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Reporting Reform



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# Knowledge Paper

Key Accounting and  
Auditing Reforms

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## ACRONYMS

|            |  |
|------------|--|
| A&A        | Accounting and Auditing  |
| ACCA       | Association of Chartered Certified Accountants                               |
| CAOA       | Council for Advancement and Oversight of the Audit                           |
| CFRR       | Centre for Financial Reporting Reform  |
| CPD        | Continuing Professional Development  |
| EU-REPARIS | Road to Europe: Program of Accounting Reform and Institutional Strengthening |
| FEE        | Federation of European Accountants   |
| IACA       | Institute of Accountants and Certified Accountants                           |
| IAESB      | International Accounting Education Standards Board                           |
| ICARM      | Institute of Certified Auditors of the Republic of Macedonia                 |
| IFRS       | International Financial Reporting Standards                                  |
| ISA        | International Standards on Auditing  |
| ISQC       | International Standard on Quality Control                                    |
| MAPAS      | Agency for Supervision of Fully Funded Pension Insurance                     |
| MoF        | Ministry of Finance  |
| MSE        | Macedonian Stock Exchange  |
| MSEC       | Macedonian Securities and Exchange Commission                                |
| PAO        | Professional Accountancy Organization  |
| PIE        | Public Interest Entity   |
| QA         | Quality Assurance  |
| ROSC       | Report on the Observance of Standards and Codes                              |
| SME        | Small and Medium Sized Enterprises   |
| SMPs       | Small and Medium Sized Practices   |

## 1. EXECUTIVE SUMMARY

The purpose of this Knowledge Paper focusing on Key Accounting and Auditing Reforms is to assist the Government to make informed decisions for future reform actions following the publication of the Macedonian *Report on the Observance of Standards and Codes (ROSC) on Accounting and Auditing (A&A)*<sup>1</sup>.

The Knowledge Paper was developed by a team of experts from the World Bank Centre for Financial Reporting Reform (CFRR), through its *Road to Europe: Program of Accounting Reform and Institutional Strengthening (EU REPARIS)*<sup>2</sup>, and delivered through its in-country implementation support and technical assistance component tailored to address the country's specific needs on an on-demand basis. The paper should be used as a tool to assist the Ministry of Finance when discussing and further analyzing some possible implications of various reform actions that the Government and key stakeholders may choose to conduct, as well as provide possible application examples when possible.

The Government has remained committed to continue its reform efforts in corporate financial reporting frameworks and actual practices and implement the recommendations of the ROSC A&A Update. These reform efforts should consider the economic and human resource constraints facing the country and seek to:

- Strengthen and build upon existing mechanisms that work adequately;
- Simplify accounting and auditing obligations whenever possible, especially for small businesses; and
- Establish synergies between institutions to avoid duplication of efforts.

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<sup>1</sup> The ROSC A&A is publicly available at:

<http://documents.worldbank.org/curated/en/110691468046854315/pdf/958010ROSCOP120BLIC00Box391428B0ACS.pdf>

<sup>2</sup> The EU REPARIS Program is a regional program aimed to support the implementation of corporate financial reporting frameworks in line with the EU *acquis communautaire* in the countries of Southeast Europe with a view to promoting enhanced availability, transparency and reliability of financial information. More information is available on [www.worldbank.org/cfrr](http://www.worldbank.org/cfrr).

## 1.1. Summary of Findings

### Definition and Special Considerations for Public Interest Entities (PIEs)

The EU Directive and Regulation prescribe more demanding requirements regarding Public Interest Entities (PIEs) including additional governance, reporting, disclosure and transparency requirements. Further, as audits of PIEs enhance the degree of confidence of the public in their financial statements and a broad community of stakeholders and institutions rely on the quality of the statutory auditor's work, there are more demanding requirements introduced regarding statutory audits of PIEs.

**A clear definition for identification of Public Interest Entities (PIEs) is important for both preparers and regulators to avoid ambiguity regarding the requirements that need to be met.**

When designating PIEs, an important consideration is that not all companies subject to statutory audit are of such public interest to require designation as PIEs and such responsibilities could be unnecessarily burdensome, expensive and market restrictive if applied to large pool of audited entities. As presently formulated in national legislation, the definition of PIEs captures some entities which are not economically significant and therefore have less public interest and on the other hand, the definition does not include some entities which might be of economic significance to the country and therefore of public interest.

### Reducing Regulatory Burdens for Micro and Small and Medium Sized Enterprises (SMEs)

The European Commission has linked the principle of "Think Small First" while developing the *acquis* and has introduced a number of policy measures aiming to reduce the administrative burden for micro enterprises and SMEs, which also extend to accounting, financial reporting and auditing.

**Macedonian micro enterprises and SMEs face greater financial reporting and audit requirements as compared to their European peers.**

According to national legislation, all companies in the country, including micro enterprises, are required to use the same rules in preparation of their annual accounts and the present audit requirement extends to a large number of companies that according to EU criteria would be considered as micro entities or small companies. Further, the present requirements of the Law on Performance of Accounting Services require all accountants, no matter if they are engaged in public practice or in business, to be mandatory members of the Professional Body of Accountants and hold a professional certificate even if their role extends to basic bookkeeping activities for micro enterprises or SMEs. Such regulatory requirements could have disproportionate financial impact for a significant number of accounting technicians

employed as administrative staff or engaged by small firms for provision of basic bookkeeping and accounting services.

A number of policy measures should be considered in further legislative amendments to lessen the administrative burden for micro enterprises and SMEs, including adopting the EU size thresholds for companies' classification, simplifying the financial reporting requirements for small companies by limiting the disclosures required, revisiting the requirements of the Law on Performance of Accounting Services in order to reduce the regulatory burden for accountants employed in business.

## **Public Oversight and Quality Assurance**

The Council for Advancement and Oversight of Audit (CAOA) is the body with delegated responsibility for Public Oversight. Although established and operational, the CAO is struggling to secure sufficient funds to finance its operations and gain technical expertise to effectively fulfill its legal responsibilities, and especially in respect of Quality Assurance. Approximately 80 percent of the

CAOA budget is financed from the state budget and the remaining 20 percent comes from the Professional Body of Auditors (i.e. the Institute of Certified Auditors of the Republic of Macedonia: ICARM), licensing fees, and other income arising from operations. The CAO Council members do not contribute financially to the budget. These members include representatives from industry and other regulatory bodies (e.g. the Macedonian Security Exchange Commission, the Central Bank and the Insurance Supervision Agency).

At present capacity for Quality Assurance is available with ICARM who perform Quality Assurance reviews over both PIE and non-PIE auditors. An illustrated computation of the costs necessary to implement a Shared Regulation Quality Assurance model, whereby the Quality Assurance over PIE auditors is housed with CAO, is estimated to cost additional EUR 45,000 – EUR

50,000 per year. Considering CAO's current capacity constraints and in particular its relatively scarce human and financial resources, some form of shared regulation for the quality assurance of audits of PIEs between the CAO and ICARM might well be a useful interim step until those capacity constraints have been addressed. Such an approach would recognize both that securing an incremental budget as well as the human resources to finance the CAO's Quality Assurance responsibilities will take time to develop in the medium term.

**A sustainable funding model and resources are key for CAO to fully discharge its mandate and responsibility for Audit Oversight in Macedonia.**

**In the medium-term period, until capacity is built in CAO, a purely independent system from the profession for Quality Assurance of PIE auditors is not possible or desirable.**

## Professional Accountancy Education and Training

The Institute of Accountants and Certified Accountants (IACA) and the Institute of Certified Auditors of the Republic of Macedonia (ICARM), as professional bodies recognized by law, have taken positive initial steps to establish coordination within their Continuing Professional Development (CPD) systems. The cooperation should extend to other areas of mutual interest for their members, including approaching professional accountancy education in a coordinated and cohesive manner, and by building further on the already established capacity. Efforts should be aimed to strengthen the quality of accountancy education, including strengthening the monitoring system for professional competence of auditors and accountants acquired through practical experience.

IACA and ICARM, as legally recognized professional bodies of accountants and auditors, with a mission to serve the public interest, should consolidate their efforts and coordinate to achieve economy of scale.

