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IMPLEMENTATION OF INTERNATIONAL ACCOUNTING STANDARDS[1] IN MACEDONIA

Introduction

Similarly to other countries in transition, Macedonia has tried to establish a recognizable and business friendly environment in order to attract potential investors and to ease the operation of the existing ones. Macedonia shares most of the features of the corporate governance structure of majority transition countries. Still, the major distinctive feature of the country is the ownership structure of most of the companies, which developed through the privatization process. It has been acknowledged that the ownership structure affects the manifestation of the agency problem (Claessens, 2003). Majority of Macedonian companies have a diffuse ownership structure, which directs the principal-agent relationship towards the shareholder-management conflict. Such structure suffers from a higher information asymmetry in comparison to the minority shareholder-controlling shareholder relation. The main agent is insider, has a complete grasp of the needed information for qualified decision making and might, if not properly regulated, abuse the information in his/her own benefit, against the interests of the principal and of the public at large.

The predominance of such ownership structure emphasizes even more the need for a well structured and recognizable disclosure and transparency framework, that would more effectively cope with the increased risk of information asymmetry misuse. Providing a good quality of the corporate information by the implementation of the internationally recognized accounting language is considered to be a proper way of increasing the transparency, and for decreasing of the capital costs, which would be necessary for promoting investment and fostering capital market development. Adopting the International Accounting Standards as national standards was thought to be the best tool for building a comparable and transparent financial reporting system that would help investors make informed financial decisions. However, it was soon realized that the legal setup, especially if it was not perfectly instituted, was not sufficient to serve the goals for which it had originally been put in place.

In spite of the fact that Macedonian laws provide for a nominal adherence to the International Accounting Standards, Macedonia, according to many studies, has been classified as a country, which has an "inconclusive" (Ichizli, 2002) implementation of these standards. Several other studies have been prepared demonstrating that

[1] Please note that International Accounting Standards refer to International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board, the Standards issued by the Board of the International Accounting Standards Committee, and each applicable Interpretation of the International Financial Reporting Interpretations Committee.

Macedonia is incompliant with the IFRS in several aspects (ROSC, 2003, Deloitte & Touche, 2001, Hepp, Dimitrov, 1999). The objective of this paper is to show the legislative and regulatory setup for the implementation of IFRS, but also the implementational substance, which involves the numerous aspects of the enforcement of what had been designed by the legal framework.

Legislative framework

The central law regulating the accounting and audit in Macedonia is the Trade Company Law (Official Gazette No. 28/2004). The new Trade Company Law was enacted in April 2004, replacing the 1996 Law. The expectations are that the new Law will resolve the shortcomings of the old one, especially the ones related to the disclosures and transparency requirements.

The new Law provides for four types of trading companies: large, medium sized, small and micro traders[2]. The International Accounting Standards are obligatory for the following companies, classified by size, industry and regulatory framework:

- Large trading companies;
- Medium sized trading companies;
- Banking trading companies;
- Insurance trading companies;
- Companies listed on the Stock Exchange;
- Companies being part of the consolidated financial statements of some of the above mentioned types of companies.

The former Trade Company Law has nominally provided for the International Accounting Standards as **the** only standards for the preparation of the financial statements. However, the reference to the standards was to the ones translated in Macedonian and published in the Official Gazette in 1999. Based on this, all further amendments to the IAS seemed to have not been applicable. This was a serious legal drawback of the previous Law. The new Law states that the eligible companies, as defined above, should prepare their financial statements in accordance with the IAS, published in Official Gazette. The novelty is that the IAS should be updated on a

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[2] Based on the number of employees, annual turnover and average value of the total assets within the last two years. In addition to the first criterion, one more needs to be satisfied, in order for the company to be classified in a respective group:

	Micro traders	Small traders	Medium – sized companies	Large trading companies
No of employees	Less than 10	Less than 50	Less than 250	Above 250
Annual turnover	Less than EUR 50,000	Less than EUR 2,000,000	Less than EUR 10,000,000	Above EUR 10,000,000
Average assets		Less than EUR 2,000,000	Less than EUR 11,000,000	Above EUR 11,000,000
Diversification of clients	80% of the turnover comes from one client			
Ownership	At most two physical persons			

yearly basis, following the amendments and additions of the IAS as adopted by IASB. This means that the major problem of the previous law of non-compliance with the IAS amendments has been resolved. Now, at least nominally, by Law, the most recent IAS/IFRS are the valid financial reporting standards in the Republic of Macedonia. It should be noted that no reference is made to the application of IFRIC interpretations in the Law.

