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CORPORATE GOVERNANCE AND FINANCIAL REPORTING IN MACEDONIA THROUGH THE PRISM OF INDEPENDENT AUDITORS REPORTS

If management means running the business,
governance means proper running of the business.
Every company needs
both governance and management "
Prof. Bob Trikeri

Abstract

In companies with good corporate governance decisions are made not only for achieving economic objectives, in the strict meaning of this concept, but also because of protecting the interests of the stakeholders. One of the most important characteristics of companies with good corporate management is their commitment to maintain a high degree of transparency, demonstrated by consistently reporting of their situation. In the

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terminology of corporate governance, one of the most important form of transparency is *disclosure* of data and information for companies.

Through transparent disclosure of financial statements, the companies inform stakeholders about the financial position and performance, changes in equity and cash flows, as well as the accounting policies used in disclosures of operating activities in the reporting period. Through the opinion of the independent external auditor, stakeholders are informed whether the financial statements are prepared in accordance with generally accepted financial reporting framework and applicable legislation.

Companies clinging to quality corporate governance are introducing control and informative systems, to maintain the high level of quality of its products and services, as well as quality prepared financial statements, for which the external auditors provide a positive opinion. From this reason the paper presents research on the quality of corporate governance in Republic of Macedonia, through the prism of the reports of the independent auditors, by analyzing the audit reports of 100 companies listed on the Macedonian Stock Exchange.

Keywords: corporate governance, reporting, transparency, decisions, smallest risk

JEL Classification: G30; M41; M42; M48

Introduction

The globalization, which involves free movement of capital, money, labor and technology between countries, exerts pressure on the application of generally accepted principles and behaviors in many areas, including the area of corporate behavior. In this sense, corporate governance based on global standards can be understand as the introduction of a pattern of behavior of companies, that would be understood by every participant in the global market, regardless of his origin.

The introduction of corporate governance means nothing else but standardization of processes, procedures and behavior in the companies, which is based on the principles of responsibility, transparency and control in decision making, daily operations and reporting the situations in the company. Like any other standardization, its aims to reduce uncertainty and

risk of entering into relations with the company, and in this case, goal of increasing confidence in the company is particularly important. Accepting the standardized approach to the management and running of the business it gives the companies a special kind of added value - a value derived from business in an ethical frames.

The companies with good corporate governance abide by special reporting rules. This has particular significance for companies working on the capital market. In order to decide whether to invest in a company, investors want to be sure where to invest with the purpose the investments not to bring harm or loss. Standardized systems of disclosure of data and information about the companies, with standardized practices for the operation of companies in general, provide certainty to investors that investment bears the lowest risk[1].

1. DEFINITION OF CORPORATE GOVERNANCE

The term corporate governance, in the broadest sense, refers to method of establishing balances of interests in certain company, which exists between different persons and entities. Despite the growing popularity of the term in recent decades, from the multitude of definitions can not be selected a comprehensive one, that in the same time precisely and briefly explains its essence. The main reason is the complexity of the concept of corporate governance, its fulfillment with different contents, each of them equally complex, and hard to define.

Some definitions focus on the financial aspects of corporate governance, some on his legal background, while however, a growing number of definitions are attempting to explain it in detail and more fully specify the structure of corporate governance. Here are several definitions of the term corporate governance:

- **James D. Wolfensohn,** the ninth president of the Group World Bank: *"Corporate governance means promoting fair relations, transparency and accountability"*[2].

[1] Guidelines for Corporate Governance in Macedonia, Second Edition, 2011, p.12
[2] James D. Wolfensohn to *Financial Times,* June 21, 1999

- Professors **Andrew Shlajfer** (Harvard) and **Robert W. cherries** (University of Chicago): *"Corporative management refers to the ways those corporation's funders ensure that their investments will return"*[3].
- Professor **Henrik Matjesen** of Center for Corporate management of the Copenhagen Business School: *"Corporate management is an area of economics that explores ways through which the application of incentive mechanisms, such as contracts, authorities design and regulation, are providing efficient management of corporations. It is often limited to the issue of improving financial performance, for example - how owners of corporations can motivate managers in the corporation to provide horse-competitive contribution"* [4].
- Sir **Adrian Cadbury,** the promoter of the debate on corporate governance, a businessman and longtime director of central Bank of England: *"Corporative management aims to maintaining a balance between economic and social goals and between individual's goals and goals of the community. The framework of corporate Management should encourage efficient use of resources while* simultaneous *insistence on the responsibility of those who manage resources. The goal is the interests of individuals, corporations and society to get more closer"* [5].
- Professor of Corporate Governance at the University of Cambridge, **Simon Deakin:** *"The corporative governance denotes the way companies manage and control. Good Management is a necessary ingredient of corporate success and sustainable economic growth. Research in the field of management should be rely on interdisciplinary analysis, mainly on economics and law, good knowledge of contemporary business practices resulting from depth empirical studies in national terms"* [6].
- **Margaret Blair,** economist, professor of managerial right of Vanderbilt University, USA: *"Corporative Governance introduces a host of legal, cultural and institutional activities that accurately determine*