### 1.2. Key Recommendations

The following recommendations are proposed to be considered in the short term and addressed, when applicable, with the upcoming legislative amendments:

#### Definition and Special Considerations for Public Interest Entities (PIEs)

- The present definition of PIEs should be revised in order to comply with the requirements of the *acquis communautaire*. As presently formulated in national legislation, the definition of PIEs captures some entities which are not economically significant and therefore have less public interest and on the other hand, the definition does not include some entities which might be of economic significance to the country and therefore of public interest.
- The Law on Audit should be amended in order to prescribe the more demanding requirements for statutory auditors of PIEs and public oversight over statutory auditors as required by the *acquis communautaire*, including requirements regarding quality assurance systems that need to be independent from the audit profession, mandatory audit firm rotation of auditors of PIEs, restrictions on non-audit services to audited PIEs and caps on fees for such services to safeguard auditor independence.

## **Reducing Regulatory Burdens for Micro and Small and Medium Sized Enterprises (SMEs)**

- The EU size thresholds for companies' classification should be adopted in national legislation. Further, the national legislation should simplify the financial reporting requirements for small companies by limiting the disclosures required.
- The current requirements of the Law on Performance of Accounting Services need to be revised in order to reduce the regulatory burden for accountants employed in business. One possible approach is to require only firms or proprietors that provide external accounting and bookkeeping services to be registered with the accountancy body and complete relevant professional education.

## **Public Oversight and Quality Assurance**

- In light of transposing the requirements of the new Audit Directive and Regulation, which clarify that delegation of many tasks, including quality assurance for statutory auditors of PIEs, cannot anymore be delegated to the profession, the Council for Advancement and Oversight of the Audit (CAOA) will need to start preparing to undertake additional responsibilities in the future. In this respect, there is an urgent need to revisit the funding and expenditures of CAO A, through changes in the Law on Audit, particularly considering the technical staffing and training needs required to (i) establish capacity for quality assurance for direct inspection of PIE statutory auditors as well as (ii) to oversee the activities of the Institute of Chartered Auditors of Republic of Macedonia (ICARM).
- The recently amended requirement of the Audit Law pertaining to the use of a pool of quality inspectors (i.e. peer review system), is a step back relative to the present Quality Assurance system whereby two trained, skilled, full-time employees of ICARM perform Quality Assurance reviews over PIE and non-PIE auditors. Considering that ICARM has already developed internal capacity for Quality Assurance, a peer review system is not considered an optimal and effective solution and such requirement should be urgently reconsidered.
- Until capacity is developed with CAO A a purely independent system for Quality Assurance over PIE auditors from the profession is not possible or desirable. In the inception period the CAO A technical staff should familiarize themselves with ICARM inspection methodologies and join ICARM quality assurance review teams (i.e. shadow ICARM inspectors) during field inspections. This would provide them with valuable developmental opportunities and a means to exchange knowledge and experience. CAO A would need to have sufficient funding in order to attract and retain qualified professionals who have sound professional audit experience to enable effective quality assurance over PIE audits and auditors.

- There is a need to move away from audit selections that focus predominately on cost during selections as such selections may have a negative impact on audit quality. A number of measures should be taken including: (i) abolishing e-auctions for audits and establishing appropriate criteria (the right amount and the right criteria) to measure and evaluate the auditors selection; (ii) raising the capacity of regulators who oversee the external auditors which needs to be at adequate level to perform effective monitoring of audit quality that is linked to the audit licensing processes; (iii) having in place audit rotations that are sensible and restricted to a reasonable time interval; (iv) increasing the capacity of selecting committees, and targeted capacity building for Audit Committees charged with audit sections; (v) raising awareness among Government of the problem and its negative effects to State Owned Enterprises (SOEs) transparency including present risks for government; and other important considerations.

### **Professional Accountancy Education and Training**

- The Institute of Accountants and Certified Accountants (IACA) and the Institute of Certified Auditors of the Republic of Macedonia (ICARM), as professional bodies recognized by law, should coordinate efforts in the area of professional certification and development of members and build on the already established capacity in accountancy education.
- ICARM and CAO A should strengthen the monitoring system for professional competence of auditors acquired through professional experience by developing competence areas and learning outcomes and reflective reporting by candidates and supervisors.

## 2. INTRODUCTION

### 2.1 Objectives of this Report

The purpose of this Knowledge Paper focusing on Key Accounting and Auditing Reforms is to assist the Government to make informed decisions for future reform actions following the publication of the Macedonian *Report on the Observance of Standards and Codes (ROSC) on Accounting and Auditing (A&A)*<sup>3</sup>.

The Knowledge Paper was developed by a team of experts from the World Bank Centre for Financial Reporting Reform (CFRR), through its *Road to Europe: Program of Accounting Reform and Institutional Strengthening (EU REPARIS)*<sup>4</sup>, and delivered through its in-country implementation support and technical assistance component tailored to address the country's specific needs on an on-demand basis. The paper should be used as a tool to assist the Ministry of Finance when discussing and further analyzing some possible implications of various reform actions that the Government and key stakeholders may choose to conduct, as well as provide possible application examples when possible.

While developing the Knowledge Paper, the World Bank CFRR team selected some areas for consideration raised in the ROSC A&A update that were considered important in the team's judgement for action in the short term. Country examples and information was gathered by analyzing publicly available information from various sources including the EU *acquis communautaire*, research concluded by recognized international accountancy bodies, as well as information and knowledge sourced from CFRR capacity building events and workshops.

The Macedonian ROSC A&A Update was published in September 2014. The report was presented at a dissemination event in Skopje in December 2015. The dissemination brought together a wide group of in-country stakeholders, including policy makers, financial and capital market regulators, the accounting and audit profession and their regulators, as well as the academic and business communities. Discussions focused on the strengths and weaknesses of the accounting and auditing environment in the country - both statutory requirements and actual practice - that influence the quality of corporate financial reporting.

Following these discussions, the Government has remained committed to continue its reform efforts in corporate financial reporting frameworks and actual practices and implement the

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<sup>3</sup> The ROSC A&A is publicly available at:

<http://documents.worldbank.org/curated/en/110691468046854315/pdf/958010ROSCOP120BLIC00Box391428B0ACS.pdf>

<sup>4</sup> The EU REPARIS Program is a regional program aimed to support the implementation of corporate financial reporting frameworks in line with the EU *acquis communautaire* in the countries of Southeast Europe with a view to promoting enhanced availability, transparency and reliability of financial information. More information is available on [www.worldbank.org/cfrr](http://www.worldbank.org/cfrr).

recommendations of the ROSC A&A Update. These reform efforts should consider the economic and human resource constraints facing the country and seek to:

- Strengthen and build upon existing mechanisms that work adequately;
- Simplify accounting and auditing obligations whenever possible, especially for small businesses; and
- Establish synergies between institutions to avoid duplication of efforts.

This paper is divided into four thematic areas including: (i) Definition and special Considerations for Public Interest Entities (PIEs); (ii) Reducing regulatory burdens related to compliance with accounting, financial reporting and auditing requirements for Micro and Small and Medium Sized Enterprises (SMEs); (iii) public oversight of statutory auditors and quality assurance over external audit function; and (iv) professional accountancy education and training.

## 2.2 2104 ROSC A&A Update

The box below provides a summary of the main areas for consideration raised by the ROSC A&A Update of 2014:

### **Box 1: Macedonian ROSC A&A Update – Main Areas for Consideration**

Since the first ROSC A&A assessment in 2003, the country has made significant progress in aligning the statutory and institutional framework with EU requirements, and the Government has implemented many reforms consistent with good international practices and the *acquis communautaire*. The main accountancy reforms include the enactment of a Law on Performing Accounting Services; the adoption of the IFRS for Small and Medium-sized Entities (SMEs) Standards 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.