Even companies that do not belong to the above groups of companies can prepare and submit their financial statements in accordance with IAS/IFRS if they decide so.

The Minister of Finance will issue a specific regulation in order to proscribe the way how the accounting will be carried out. The Minister also prescribes the form and contents of the annual accounts.

The Trade Company Law requires audits of large and medium sized joint stock companies, all listed companies, and all large and medium sized limited liability companies. The audit is to be performed in accordance with the International Standards of Auditing, as published in Official Gazette and yearly updated, following the amendments adopted by the IFAC. This provision is similarly presented in the Law on Audit (Official Gazette No. 65/1997, 27/2000, 31/2001 and 61/2002). According to this law, the Minister of Finance publishes the International Standards of Auditing in the Official Gazette of the Republic of Macedonia. The auditor is obliged to adhere to the Code of Ethics of Professional Accountants as defined by IFAC.

Similarly to the Law on Audit, the Law on State Audit (Official Gazette No. 65/1997, 70/2001 and 31/2003) defines how the state audit shall be conducted, in accordance with the INTOSAI standards.

Neither the Banking Law (Official Gazette No. 63/2000, 103/2000, 37/2002, 51/2003, 85/2003), nor the Law on Supervision of Insurance (Official Gazette No. 27/2002, 84/2002, 98/2002) has any specific accounting requirements regarding the financial statements. The Banking Law refers to the general accounting regulation and accounting standards, which means that they will have to comply with the requirements set out in the Trade Company Law. The Insurance Law refers directly to the Trade Company Law as the accounting and reporting framework. Since the new Trade Company Law sets the International Financial Reporting Standards as national standards, these should be the applicable standards for financial services organizations as well. In addition to this, the Insurance Law specifically states that the Ministry of Finance should draft additional legislation, according to the international accountings standards, and especially: chart of accounts, form and contents of the financial statements, detailed contents of the annual accounts, valuation method for the balance sheet items, form and contents of the audit report and a detailed content of the certificate provided by the certified actuary. Most of these regulations have not been drafted yet.

The Law on the National Bank of the Republic of Macedonia (Official Gazette No. 3/2002) requires that the National Bank prepare the annual financial statements in accordance with the international accounting standards and accounting regulation in the country. These financial statements are an integral part of the Bank's Annual Report, which is published for the broader audience.

The Securities Law (Official Gazette 63/2000, 103/2000, 34/2001, 4/2002, 37/2002, 31/2003 and 85/2003) provides for additional requirements for listed companies. They need to publish information on the company's financial position, change of capital structure, legal status and their business activities. They are supposed to publish their un-audited financial statements twice a year, 30 days upon the completion of the 6-months' term. They should also publish the audited financial statements 15 days upon their adoption by the Company's General Assembly.

One more Law deserves a special reference: The Law on Accounting for Budgets and Budgetary Users (Official Gazette No. 61/2002 and 98/2002). The accounting standards for the budgets and budgetary users are the International Accounting Standards for public sector, which are published in the Official Gazette of the Republic of Macedonia. The Minister of Finance is empowered by this Law to enact additional decision or other regulation for the compliance of the standards with this Law, if needed. Further on, the Law states that the budgets and budgetary users are supposed to prepare the accounting records in accordance with the Law, with the generally accepted accounting practice and accounting principles.