[3] Andrei Shleifer, RobertW.Wishny in *Survey of Corporate Governance,* The Journal of Finance, Juni 1997

[4] Henrik Mathiesen, 2002

[5] Sir Adrian Cudbary, *"Global Corporate Governance Forum",* World Bank, 2000

[6] http://www.corpgov.net/library/definitions.htmlIFC-priracnik-1-11-final:new-moment-Anglisko7.qxd 07.12.2011 14:47 Page 16-17

what would work public corporations, who will control them, how will the control be performed, and how will the risks and benefits of the activities that corporations had undertaken *be distributed"*[7].

Experts from the Organization for Economic Cooperation and Development (OECD): *"Corporate governance a system that manages and control business corporations.* The s*tructure corporate governance has specifies the distribution of rights and responsibilities among the various participants / members of a corporation such as those on board, managers, shareholders and concerned persons, and detail describes the rules and procedures for making corporate decisions. That way, it also provides the structure through which the company sets their objectives, the resources with which* these goals are achieved *and the manner of monitoring Performance"* [8] .

Maybe, the most appropriate definition of corporate management is: *"Corporate governance is system by which the business corporations are managed and controlled. The structure of corporate governance specifies the distribution of rights and responsibilities among different participants / members of the corporation, such as those on board, managers, shareholders and other concerned persons and describes in detail the rules and procedures for making corporate decisions. Thus, it provides the structure through which the company sets their objectives, the resources with which* these goals are achieved *and the manner of monitoring* p*erformance"* [9].

2. ORGANIZATIONAL STRUCTURE OF CORPORATE GOVERNANCE

A good organizational structure of corporate governance is the one in which a successful system of setting goals is established, making decisions and proper monitoring of implementation of the decisions and meeting the goals of the company. By this way of built relationships and

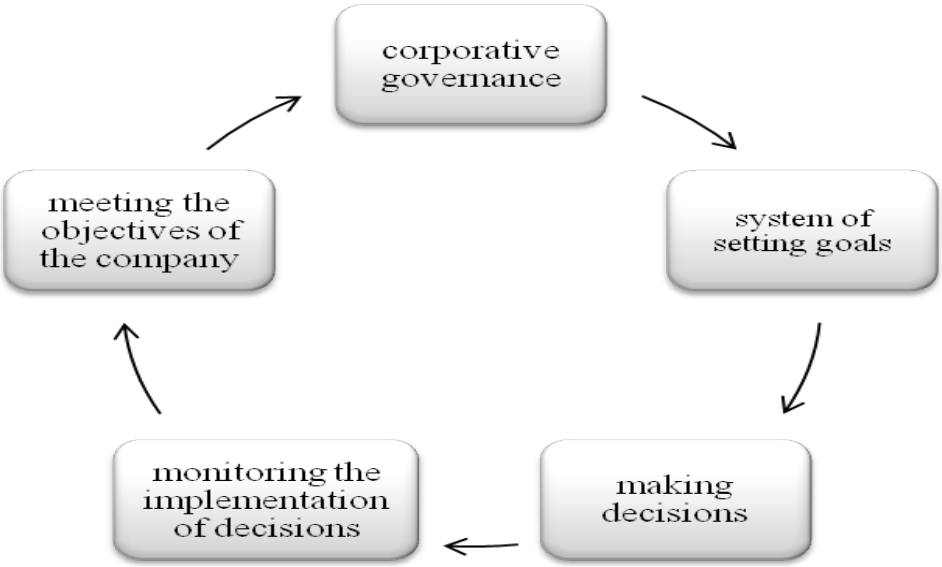
[7] Margaret Blair, *"Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century",* Brookings, 1995

[8] OECD, April 1999

[9] Nikolce RUNCHEVA * Boris Krastev ** Mirjana Golomeova "K orporativno management vs. corporate management ", University Goce Delchev Stip, 201 0, p.4

processes structure, the company can successfully face the changes in the surrounding area and, thereby, to respond in a way that does not jeopardize the interests of any of the groups concerned.