The ROSC A&A Update from September 2014 highlighted a few further areas for consideration along the five major pillars of the corporate financial reporting framework, including:

- **Statutory Framework.** Along this pillar the report recommended several considerations including the need to clarify the definition of the Public Interest Entities (PIEs) and develop a reporting regime in line with the EU Directive; adopt size thresholds for companies according to the EU approach; simplify accounting requirements for micro and small entities and reduce regulatory burden for accountants in business.
- In the area of **Accounting and Auditing Standards**, the report highlighted the need to develop an effective, sustainable system for translating and publishing IFRS Standards®, the IFRS for SMEs® Standard and ISA®.
- **Monitoring and Enforcement.** Several areas for consideration are proposed under this pillar including the need to improve the capacity of the Council for Advancement and Oversight of the Audit (CAOA); improving the cooperation between the CAOA and the Institute of Certified Auditors of the Republic of Macedonia (ICARM); aligning the quality assurance system to EU Audit Directive and Regulation requirements; and developing capacity among regulators to monitor IFRS financial statements and ISA's audit reports.
- **The Profession.** Areas for consideration include Operationalization of the Institute of Accountants and Certified Accountants (IACA); development of ICARM's professional certification and CPD system and resolving challenges of the Audit profession, including inadequate audit fees to support rigorous auditing and gaps in capacity to provide quality audit services.
- **Education and Training** considerations involve the lack of resources and limited practical teaching of IFRS and ISAs; the need to increase flexibility of universities to create project proposals and engage donors as well as to facilitate cooperation among universities, the profession, and business.

### 3. DEFINITION AND SPECIAL CONSIDERATIONS FOR PIEs

The Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 (EU Audit Directive) and Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 (EU Accounting Directive) define Public Interest Entities (PIEs) as listed companies, credit institutions and insurance undertakings. In addition to these categories, Member States can designate as PIEs other undertakings that are of significant public relevance, because of the nature of their business, their size or the number of their employees.

Having a clear, unambiguous definition of what companies are identified as PIEs is very important because of the following considerations<sup>5</sup>:

- It is crucial to determine the entities that are within the scope of the EU Regulation No 537/2014 of the European Parliament and of the Council of 16 April 2014 (EU Audit Regulation) for the more demanding requirements<sup>6</sup> regarding statutory audit of public-interest entities. Audits of public-interest entities enhance the degree of confidence of the public in their financial statements and a broad community of stakeholders and institutions rely on the quality of the statutory auditor's work.
- Additional governance, reporting, disclosure and transparency requirements apply to PIEs. For example, PIEs (and in some cases large companies) are required to disclose fees charged by the external auditor; PIEs (and in some cases large companies) in the extractive industry or lodging of primary forests must prepare and report on payments made to governments on an annual basis; and listed PIEs must prepare a Corporate Governance Statement as part of the Management Report. A clear definition for their identification is important for both preparers and regulators so as to avoid ambiguity regarding the requirements that need to be met.

#### **Box 2: Overview of the definition of PIEs across European Countries**

The designation of entities for their public relevance is not uniform within Europe and different entities fall under the scope of the definition of public interest entities in different European countries.

The Federation of European Accountants – FEE (recently rebranded as Accountancy Europe from 1 January 2017) released results from a survey in October 2014, *Definition*

<sup>5</sup> A comprehensive list of requirements for public-interest entities is provided under Section 3.2. Special considerations for PIEs.

<sup>6</sup> The more demanding requirements for statutory auditors and audit firms prescribed by the EU Audit Regulation include the following: auditors of PIEs are overseen directly by competent authorities, there is a cap on fee from other services, mandatory auditor rotations, more extensive list of prohibited services and etc.

*of Public Interest Entities in Europe*, that provides an overview of different PIE definitions adopted all over Europe. According to the findings of the survey, some countries have implemented the minimum requirements (e.g. Austria, Belgium, Germany, Hungary, Ireland, Norway), but others, implicitly or explicitly, have included a number of other entities to their applicable PIE definition, such as investment companies, large non-listed companies according to size criteria, state-owned companies, pension funds, and others (e.g. Poland, Portugal, Romania, Slovakia, Italy, Croatia and etc.).

Although this report is a very good source of information, it should be used with care as many countries revised significantly the definition in the meantime while transposing the latest changes to the statutory audit directive and also due to the adoption of the EU Audit Regulation which is directly applicable to the member states.

### **3.1. Clarifying the PIE Definition**

According to the current legislation there is a risk that the definition of PIEs captures some entities which are not economically significant and therefore have less public interest and on the other hand does not include some entities which might be of economic significance to the country and therefore of public interest. The PIE definition as worded in national legislation (i.e. the Law on Auditing) designates as PIEs: (i) listed companies and other companies regulated by the Macedonian Securities and Exchange Commission (MSEC), and (ii) trade companies<sup>7</sup> for which statutory audit is required in "special" laws under the same rules for listed entities. There is no further reference or clarification that explains what "special" laws should be considered in order to identify the PIEs and there is room for different interpretations in practice by statutory auditors and entities concerned if they meet the PIE definition or not.

Another important consideration is that not all companies subject to statutory audit are of such public interest to require designation as PIEs and additional responsibilities apply in the EU for auditors of PIEs. Such responsibilities could be unnecessarily burdensome, expensive and market restrictive if applied to large pool of audited entities. For example, within the scope of the current definition of PIEs are financial and leasing companies. However, the nature of business of these companies does not include accepting deposits from the general

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<sup>7</sup> The Trade Company Law sets out the main company law requirement. 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.

public, nor is their size in the national economy of such significance to warrant designation as PIEs.

| Description  | Number | Source of data  | PIE Definition   | Compatible with Directive                         |
|--|--------|---|--|---|
| Listed entities  | 109    | Macedonian Stock Exchange (MSE) web page, February 2017   | Explicitly stated in the Audit Law   | Fully compatible                                  |
| Companies with special reporting obligations regulated by MSEC rules | 13     | Macedonia Security Exchange Commission (MSEC) web page, February 2017                           | Explicitly stated in the Audit Law   | Fully compatible                                  |
| Banks and saving houses  | 6      | National bank web page, February 2017*  | Other companies subject to statutory audit by “special law” - Law on Banks                       | Fully compatible                                  |
| Insurance Companies  | 13     | Agency for Supervision web register, February 2017*   | Other companies subject to statutory audit by “special law” – Law on Insurance Supervision.      | Fully compatible                                  |
| Companies managing pension funds                                     | 2      | Agency for Supervision of Fully Funded Pension Insurance (MAPAS) Agency web page, February 2017 | Other companies subject to statutory audit by “special law” – Law on Mandatory Pension Insurance | Compatible considering the nature of the business |
| Companies managing investment funds                                  | 5      | MSEC web page, February 2017  | Other companies subject to statutory audit by “special law” – Law on Securities                  | Compatible considering the nature of the business |
| Financial Companies (retail  | 15     | MoF web register, 23.12.2016  | Other companies subject to statutory audit by “special   | Not fully compatible, due to small size and       |

| Description              | Number     | Source of data              | PIE Definition   | Compatible with Directive   |
|--------------------------|------------|-----------------------------|--|---|
| lending, factoring etc.) |            |                             | law” – Law on Financial Companies  | limited economic significance   |
| Leasing Companies        | 7          | MoF web register, 23.1.2017 | Other companies subject to statutory audit by “special law” – Law on Leasing Companies | Not fully compatible, due to small size and limited economic significance |
| <b>Total:</b>            | <b>170</b> |                             |  |   |

\* Excluding listed entities already counted in category “Listed entities” from the MSE source.

Illustrative examples of selected EU Members States and their PIEs definitions is further provided in Box 3.

### **Box 3: Selected Illustrative Examples PIE Definitions in selected EU Member States**

**Croatia** has defined strict rules and designated a list of entities considered as PIEs, within the new Law on Accounting effective from July 2015. The list includes the minimum EU requirements for the essential three categories of entities (i.e. listed companies, credit institutions and insurance undertakings), but also the scope of the definition has been broadened to include all large companies, leasing companies, electronic money institutions, companies managing investment funds and pension funds, state owned banks and other companies designated further by Decision of the Government as companies of significant public relevance, because of the nature of their business, their size or the number of their employees.

**Bulgaria** is another EU member state that has opted to include a broader scope of PIEs and according to the Independent Financial Audit Act, the following entities are designated as PIEs:

- Listed entities and securities issuers in the country, as well as in another European Union country, and the European Economic Area;
- Credit institutions;
- Insurance companies, reinsurance companies, health insurance companies and pension insurance companies;

- Commercial entities which generate, transmit and sell electricity and heating energy;
- Commercial entities which import, transmit, distribute and transit gas;
- Commercial entities which provide water, sewage and telecommunication services; and
- Bulgarian State Railways EAD and its subsidiaries.