The short overview of the legislation in Macedonia illustrates that the different laws covering the accounting, audit and reporting requirements are nominally converging towards the adoption of international financial reporting standards as national standards. Looking in more details, several things can be observed: laws use different terminologies, not always in compliance with the IFRS, and not always in full compliance to one another, there are some redundant forms of over-regulations, which bring more confusion, rather than clarification in the area and there are some other minor deficiencies, which still need refinement. Still, a noticeable progress is visible, especially with the New Trade Company Law, being the main reference law in this matter, which has literally pronounced the IFRS as national standards for the defined group of companies and for all others that prefer using these standards for their reporting purposes. Insisting on every year updating of the published IFRS, is a serious step forward in the Law. It seems that what is in the Laws may be not perfectly and consistently spelled out, but the intention is clear and it allows the professional bodies in the country to act and fine-tune the additional regulation and the institutional set-up, in order for the international accounting standards to be fully embraced and truly become the main reporting framework in the country.

Accounting Profession in Macedonia

Probably the weakest link in the institutional framework for the accounting, auditing and reporting system in Macedonia is the absence of an appropriately organized professional organization of accountants and auditors. In fact there are or there have been efforts to organize several such associations. The first and the oldest organization is the Association of Accountants, Financial Workers, and Auditors, which was established in 1956. Although it managed to become a member of some international organizations (IFAC, SEEPAD), this organization was seriously lacking capacity and did not manage to portray itself as a true representative of the profession, because of which it is practically inactive. There were two more efforts to organize alternative associations: Macedonian Association of Certified Auditors and Council of Certified Auditors. Macedonian Association of Certified Auditors was established with a subtle support of the IBTCI – a project funded by the USAID for accounting development in Macedonia. The Association seemed to be active at the beginning, in the process of initial licensing of auditors, after which it completely stopped any activities. The newest effort was made by the recent certified auditors, who tried to establish a Council of Certified Auditors. No information is available on whether this effort gave any result and whether the proponents of the Council are still trying to give it a birth. For the time being, none of the organizations seems to work and the process of organizing the profession seems to be at a worst stage than ever. Professionals have not proved so far to be either willing or able to put sufficient effort in building the professional quality assurance process and any novel processes in this respect will have to be backed fully and openly either by the Government or the international community (or both). Of course, the acknowledgment of such a reality is extremely embarrassing for the profession, but unless this pillar gets fully in place, the efforts for an efficient accounting reform will remain sterile, as indeed they have proved to be so over the last decade. By no means can the system perform efficiently and effectively while it is missing probably the most important watchdog – the professional association. The problem of the absence of self-regulated professional organization has been elaborated in several studies exploring the state of the accounting and auditing profession in Macedonia (Bozinovska-Lazarevska, 2001, ROSC, 2003).

In the meantime, and in the absence of such an organization, the Ministry of Finance acts as the main agent regulating the auditing profession. It is exclusively empowered with the legislation drafting activity, with the regulation of professional performance of the audit professionals and audit companies, with the organization and conduct of professional examinations and licensing of auditors. It should be noted that the Ministry managed to put some order in this area. The process of examining and licensing auditors is going more or less smoothly and it is gaining in validity and overall acceptance.

The most recent developments are that the new draft law on audit has entered the Government procedure. The main novelty of the new Law is that it insists on the establishment of a self-regulatory body – Institute of professional accountants and auditors, which will really take over the common activities of such an Institute: licensing, quality control, care about permanent training of accountants, auditors, but also regulators, adherence to professional code of ethics etc.

For the time being there are around 15 licensed audit firms in Macedonia. All the big four are present in the country. There are also not more than 150 licensed auditors, but not all of them are in public practice. They don’t seem to be sufficient to efficiently respond to the massive requirement for audit of what is estimated to be a pool of 900 companies that need to be audited (ROSC, 2003). A good portion of these professionals is faculty professors or corporate accountants. There are constantly new certified accountants joining the profession. Fundamental improvement comes from the fact that the first young holders of international recognized certificates are emerging in Macedonia and they are expected to be the major proponents for adherence to quality standards. Still, there is not yet a system of recognizing their certificates nationally and transferring them into national certification.

