of local government, the budget of the social security funds, users and individual users of the budgets, public enterprises, the National Bank, legal entities in which the state is the dominant shareholder, political parties financed by the budget, agencies and other institutions established by law, other institutions financed by public funds and users of funds from European Union and other international institutions. The state audit represents conducting test procedures of the financial transactions with government expenditures in terms of legal and authorized use of funds. State audit also include the provision of an assessment of the use of funds in terms of achieved economy, efficiency and effectiveness. State audit is performed by the State Audit Office.<sup>94</sup>

#### 4. Supporting education, training and public awareness

Financial reporting plays a key role in the functioning modern economy. Clear understanding of the important role which high-quality financial reporting plays in a successful economy, by future generations of Macedonian entrepreneurs, lawyers, bankers, creditors and, of course, statutory auditors, will greatly increase the opportunities for further development of Macedonian economy. Such understanding can be gained through a good curriculum in the area of accounting and auditing at university level education in Macedonia.

<sup>90</sup> Audit Act, Official Gazette of the Republic of Macedonia, No. 135/2011

<sup>91</sup> [www.iorm.org.mk](http://www.iorm.org.mk), accessed on August 2012

<sup>92</sup> Law on Internal Audit in the Public Sector, Official Gazette of the Republic of Macedonia, No. 22/2007

<sup>93</sup> Law on State Audit, Official Gazette of the Republic of Macedonia, No. 145/2010

<sup>94</sup> [www.dzr.mk](http://www.dzr.mk), accessed on August 2012

It is significant not only directly to students at accounting and auditing, but also for other disciplines (e.g. business administration, law, economics) to provide potential experts engaged in all sectors of the functional economy to bring the appropriate decision based on confidential financial information. For example, future entrepreneurs should appreciate the potential benefits that come with the quality of the annual accounts and consolidated accounts, the leaders of the listed entities should recognize that the cost of capital will be reduced by the improvement of financial reporting and the general public should be aware of importance to have a trust in annual accounts and consolidated accounts of companies who have substantial pension investments. Provision of necessary resources to initiate programs of activities that will lead to innovation of the curriculum of accounting and auditing departments at the universities in Macedonia will result with better knowledge of potential candidates for training of certificated auditors. Also it is significant that improved knowledge of all university students studying at accounting and auditing departments will increase the overall knowledge base for quality financial reporting.

Understanding the requirements for quality of financial reporting is important for protection of key stakeholders. National economies can't be developed without investors. Investors in the company should have some protection if the directors or management cheats or ignore trusted duties. The judicial process is a key component in the overall financial transaction between the involved parties - shareholders, directors, management and the state government (legislative, executive and judicial). Investors have certain expectations about the role of the courts in implementing trusted duties. There is a need for well prepared and implemented training program that will improve understanding of the judges on the importance of high-quality financial reporting and the rights and obligations of stakeholders. Encouraging awareness of good financial disclosure and transparency of financial reporting in long term will lead to increased confidence in financial reporting in Macedonia, will increase public demand for good financial disclosure and transparency, will reduce the risk from major frauds, will increase people awareness of the rights and responsibilities and will increase knowledge of financial reporting at the local level, and all these will maximize the potential base for investment in Macedonia.

### Conclusions

Achieving a consistent, predictable and practical framework for financial reporting is one of the key benchmarks for a healthy financial system. Creating high quality regulatory and institutional framework for accounting and auditing, requires reform in Macedonian legal framework, institutions and accounting profession, as well as changes in its accounting, auditing and business culture. Strengthening the legal and institutional framework for financial reporting is guided by a primary benchmark, i.e. *acquis communautaire* of EU complemented with International Financial Reporting Standards (IFRS), International Standards on Auditing (ISA) and international good practice. Successful financial reporting should be implemented and enforced in practice by institutions with adequate resources. The major stakeholders in this process are: Banking sector and other financial institutions, Tax authorities, Securities commission, Central Registry, and Institute of Accountants and Certified Accountants of the Republic of Macedonia. Strengthening key actors responsible for regulation is one of the methods to ensure companies comply with financial reporting requirements. Statutory audit of selected annual accounts and consolidated accounts (e.g. annual accounts of company of public interest) is another effective method to encourage compliance with the financial reporting standards. Essential pillar for ensuring quality and consistency in financial reporting is the presence of a reliable and independent auditing profession loyal to the creditors, shareholders and other stakeholders of the company. Effective audit procedures are implemented through adherence to relevant international benchmarks, in particular International Standards on Auditing (ISA). Continuous availability and implementation of these standards is essential. Translation of ISA and the constant updating of the translated text are under the control of the Institute of Certified Auditors, as a professional body which brings together the statutory auditors in the Republic of Macedonia. Provision of necessary resources to initiate programs of activities that will lead to innovation of the curriculum of accounting and auditing departments at the universities in Macedonia will result with better knowledge of potential candidates for training of certificated auditors. Also it is significant that improved knowledge of all university students studying at accounting and auditing departments will increase the overall knowledge base for quality financial reporting. The judicial process is a key component in the overall financial transaction between the involved parties - shareholders, directors, management and the state government (legislative, executive and judicial). Investors have certain expectations about the role of the courts in implementing trusted duties. There is a need for well prepared and implemented training program that will improve understanding of the judges on the importance of high-quality financial reporting and the rights and obligations of stakeholders. Encouraging awareness of good financial disclosure and transparency of financial reporting in long term will lead to increased confidence in financial reporting in Macedonia.

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