**Slovakia** is an example of EU member state that uses the size criterion to designate very large companies as PIEs<sup>8</sup>. The following are considered as PIEs in this country:

- Listed entities;
- National Bank of Slovakia, banks, branches of a foreign banks and Export-Import Bank of the Slovak Republic;
- Insurance companies, branches of foreign insurance companies, reinsurance companies and branches of foreign reinsurance companies;
- Health insurance companies;
- Asset management companies and branches of a foreign asset management companies;
- Pension management companies and supplementary pension insurance companies;
- Stock exchanges and the Central Securities Depository of the Slovak Republic;
- Railways of the Slovak Republic;
- Commercial companies meeting two of the following criteria: €170 million net turnover, €170 million gross assets or 2,000 employees;
- Entities that prepare consolidated financial statements; and
- Security trading companies and branches of foreign securities trading companies if they decide to prepare financial statements in accordance with IFRS as adopted by the EU.

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<sup>8</sup> According to a EY Guide on EU Audit Legislation from October 2014.  
[http://www.ey.com/Publication/vwLUAssets/EY\\_\\_EU\\_audit\\_legislation\\_Understanding\\_the\\_legislation\\_and\\_how\\_it\\_will\\_affect\\_you/\\$FILE/EY-EU-audit-legislation-public-interest-entities.pdf](http://www.ey.com/Publication/vwLUAssets/EY__EU_audit_legislation_Understanding_the_legislation_and_how_it_will_affect_you/$FILE/EY-EU-audit-legislation-public-interest-entities.pdf)

### 3.2. Special Considerations for PIEs

As summarized in the table below, there are several important considerations for PIE reporting, disclosure, transparency and audits that need yet to be implemented in national legislation:

| Requirement  | Description  |
|--|--|
| <b>PIE auditors are overseen directly by competent authorities</b> | The EU Audit Regulation No. 537/2014 prohibits certain activities to be delegated by the competent authorities (oversight bodies) to the profession, among which are the quality assurance review system for PIE audits and the system of sanctions (both for PIE auditors and PIE audits). If PIEs are defined too broadly, public oversight bodies may be overburdened and unable to focus their resources on the highest risks.   |
| <b>Corporate Governance Statement</b>                              | Entities whose transferable securities are admitted for trading on a regulated market in EU should prepare a Corporate Governance Statement as part of the Management Report. Currently only banks are obliged to incorporate a Corporate Governance Statement within the annual report. The obligation should be introduced through the Law on Securities for all entities whose securities are traded on the MSE.  |
| <b>Public report on payments made to governments</b>               | The Accounting Directive 2013/34/EU introduces new requirements in Article 42 for large entities and all public interest entities active in the extractive industry or lodging of primary forests to prepare and make public a report on payments made to governments on annual basis. The requirement should be transposed into accounting legislation in the country.  |
| <b>Cap on fees for other services</b>                              | Article 4 of the EU Audit Regulation No. 537/2014 provides limits for audit and other fees received by statutory auditors or audit firms from PIEs as a measure to safeguard against independence threats. Also, the article requires auditors to report to the audit committee regarding fees from other services. The caps on audit fees for PIE's auditors' needs to be introduced in the Law on Auditing as well as the reporting requirement on fees from other services to the audit committees. |
| <b>Prohibited non-audit services for PIE auditors</b>              | According to the Audit Law, all statutory auditors in relation to any client are forbidden to provide services related to accounting, design or implementation of accounting information systems, internal audit, and valuation for financial reporting purposes. Separate restrictions for auditors of PIE's do not apply. The Audit Law should be further aligned  |

| Requirement                                     | Description   |
|---|---|
|   | <p>with article 5 of the Regulation No. 537/2014 and the following non-audit services prohibited to be offered alongside audit services:</p> <ul style="list-style-type: none"> <li>• Services that involve management or decision-making role,</li> <li>• General valuation services or litigation support,</li> <li>• Legal counselling, negotiating on behalf, or advocating in resolution of litigation,</li> <li>• Specific human resource services related to recruiting key accounting staff, structuring organisation, design and cost control.</li> </ul>  |
| <p><b>Additional reporting requirements</b></p> | <p>According to Article 12 of the Regulation No. 537/2014 the statutory auditor of PIE has a duty to promptly report to the supervisory authorities of the PIE when there is material breach of the laws and by-laws, a threat concerning continuous functioning of the PIE or refusal to publish an audit report. These requirements have been transposed for Banks and Insurance companies through respective industry laws, however, the requirements are not yet imposed for other PIE's, such as listed entities reporting to MSEC.</p> <p>Requirements of Article 11 of the Regulation No. 537/2014 regarding the detailed contents of the report for the audit committee need to be introduced in the Audit Law, including disclosure of materiality used, name of the audit partner, methodology applied, judgments in respect of going concern, significant deficiencies in internal controls, significant matters involving non-compliance with laws and etc.</p> <p>According to Article 14 of the Regulation No. 537/2014 statutory auditors of PIE's should provide to the competent authorities (CAOA) annually a list of audited PIE's by generated revenue, separating revenues from different services. These requirements should be transposed through the Law on Auditing.</p> |
| <p><b>Mandatory auditor rotation</b></p>        | <p>Article 17 of the Regulation No. 537/2014 determines that after 10 years the statutory auditor or audit firm of a PIE needs to be rotated with a cool-off period of 4 years. The current Law on Auditing transposes the maximum duration period of 7 years of being responsible for an audit of a PIE. Further revisions of the Law on Audit may focus on harmonizing the mandatory auditor requirements with the EU Regulation.</p>   |

### 3.3. Key Recommendations

The following key recommendations are proposed in respect of improvements to the definition and special considerations for PIEs:

- Clearly state in the PIE definition that listed companies, commercial banks (being credit institutions according to EU definition) and insurance undertakings are PIEs;
- Remove the reference in the Company Law for which statutory audit is required in "special" laws under the same rules for listed entities because of two main reasons: (i) this formulation does not allow PIEs to be easily identified and (ii) not all entities subject to statutory audit must be PIEs. For example, small financial and leasing companies are presently being considered as PIEs, although in essence they do not represent a credit institution acting as financial intermediary that collects deposits from the general public and provides credit to others;
- Further considerations are required to determine whether to extend the definition of PIEs to other companies of significant public relevance, because of the nature of their business, their size or the number of their employees. For example, at present from the top 50 largest companies in the country, only 10 are considered as PIE's according to the current definition<sup>9</sup>. Also, there may be a need to consider if the PIE definition should be broadened to include major and economically significant State-Owned Companies (SOEs) (e.g. water supply, production and whole sale electricity, railways and other economically significant SOEs who according to OECD guidelines should have the same financial reporting and auditing requirements as listed companies);
- The Law on Audit should be amended in order to prescribe the more demanding requirements for statutory auditors of PIEs and public oversight over statutory auditors as required by the *acquis communautaire*, including requirements regarding quality assurance systems that need to be independent from the audit profession, mandatory audit firm rotation of auditors of PIEs, restrictions on non-audit services to audited PIEs and caps on fees for such services to safeguard auditor independence. Also, legislative amendments should introduce the requirement for the preparation of Corporate Governance Statement as part of the Management report for all Securities that are traded on the Macedonian Security Exchange.

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<sup>9</sup> "200 largest companies in Macedonia –" <http://club200.com.mk/analyzes/>

## **4. REDUCING REGULATORY BURDENS RELATED TO FINANCIAL REPORTING AND AUDITING FOR MICRO AND SMALL AND MEDIUM SIZED ENTERPRISES (SMEs)**

There are several areas that should be considered by the Government in future legislation reforms to ease the administrative burden and compliance cost for micro enterprises and Small and Medium Enterprises (SMEs) companies, including:

- Harmonizing the classification thresholds for entities with the EU size criteria and statutory audit requirements, as well as further simplifying accounting requirements for micro enterprises and SMEs; and
- Reducing the regulatory burden for Accountants in Business.