Enforcing the Accounting Standards

There are practically no effective mechanisms enforcing the implementation of the international financial reporting standards as they have been provided for in the Trade Company Law. The major role of the Ministry of Finance as a regulator ends with the examination and licensing of auditor. The Central Registry simply collects the abridged financial statements, without checking for their compliance with the stated financial reporting requirements. Even the Securities and Exchange Commission and the Stock Exchange do not review the financial statements for their adherence with the reporting framework. The Securities and Exchange Commission does not have the legal power, to review and to take measures against the companies ant their managers who do not comply with the requirements.

An important and relatively efficient and effective regulatory agent is the National Bank of the Republic of Macedonia. Still, they do not insist on the enforcing of the general accounting framework, but they are mainly focused on the enforcement of the bank supervision criteria.

The similar, although to a much smaller extent is valid for the supervision of the insurance companies. The Insurance Supervision Department of the Ministry of Finance is indeed focused only at its regulatory role. It should be emphasized that the size of the Supervision Department and its professional capacity is much smaller than the one of the National Bank, which makes this important industry to be de facto not properly supervised yet.

This means that the real enforcement agent for enforcing the financial reporting standards is the auditors. Having in mind the situation that we have described above on the absence of external quality assurance process of the audit firms and professionals, it becomes obvious that this is the area that needs immediate address and action.

Areas of Difference

The most detailed analysis on the perceived departure of the reviewed financial statements in Macedonia from the IFRS is probably the one presented in the ROSC study on accounting and audit (ROSC 2003). They have noticed the following areas of incompliance:

- Conceptual Framework. The previous Trade Company Law was based on the 1999 translation of IFRS, which left several sections of the IASB framework out of the Macedonian legislation. The new Law addresses more adequately this issue.
- Interpretations of IAS. Macedonian legislation does not endorse any of the 31 existing interpretations.

- Investment property. IAS 40 has not been adopted in Macedonia, because of the implementation of the 1999 translation of IFRS.
- Bank regulatory reporting requirements dominate over the standards prescribed for the general-purpose reporting (IFRS).
- ROSC team found reports including only the balance sheet and income statements, without containing cash flow statement, statement of changes of equity, accounting policies and notes disclosures.
- General purpose financial statements are often influenced more by the taxation rules, rather than by the IFRS requirements.
- ROSC team reviewed a sample of IAS based financial statements and found several variations. These were classified as follows:
    - Absence of information on related party relationships and transactions,
    - Revaluation of property, plant and equipment in most of the companies has been made based on the general price index, which may contradict IAS 16,
    - Revaluation of intangible assets has been done on the same basis: price index (may not be in compliance with IAS 38),
    - Measurement of financial assets at fair value has been done by the use of approximated fair value, which may conflict IAS 32 and IAS 39.
    - Compound financial instruments have not been presented as required by IAS 32, Some companies did not consolidate subsidiaries, especially loss-making ones, or did not properly eliminate intra-group revenues and expenses in the financial statements that were consolidated, which is not in compliance with IAS 27.
    - The classification in the cash flow statements of several banks into cash flows from investing activities, and cash flows from financing activities, did not comply with IAS 7,
    - The ROSC team found situations of understatement of expenses because certain payments to management and employees were charged to equity instead of being recognized as expenses.

The other robust study on the transparency and disclosures matter as major standpoints of the corporate governance architecture in South East Europe is the OECD White Paper on Corporate Governance (OECD, 2003). The findings of this study refer to the whole SEE region, but they reflect to a great extent the specific situation in Macedonia as well. The resemblance between some of the findings of the two studies is visible, although the angle of perception and the focus is different:

- Legal requirements for disclosure are usually high in SEE, although not always tied to the IAS. However, the reliability of the disclosed information tends to be low.
- The mindset of the major players towards the idea of transparency (managers, shareholders, professionals, regulators) needs to be fundamentally changed.
- Financial statements are not prepared in accordance with IFRS, even when they were meant to be consistent with them. This is especially the case with the inflation accounting, undisclosed liabilities, valuation of assets and reporting of related parties transactions, inadequate depreciation and provisions, avoiding of proper consolidation.
- Outside shareholders are facing a serious lack of transparency on ownership and control structure.