Figure1. Structure of the corporate governance



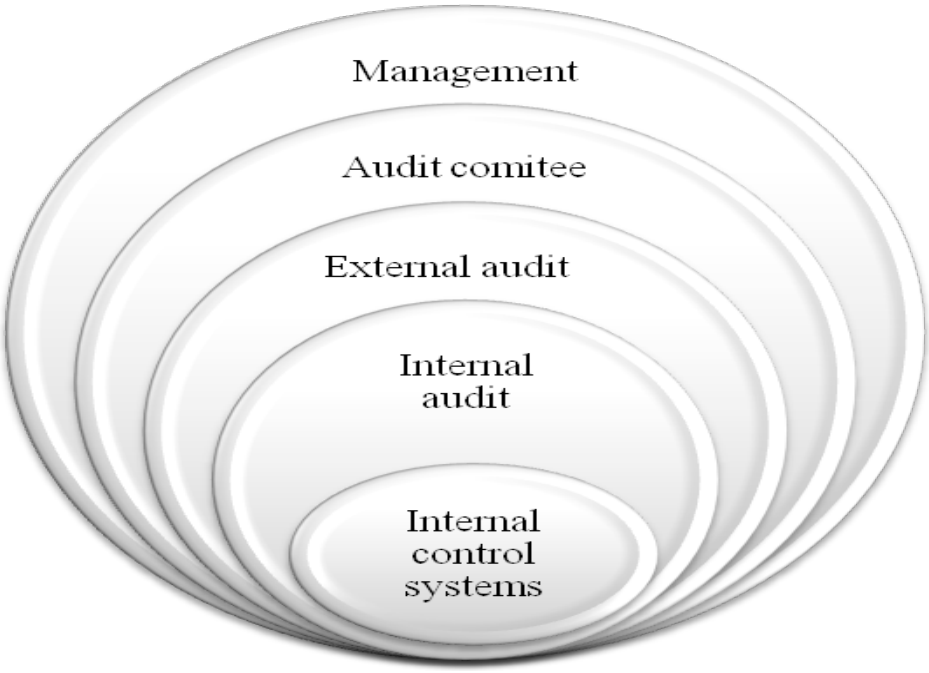
One of the key characteristics of companies with good corporate governance is their readiness for regular disclosure of data and information on the operation of the companies. With shareholders, potential investors and other stakeholders, the company should communicate in a way that will allow them to receive accurate, realistic, timely and relevant information on the situation in the company, its financial performance, its objectives and development. Voluntary disclosure of information and data for companies contributes to the improvement of corporate governance.

The internal and external control and audit are important tools both for management and for oversight of the companies. They provide information about how much the information for the management work, finance and other aspects of the operation of the company are realistic and integrated, and the extent to which the organization structures and systems in the company is the basis for respect policies, laws, regulations and procedures.

Quality preparation for the company's financial statements, free of material errors and mistakes, has responsibility by the management, but also

and the chartered accountants, administrative and managerial staff, the Audit Committee, the employees in the sector for internal audit give input[10].

Figure2. Systems for quality corporate governance



Quality of corporate governance is visible from the efforts of management to establish **internal control systems** in all sectors of its organizational structure (production, marketing, sales, human resources, Finance, Accounting …) in order to improve the quality of their products, the confidence in purchasers and finally to achieve maximum profit. The introduction and implementation of commonly accepted standards for quality products and services is also an indicator of the quality of the corporate governance.

[10] Phd. Janka Dimitrova The contribution of the audit and audit reports to improve the quality of financial reporting and to increase the international flow of capital, "Managing the development of economic and regional systems: an Eurasian perspective", Organizers: "Higher Business School "OmSPU (Omsk, Russia)" Goce Delcev "University (Stip, Macedonia), 30-31.05. 2016, p. 3

The Internal audit is an activity organized by the management of the company or other business entities for assistance in assessing the working as a whole or of individual segments. It is part of the management supervising of business functions in order to perform them more effectively, and thus to ensure the functioning of the information subsystem that will provide information, as a base for taking appropriate business decisions of the management.

The scope of internal audit includes examination and assessment of applicability and clarity of the system of internal controls, and quality execution of undertaken responsibilities. **Therefore,** the **internal audit is management's service. The management organizes it as own "extended arm" in order to supervise the accounting system and the system of internal controls**, **giving contribution in meeting the planned objectives.**

As in many other areas related to the corporate management, the last decade brought vast number of changes in internal audits. Especially progressed the profession of internal auditors, particularly in terms of adaptation to the needs of the companies. The internal audit is growing more and more in consulting activity that helps the management with risk management. Exactly, the risk management is the new specific focus of the internal audit, in addition to the general role to be the last internal guarantee of a company that laws, regulation, internal rules, policies and procedures are respected[11].