### **4.1. Simplification of Requirements for Micro Enterprises and SMEs**

Macedonian micro enterprises and SME companies face greater financial reporting and audit requirements compared to their European peers. For example, because the classification of companies into micro, small, medium and large in the country are not harmonized with the EU requirements<sup>10</sup>, much smaller companies than their EU peers may be subject to statutory audit requirement or they are subject to stricter financial reporting requirements.

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

<sup>10</sup> The EU Accounting Directive requires two of the three criteria (number of employees, total income and average total assets) to be exceeded for at least two consecutive years.

<sup>11</sup> 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.

The present statutory audit requirement in the country extends to all medium and large companies classified with the thresholds provided in the previous table that are much lower than the EU requirements. According to the EU Accounting Directive, small companies (including micro entities as defined in the EU thresholds) are not required to undergo audit, but member states can require (or continue to require) a financial statement audit from them if the audit should be appropriate for the conditions and needs of these companies and the users of their accounts.

Further, at present, all companies in the country, including micro enterprises are required to follow the same rules in preparation of their annual accounts comprising of the balance sheet, income statement and disclosures in the form and content prescribed in the Ministry of Finance-issued Rulebook. IFRS for SMEs is the applicable financial reporting framework for micro, small and medium sized companies; however, this standard is still considered too complex for micro enterprises and in the case of small entities it is not compatible because the EU Audit Directive limits the number of disclosures that member states can impose on small entities. The Accounting Directive mandates simplified financial reporting requirements for small entities (for example by limiting the number of disclosures required) and allow micro-entities to prepare abridged balance sheet and income statements, without the requirement to prepare notes or disclose same amount of information in the notes as other entities.

#### **Box 4: Selected Illustrative Examples Simplified Reporting Regimes in Neighboring Countries**

**Serbia**, an EU candidate country, opted to simplify the financial reporting regime by adopting size thresholds for companies' classification closer to EU thresholds and requesting full IFRS reporting only for a limited number of large or public interest entities. For example, companies with annual turnover of less than 35 million EUR and total assets of 17.5 million EUR are considered medium size companies (considerably higher than the respective 10 million EUR for turnover and 11 million EUR for total assets applicable in Macedonia).

In Serbia, only large companies, group companies for consolidation purposes and listed companies are obliged to prepare financial statements in accordance with full IFRS. Small and medium size companies follow IFRS for SMEs or medium size companies can opt for full IFRS. Micro entities are obliged to report with balance sheet and income statements in accordance with abridged general accounting principles enacted by the Ministry of Finance. Also, micro companies can opt to apply IFRS for SMEs.

**Montenegro**, also an EU candidate country, has fully adopted EU thresholds for classification of companies. All large and medium companies, issuers of securities

traded on organised markets, and group companies prepare full IFRS for single entity and consolidated financial statements. Micro and small companies are allowed to prepare abridged statements, including only a balance sheet, income statement and statistical annex for the public revenue office.

## **4.2. Reducing Regulatory Burden for Accountants in Business**

During 2012, a new Law on Performance of Accounting Services was enacted imposing equal requirements for all accountants, no matter if they are engaged in public practice or in business. These requirements include:

- Professional certification requirement and obligation to adhere to professional standards of ethics and Continuous Professional Development (CPD);
- Mandatory membership in a professional organization of accountants – Institute of Accountants and Certified Accountants - IACA (i.e. meet membership fees and other membership obligations); and
- All accountants and accounting firms should regularly acquire and pay for professional indemnity insurance.

Such regulatory requirements could have disproportionate financial impact for a significant number of accounting technicians employed as administrative staff or engaged by small firms for provision of basic bookkeeping and accounting services. Furthermore, the access to the profession for technically educated high school or university graduates could be unnecessarily prolonged and employability of youth decreased by the requirement to hold a professional certificate for roles involving maintaining basic bookkeeping activities.

This approach of regulating the whole accounting profession with equal requirements, is not a preferred approach taken by EU member states. Clearly there are countries in Europe that require certification through examination (Germany, Austria, Belgium, France, Netherlands and etc.) in order to practice as an accountant. This commonly refers only to accountants in public practice engaged in issuing financial statements or providing accounting and tax consulting services. But there are also countries that regulate only part of the profession, mostly the public practice in statutory audit (Denmark, Finland, Bulgaria, Croatia etc.)<sup>12</sup> and, therefore, do not subject all accountants to similar requirements.

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<sup>12</sup> FEE Survey on 'Structure and Organization of the Accountancy Profession across 30 European countries'

In Norway, there is a requirement for “external accountants” and “external accounting firms” to be authorized by the Financial Supervisory Authority of Norway.<sup>13</sup> The term external means that the person responsible for preparation of financial statements of the company is not an employee of the company. External accounting firms in Norway should have an authorized external accountant as Chief Executive Officer, and only accountants that choose to be authorized as external accountants need to complete university education with concentration in accounting, complete relevant professional experience of at least two years and adhere to the requirements for continuing professional education.

One possible solution is that the Law on Performance of Accounting Services be revised to follow the Norwegian model, whereby only firms or proprietors that choose to register a business that will provide external accounting and bookkeeping services to other businesses will need to register with IACA and comply with the requirements for professional certification of partners, CPD, and etc.

### **4.3. Key Recommendations**

The following key recommendations are proposed in respect of reducing the regulatory burdens related to financial reporting and auditing for micro entities and SMEs:

- The present requirements pertaining to the classification of micro, small, medium and large entities should be revisited and ideally harmonized with the size criteria of the EU Accounting Directive.
- Further, additional measures to reduce the regulatory burden for smaller companies should be considered, including possible revisions to the audit thresholds and simplification of the financial reporting requirements for small companies by limiting the disclosures required.
- The current requirements of the Law on Performance of Accounting Services need to be revised in order to reduce the regulatory burden for accountants employed in business. One possible approach is to require only firms or proprietors that provide external accounting and bookkeeping services to be registered with the accountancy body and complete relevant professional education.

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<https://www.accountancyeurope.eu/publications/fee-survey-on-structure-and-organisation-of-the-accountancy-profession-across-30-european-countries/>

<sup>13</sup> See details on Altinn web portal for information dialogue, developed by several government agencies in Norway. <https://www.altinn.no/en/Start-and-Run-a-Business/Start-up-and-registration/Accountant-and-auditor/Do-you-need-to-have-an-accountant/>

## 5. PUBLIC OVERSIGHT AND QUALITY ASSURANCE

### 5.1. Capacity and Resources for Audit Oversight

The Council for Advancement and Oversight of the Audit (CAOA), as the body with delegated responsibility for Public Oversight in the country, will need to undertake additional responsibilities in light of the requirements of the new Audit Directive and Regulation, which clarify that delegation of many tasks, including the Quality Assurance for statutory auditors of PIEs, cannot anymore be delegated to the profession.

However, even now the CAO A is struggling to secure sufficient funds to finance its operations and gain technical expertise to effectively fulfill its legal responsibilities. Approximately 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. The CAO A Council members do not contribute financially to the budget. These members include representatives from industry and other regulatory bodies (e.g. the MSEC, the Central Bank and the Insurance Supervision Agency).

There is an urgent need to revisit the funding and expenditures of CAO A, through changes in the Law on Audit, particularly considering the technical staffing and training needs required to (i) establish capacity for quality assurance for direct inspection of PIE statutory auditors as well as (ii) to oversee the activities of ICARM.

#### **Box 5: Selected Illustrative Examples Public Oversight Funding Practices**

Based on research performed by a team of CFRR staff and consultants' findings from a study of Public Oversight Systems of 19 European examples, include:

- 8 were funded entirely or almost entirely from regulated entities, mostly by auditors (Finland, France, Germany, Luxemburg, Netherlands, Spain, Sweden, UK); in addition, Ireland, Italy and Malta obtain some or all of their funding from auditors;
- 7 countries were funded only by state funding (Bulgaria, Croatia, Czech, Estonia, Lithuania, Slovenia, Russia), and
- 4 have had a mix of some state funding and some funding from regulated entities (Hungary, Poland, Romania, Slovakia).