- The ongoing disclosure of material events is not up to the standards for proper information of shareholders and the other interested public. Voluntary additional disclosure is even less visible.
- There is not good distinction of who is responsible for what in the disclosure process: management, board of directors, audit board, internal auditors, external auditors.
- Securities regulators and stock exchanges are not enough empowered to monitor and enforce the disclosure requirements.
- Financial statements and trade registries are not easily accessible to all shareholders
- The regulation of the accounting and the auditing profession is very ineffective in SEE. Professional organisations are weak. They lack resources and they have sustainability problem.
- The regulatory provisions and their enforcement are not strong enough
- The insufficient number of duly trained Certified Public Accountants is a major obstacle to improving accounting and auditing practices in most SEE countries.
- The performance of SEE media to the increase of the public awareness for these important matters has been mixed and controversial. As has been acknowledged in the Report the media may have played a role in bringing major scandals and debates to public notice, but they have not proved to be sufficiently educated in business matters and they did not manage to be resistant to the influence of interested parties.

Conclusions and Policy Implications

The overview of the legislation in Macedonia illustrates that the different laws covering the accounting, audit and reporting requirements are nominally converging towards the adoption of international financial reporting standards and treating them as national standards. It seems that the legal framework is not the major hindrance to the more significant embracing of the IFRS. Even if separate regulations need further clarification, terminology clearance and additional fine-tuning, they can be considered as a good basis and not impediment to the implementation of good disclosures and transparency standards.

Probably the weakest link in the institutional framework for the accounting, auditing and reporting system in Macedonia is the absence of an appropriately organized professional organization of accountants and auditors. Professionals have not proved so far to be either willing or able to put sufficient effort in building the professional quality assurance process and additional processes in this respect will have to be backed fully and openly either by the Government or the international community (or both). It is expected that the new Draft Law on Audit will insist on the establishment of a self-regulatory body – Institute of professional accountants and auditors, which will really take over the common activities of such an Institute: examinations, licensing, quality control, care about permanent training of accountants, auditors, but also regulators, adherence to professional code of ethics etc. Once the Institute is in place and operational, it should engage firstly in a project of refreshing and harmonizing all legislation dealing with the accounting and auditing matters, among which full implementation of IFRS would be one of the major topics. An appropriate treatment of the IFRIC interpretations should be established in Macedonian legislation. This is the only competent, professional and integral manner of refining the existing legal framework. The development of standards for the small and micro traders will also be an obligation of the professional organization.

For the time being there are around 15 licensed auditors and not more than 150 licensed auditors, out of which many are not in public practice. They don't seem to be sufficient to efficiently respond to the massive requirement for audit of the numerous companies that need to be audited. The first young holders of internationally recognized certificates are emerging in Macedonia and they are expected to be the major proponents for adherence to quality standards. A system of recognizing their certificates nationally and transferring them into national certification should be promptly established.

There are practically no effective mechanisms enforcing the implementation of the international financial reporting standards as they have been provided for in the Trade Company Law. Larger authority for monitoring and enforcement of the general-purpose reporting should be given to the Security Exchange Commission, Stock Exchange, Central Bank, Insurance Supervisory Department in the Ministry of Finance and especially to the professional association of accountants and auditors. The Government should make sure that the auditing profession is appropriately regulated and some of these powers can be delegated to the self-regulating professional organization. Other protagonists of the disclosure and transparency rules (managers, directors, internal auditors, employees of the audit firms) should also be subject to administrative, civil or criminal penalties for violating the financial reporting or audit standards.

Even more profound and permanent professional education and training should be imposed. This should involve the University curricula, professional education and training of accountants and auditors, training of regulators, training (including IAS training) of corporate accountants

There should be a well-designed and implemented public awareness program that would increase the public demand for good corporate disclosure and transparency, among which the financial reporting framework holds the central position. The professional association might be assigned with this obligation as well. This is especially for the activation of the third pillar of the transparency and disclosure system – the internal control and external disclosure mechanisms of the individual companies. Unless there is a public demand and pressure for bigger corporate openness, it is hard to believe that corporations will be willing to voluntarily offer better quality of corporate information.

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