Below are few selected funding models which are provided for illustration purpose only:

**Romania:** The Council for the Public Interest Oversight of the Accountancy Profession is funded through the government budget to approximately 40% and the rest through contributions from the CAFR (the Chamber of Financial Auditors) and the CECCAR (the Body of Expert and Licensed Accountants).

**Slovakia:** The Auditing Oversight Authority is financed through: (i) contributions from public interest entities (PIEs); (ii) contribution from the state budget; (iii) revenue from fines; (iv) compensation of costs of a procedure; (v) fees for auditor's examinations; and (vi) fees for acts performed by the Office.

**Portugal:** The National Audit Oversight Board is financed by the following sources:

- Funding by the institutions that are represented on the Board. These institutions are also obliged to provide technical and administrative support as required by the Board;
- Fines and the recovery of legal costs associated with disciplinary cases; and
- Government funding, which is determined by the Minister of Finance following a proposal by the Board.

## 5.2. Estimating the Costs for the Quality Assurance System

The costs of the Quality Assurance System should be carefully considered before selecting an "ideal" model. These costs are mainly operational and are correlated with the following:

- Number of Professional Accountancy Organization (PAOs) involved in the Quality Assurance system;
- Number of audit firms to be visited;
- Number of estimated engagements to be reviewed / days to carry out each visit;
- The visit cycle;
- Number of Quality Assurance and support staff;
- Employment costs (including training, communications, etc.)

Costs increase with the increase of the number of PAOs and audit firms involved, with the length of each visit and the number of staff employed in the Quality Assurance process. Shorter visit cycles are more expensive relative to longer ones as firms will be visited in shorter periods with more frequent Quality Assurance inspections.

A draft computation of the cost for the Quality Assurance Function in Macedonia based on a methodology proposed by a Good Practice Guide on Quality Assurance for Audit issued by the Confederation for Asian and Pacific Accountants (CAPA)<sup>14</sup> and under assumption that the CAO A will perform the Quality Reviews of the PIE audit firms and delegate the Quality Assurance reviews of non-PIE audit firms is illustrated in the steps below:

### **Step 1: Calculate how many Quality Assurance (QA) inspection visit days to auditors required per year**

The number of days needed to carry out an inspection will depend both on the size of the audit firm and the number and type of audit clients it has. A sole practitioner with one office and no PIE audits would typically take 2 days on-site plus 1 day off-site (planning and completion time). Each additional partner will typically add 1 day and each additional office will also add 1 day. Inspections of large auditors of PIE entities will typically take 7 days (5 on-site and 2 off-site). Inspections of the large international audit firms will typically take 14 days (10 on-site and 4 off-site).

Actual timings used will depend on getting information on the size and nature of audit firms in each country. Further, international good practice suggests an inspection of each auditor that audits PIEs once every three years and all other auditors every six years. Once this information has been gathered a grid should be constructed showing how much reviewer resource is needed.

In the case of CAO A, and assuming that there are no more than 15 audit firms of PIEs in Macedonia, an illustration of the number of Quality Assurance Inspection visits is provided below:

| # QA reviews of PIE audit firms                   | Days      |
|---|-----------|
| No. of PIEs audit firms                           | 15        |
| No. of inspection days per PIE audit firms        | 10        |
| PIE audit firm QA review cycle (years)            | 3         |
| Subtotal PIE QA inspection days <sup>15</sup>     | 50        |
| Contribute to QA annual report                    | 10        |
| <b>Total days - QA reviews of PIE audit firms</b> | <b>60</b> |

<sup>14</sup> Quality Assurance for Audit – A Good-Practice Guide, CAPA; See: [http://www.capa.com.my/wp-content/uploads/2017/11/CAPA\\_MM\\_Guidance\\_QAauditGPG\\_2017\\_FINAL.pdf](http://www.capa.com.my/wp-content/uploads/2017/11/CAPA_MM_Guidance_QAauditGPG_2017_FINAL.pdf)

<sup>15</sup> Number of visit days = [(Number of PIE auditors x inspection days) / QA review cycle.

| # QA reviews of PAOs                   | Days      |
|--|-----------|
| No. of PAOs                            | 1         |
| No. of QA days per PAO                 | 20        |
| PAO QA review cycle (years)            | 1         |
| No. of PAO QA inspection days          | 20        |
| Contribute to QA annual report         | 10        |
| <b>Total days - QA reviews of PAOs</b> | <b>30</b> |

| # CPD and Other QA activities                   | Days      |
|---|-----------|
| Revision of QA methodology                      | 20        |
| EU and CEAOB coordination                       | 20        |
| IFIAR coordination                              | 20        |
| Training + CPD                                  | 10        |
| <b>Total days required for other activities</b> | <b>70</b> |

|                                    |            |
|------------------------------------|------------|
| <b>Total Days for PIE auditors</b> | <b>150</b> |
|------------------------------------|------------|

## Step 2 – Calculate the number of reviewers needed

Once the total days are estimates, then the number of reviewers required can be derived. A typical assumption would be between 150–200 days to allow for administration, training, holiday, sickness, etc. In the example for CAO A one full-time equivalent (FTE) reviewer is sufficient (two reviewers working 50% part-time is equivalent to one FTE reviewer). In such cases, international good practice would suggest having at least two part-time reviewers so that when one leaves there is some continuity.

## Step 3 – Calculate the Costs of the Reviewers and Other Costs

International good practice suggests that reviewers need to be of sufficiently high calibre and probably have worked at least at senior manager level with an international firm (or equivalent) and have gained experience across different sectors of industry. In the case of CAO A the salary costs and other reviewer costs such as estimated travel, phone and computer equipment, subsistence expenses, and other expenditures necessary for international representation have been estimated between EUR 45,000 - 50,000.

### 5.3. Developing the Quality Assurance System

There are a variety of different Quality Assurance models worldwide and the selection of a particular model will have a direct influence on the costs of the Quality Assurance Function. The Box below discusses some of the available models, including their key characteristics.

#### Box 6: Overview of Quality Assurance Models

**Peer review.** In a peer review model, the Quality Assurance is carried out by another audit firm. When the peer review model operates within a Professional Accountancy Organization (PAO) framework for oversight, then there are prequalified firms who are allowed to carry out the peer review as well as investigation and discipline processes involved when inadequate performance is identified.

**Inspection Unit with own employees.** Having a dedicated department with own employees performing Quality Assurance with appropriate professional expertise can lead to consistent reviews and outcomes as the same individuals are involved in repeated Quality Assurance inspections.

**Inspection Unit with subcontracted independent reviewers.** Because subcontractors will only need to be engaged for the timing of the actual inspection visits, this option can have potential advantages in smaller markets as full-time employment costs would not be incurred, therefore resulting in less expensive Quality Assurance models. Additionally, this option allows for bringing in external expertise that would otherwise not be available (for example specific expertise in case of specialized industries such as banking, insurance, etc.) and in certain cases, an independent perspective, should the subcontractors from another country be engaged.

**Shared Quality Assurance by Oversight Body and PAO.** This model assumes that a portion of the Quality Assurance function is delegated to the PAO. For example, the inspections of non-PIE auditors may be delegated to the profession, while the oversight body retains performance of Quality Assurance Reviews for PIEs.

**Fully external regulation when Oversight Body does all inspections.** In these circumstances a regulatory body performs all Quality Assurance inspections. This solution is likely to be expensive due to likely overlap and duplication of work between the regulatory body and the profession.

The involvement of the CAO in the present Quality Assurance system is limited due to the technical and financial shortcomings discussed previously. At present, the Quality Assurance system is operated by the Professional Body of Auditors – ICARM, whereby two qualified and

trained quality assurance reviewers perform inspections on a full-time basis following a well-developed risk based methodology. The quality assurance reviewers report to the Quality Control Committee of ICARM and any follow-up sanctions initiated as a result of quality reviews is processed by the CAO through a referral initiated by ICARM Management Board. One representative from CAO Managing Council takes part in the Quality Control Committee meetings, but this representative has no voting rights or any decision-making authority. Further, the information exchange between CAO and the Quality Control Committee of ICARM has not been ideal as only high-level findings and information has been communicated on performed quality reviews on an anonymous basis<sup>16</sup>.

The new Audit Directive and Regulation introduced a significant change in respect of Quality Assurance for PIEs and which requires that the system be organised in such manner that it is independent of the profession. The requirements also stipulate that the Public Oversight System and the Competent Authority be governed by non-practitioners<sup>17</sup> selected through independent and transparent nomination procedures.

As highlighted previously, the CAO needs to resolve many capacity issues, before it will be in a position to perform quality assurance reviews for PIEs. It is therefore understandable that in the medium-term period, until capacity is built in CAO, a purely independent system from the profession is not possible or desirable.

Further, the requirements of the EU Audit Regulation permit that part of the system be organized through delegation to the profession (e.g. the quality assurance over non-PIEs auditors).

In this context, some aspects of the recently amended Audit Law should be reconsidered, particularly the use of a pool of Quality Assurance inspectors which is to be established by 2017 and composed of practicing auditors. This requirement directly conflicts with the Audit Regulation and is not favorable for the reason that sufficient capacity is already in place in ICARM with two trained and skilled full-time quality assurance reviewers who are charged with performing Quality Assurance reviews. Introducing a pool of quality assurance reviewers would transform the present system into a peer review approach which, considering the already established capacity, would not be an effective solution. Further, the present Quality Assurance system has been developed with the significant assistance of the international

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<sup>16</sup> Article 4 of the Audit Law on the Procedures for cooperation and exchange of information with ICARM, require exchange of full information from the performed quality controls.

<sup>17</sup> In the context of the EU Directive and Regulation, a “non-practitioner” is a person who is knowledgeable in the area of statutory audit but has also a certain degree of independence from the profession (e.g. during the period of three years immediately preceding their involvement in the Public Oversight has not carried out statutory audits, has not held voting rights in an audit firm, or has not been a member of the administrative, management or supervisory body of an audit firm and has not been employed by, or otherwise associated with, an audit firm).

professional and donor community and any capacity developed should, therefore, be preserved.

A more effective solution would be to utilize the capacity already established in ICARM and build on these available resources and competencies. For example, in the inception period the CAO technical staff should familiarize themselves with ICARM inspection methodologies and join ICARM quality assurance review teams (i.e. shadow ICARM inspectors) during field inspections. This would provide them with valuable developmental opportunities and a means to exchange knowledge and experience. CAO would need to have sufficient funding in order to attract and retain qualified professionals who have sound professional audit experience to enable effective quality assurance over PIE audits and auditors. Further, CAO should continue its efforts to establish cooperation with public oversight bodies in the region, and focus on EU member countries to mentor CAO professionals, exchange working methodologies and experiences. Only when sufficient and appropriate capacity is established within CAO, should a fully independent system from the profession be considered as a viable solution.

#### **5.4. Monitoring Audit Quality**

The ROSC A&A update highlighted some concerns regarding the overall quality of audits in the country. Namely, the implementation of International Standards on Auditing (ISA) is a challenge especially for local small and medium size practices (SMPs) and few SMP auditors have audit methodologies fully in compliance with ISA requirements. Auditors also face difficulties in applying the international quality control standard (ISQC1). According to the findings of ICARM's Quality Control Committee many audit firms do not have documented and consistent audit methodologies and procedures, lack internal policies and procedures for quality control and lack appropriate training for audit personnel including documentation for staff professional development and training activities.

During the ROSC A&A due diligence mission, all of the interviewed statutory auditors highlighted the negative trends and major challenges imposed on audit quality by the declining audit market and fees connected with selection of auditors when costs are the only deciding criteria and the declining audit fees for State Owned Enterprises (SOEs) which according to the Law on Procurement are subject to e-auctions. When it comes to e-auctions, although price is not the sole deciding criteria in these selections, and often other criteria need to be met, such as eligibility criteria (e.g. having a valid audit license), quality (experience in similar industry, not having measures imposed by Oversight Body or Professional Association), in practice the auditors offering the lowest fees—regardless of their quality, capacity, and experience—seem to be selected as a matter of course. The practice in the past few years has shown that the initial offered price for audit services has dropped significantly

in the process of e-auctions, in most cases by half or two thirds. In some cases, the e-auction final price was five times lower than the initial offered price. The situation leads to very low audit fees which have severely impacted the quality of the audits of SOEs. In many instances these SOEs are very sizable companies and are very significant for the economy. For example, based on data for e-auctions for 2013, the State Electricity Generation company, with huge infrastructure and asset base, was audited for approximately 10 Euros per audit hour. This SOE is highly leveraged with foreign institutions and these are collateralized by Government guarantees. There are many other examples where risk is present.

In addition to the requirements for independent Quality Assurance System over statutory auditors of PIEs and appropriate audit selections, the quality of the audit could be further improved through the work of audit committees. The MoF should ensure in future amendments of the Audit Law that: i) audit committees are requirement for all PIEs; ii) the national law transposes the requirements of EU Audit Directive No 2014/56/EU and EU Audit Regulation No 537/2014 for composition of audit committees, their duties and reporting obligations of statutory auditors of PIEs towards audit committees. The EU Regulation No 537/2014 emphasizes the role of audit committees in the process of selection of statutory auditors or audit firm and in monitoring audit reporting including additional reporting requirements in respect of the audit engagement. In order to dispose effectively such obligations, audit committees should consist of individuals with appropriate competencies. Appropriate training and development system should be established for audit committee members, preferably by the competent authority (CAOA) who is required to monitor performance of audit committees as required by Article 2 of the Regulation. The approach taken in the establishment of the training and development system for audit committee members should adhere to cost-benefit requirements, i.e. the administrative burden should not outweigh the benefits of qualifying interested individuals.

## **5.5. Key Recommendations**

The following key recommendations are proposed in respect of Public Oversight and Quality Assurance:

- In light of transposing the requirements of the new Audit Directive and Regulation, which clarify that delegation of many tasks, including quality assurance for statutory auditors of PIEs, cannot anymore be delegated to the profession, the Council for Advancement and Oversight of the Audit (CAOA) will need to start preparing to undertake additional responsibilities in the future. In this respect, there is an urgent need to revisit the funding and expenditures of CAOA, through changes in the Law on Audit, particularly considering the technical staffing and training needs required to (i) establish capacity for quality assurance for direct inspection of PIE statutory auditors

as well as (ii) to oversee the activities of the Institute of Chartered Auditors of Republic of Macedonia (ICARM).

- The recently amended requirement of the Audit Law pertaining to the use of a pool of quality inspectors (i.e. peer review system), is a step back relative to the present Quality Assurance system whereby two trained, skilled, full-time employees of ICARM perform Quality Assurance reviews over PIE and non-PIE auditors. Considering that ICARM has already developed internal capacity for Quality Assurance, a peer review system is not considered an optimal and effective solution and such requirement should be urgently reconsidered.
- Until capacity is developed with CAO A a purely independent system for Quality Assurance over PIE auditors from the profession is not possible or desirable. In the inception period the CAO A technical staff should familiarize themselves with ICARM inspection methodologies and join ICARM quality assurance review teams (i.e. shadow ICARM inspectors) during field inspections. This would provide them with valuable developmental opportunities and a means to exchange knowledge and experience. CAO A would need to have sufficient funding in order to attract and retain qualified professionals who have sound professional audit experience to enable effective quality assurance over PIE audits and auditors.
- There is a need to move away from audit selections that focus predominately on cost during selections as such selections may have a negative impact on audit quality. A number of measures should be taken including: (i) abolishing e-auctions for audits and establishing appropriate criteria (the right amount and the right criteria) to measure and evaluate the auditors selection; (ii) raising the capacity of regulators who oversee the external auditors needs to be at adequate level to perform effective monitoring of audit quality that is linked to the audit licensing processes; (iii) having in place audit rotations that are sensible and restricted to a reasonable time interval; (iv) increasing the capacity of selecting committees, and targeted capacity building for Audit Committees charged with audit sections; (v) raising awareness among Government of the problem and its negative effects to SOE transparency including present risks for government; and other important considerations.

## **6. PROFESSIONAL ACCOUNTANCY EDUCATION AND TRAINING**

### **6.1. Consolidating the Accounting and Auditing Profession to Achieve Economies of Scale**

In July 2012, the Parliament passed the Law on Performing Accounting Services, anticipating the establishment of the Institute of Accountants and Certified Accountants (IACA). Two new professional accounting certifications are foreseen by the Law: “Accountant” and “Certified Accountant” and these will be mandatory for all accountants employed in business or in public practice providing professional accounting services other than audit and assurance.

Both IACA and ICARM could benefit from implementing a coordinated and synergized professional accountancy education program that would lead to many benefits for their members, including: avoiding duplicating efforts in development and update of examination resources, developing common competency framework and tailored curricula with scaled progressions of learning outcomes and proficiencies, with the more advanced learning outcomes introduced during later stages of the professional education programs thus making it possible for candidates to build their competence to meet various roles.

Considering that the professional examination program for auditors has been established and administered by ICARM in accordance with the International Education Standards (IES) since 2009, the newly established IACA should coordinate efforts with ICARM in this area. ICARM should also help the establishment of a Continuing Professional Development (CPD) program for accountants, and share valuable technical knowledge and expertise in International Financial Reporting Standards (IFRS) application. CPD programs of both bodies should be highly compatible and target almost same areas of competence, therefore joint CPD events and training activities should be planned. Further, both bodies of professional accountants should closely connect by building a long-term alliance that supports the development of accounting professionals and the quality of professional services offered in the country.

According to the Law on Auditing, the CAO is the competent authority that oversees educational activities of ICARM. The CAO President is part of ICARM’s Examination Committee, in addition the professional certification and CPD programs are subject of supervision and formal approval by CAO. Although representatives of the MoF are part of IACA Examination Committee, IACA activities in development of certification and CPD programs are not appropriately supervised. Subsequent amendments of the Law on Performance of Accounting Services should designate appropriate authority that will review and approve IACA educational programs. The MoF is the ultimate supervisor for IACA operations; however single point supervisor of professional educational programs, in this case

CAOA, may provide better benefits of compatibility and consistency among accountancy education programs.

## **6.2. Developments to ICARM education and training program**

A recent study on Accountancy Education Benchmarking<sup>18</sup> in several countries of Southeast Europe and also covering the professional education program of ICARM found several areas where urgent improvements are necessary:

| <b>Requirement</b>  | <b>Description</b>   |
|---|--|
| <b>Performing regular reviews and updates of the professional qualification program</b> | ICARM Professional qualification program is focused on competence areas and learning outcomes of particular interest for statutory auditors (financial reporting, auditing and assurance, business law and taxation, financial management, corporate governance and ethics). The program and exam materials are based on internationally recognized qualification of distinguished quality (ACCA), and were developed in 2009. Since then, the exam materials have been updated in 2013 and 2015 for the exams in financial accounting and reporting, auditing and assurance and business law and taxation. However, given significant changes in IFRS Standards ISAs take place often, there is a need for a more structured syllabus update process, ideally every three to five years, with minor conforming amendments made to syllabus content on an annual basis in order to take into account tax and regulation updates. |
| <b>Developing competence areas and learning outcomes for professional skills</b>        | In order to become a member of ICARM, a candidate needs to complete the professional examination program, gain 3 years practical experience in audit and obtain license with the Oversight Council. ICARM does not prescribe competence areas and learning outcomes for professional skills. Certain intellectual skills among candidates are developed through the professional examination process, however moving away from systems of measuring practical experience based on the amount of time served to developing evidence-based methods, such as verifying the skills and competences obtained in practical training through workplace assessments is necessary.  |
| <b>Connecting with</b>  | The recent Accountancy Education Benchmarking Study revealed limited integration between academic programs and ICARM professional education  |

<sup>18</sup> See: [http://siteresources.worldbank.org/EXTCENFINREPREF/Resources/4152117-1427109489814/9765106-1487166467531/benchmarking\\_study.pdf](http://siteresources.worldbank.org/EXTCENFINREPREF/Resources/4152117-1427109489814/9765106-1487166467531/benchmarking_study.pdf)

| Requirement   | Description   |
|---|---|
| <b>University accountancy education</b>                               | <p>program. Although there are similarities in curricula content and learning outcomes, students can be better allowed to progress through objectives, learning outcomes and proficiencies if common education policy and competency map for accountancy are defined at national level through coordinated efforts of the Ministry of Education, Ministry of Finance, Universities and the profession. Education programs will be developed more consistently, normally university programs will cover learning outcomes with basic and medium proficiency depending whether students pursue general business degree with orientation in accounting or plan for professional career and qualification. Advanced learning outcomes should be predominantly covered in professional examination program. This can help ICARM better assess university graduates that enroll to the professional examination program and university graduates can benefit from exemptions provided for some of the exams at the professional qualification program which are currently not offered at all.</p>   |
| <b>Enhancing the Continuing Professional Development (CPD) System</b> | <p>The CPD requirement is determined by the Audit Law and all ICARM members need to complete 120 hours of CPD in 3 years, minimum of 30 hours in each year. ICARM is effectively the only approved provider of CPD through formal CPD events and input based measurement of CPD completion is used. ICARM members receive no credit for training with other providers, nor for educational and professional development activities at the job place as non-verifiable CPD. Further, training sessions for competence areas for certain professional skills such as interpersonal and communication skills, personal and organizational skills are very rare. Members are not trained in effective communication with team members, client management and governance structures. Mentoring and coaching skills necessary to assist professional career development of the audit personnel have not been subject of CPD training as well.</p> <p>Finally, there is a need to introduce a more structured approach when measuring CPD which would focus on the achievement of the learning outcomes required by the revised IES 8<sup>19</sup> which became effective in July 2016, rather than purely measuring the time spent in CPD activity. For example, in Albania, the law mandates the Professional Body to conduct periodic tests of knowledge gained during CPD in order to assess the professional competence of its members.</p> |

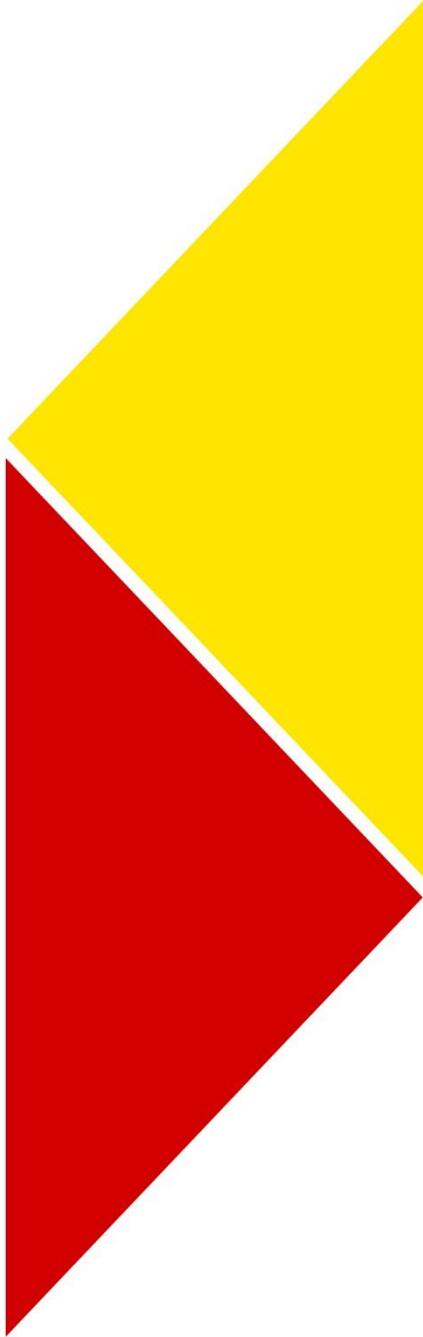
<sup>19</sup> IES 8, Professional Competence for Engagement Partners Responsible for Audits of Financial Statements (2016).

## **5.5. Key Recommendations**

The following key recommendations are proposed in respect of Professional Accountancy Education and Training:

- The Institute of Accountants and Certified Accountants (IACA) and the Institute of Certified Auditors of the Republic of Macedonia (ICARM), as professional bodies recognized by law, should coordinate efforts in the area of professional certification and development of members and build on the already established capacity in accountancy education.
- ICARM and CAO A should strengthen the monitoring system for professional competence of auditors acquired through professional experience by developing competence areas and learning outcomes and reflective reporting by candidates and supervisors.





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