The external auditors are independent, competent, educated, experienced and professional individuals, charged to investigate the presented financial statements of enterprise customers for the needs of the numerous external and internal users. Expressed opinion of the independent auditor's reality, objectivity, truthfulness and honesty of the presented information increases the credibility of the financial statements in the eyes of a wide range of customers of audit services. "An audit includes examination and evaluation of the working, organizational and business functions, the way of the adoption of business decisions, the functioning

[11] Interview with the President of the Institute of Internal Auditors, the most important worldwide organization of professional internal auditors, Mr. Richard Chambers, the magazine of the parent magazine of the Institute - boarding Auditor from April 2010.

of the information system of the audited entity, as well as other issues relevant to their work"[12].

With the help of auditing the quality of financial reporting is improved, which reduces financial misunderstandings by customers, thereby increasing the possibilities for external financing, investments and investment efficiency[13]. The audit confirms the accuracy of the assertions in the financial statements for: comprehensiveness, accuracy, existence, occurrence, valuation, measurement, rights and obligations and presentation and disclosure. The purpose of the audit is to provide the stakeholders evidence regarding the reliability of certain information obtained from those entrusted to manage the company's property.

On the base on the performed audit of the financial statements, the auditor gives opinion that may be:

- Unqualified opinion -unconditional opinion;
- Unconditional opinion with an emphasis on a particular issue;
- Qualified opinion;
- Disclaimer of opinion and
- Negative opinion.

In the audit process the auditor and his audit report represents the link between the users of the financial statements and the management team of the company, whose financial statements are audited.

Companies with good corporate governance form a separate body - **An audit committee,** whose scope of work are the three main areas: financial reporting, risk management and internal and external audit. The Board of Audit is a management body of a legal entity of public interest. The Audit Committee shall perform the following:

[12] Nikolovski Dr. Pece, Organization of audit of financial statements, Faculty of Economics, Prilep 2004, p. 44

[13] Nemit Shroff, Real Effects of Financial Reporting Quality and Credibility: Evidence from the PCAOB Regulatory Regime, Massachusetts Institute of Technology, 2015, p. 14

- Monitor the statutory audit of financial statements,
- Monitor the compliance of the legal entity of public interest regulations relating to accounting standards and financial reporting,
- Monitor the review process of the legal entity of public interest and assess the work the audit firm or certified auditor - sole proprietor,
- Proposes the audit company
- Monitor the operations and assess the effectiveness of internal audit and systems risk management.

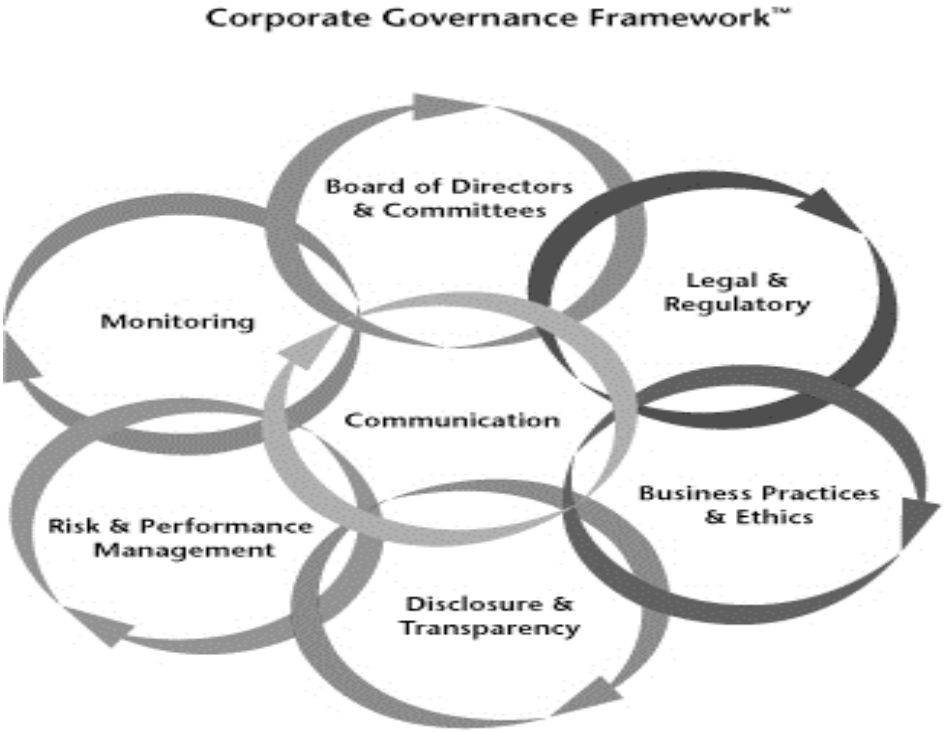
The audit company, informs the board review of the key issues arising from the statutory audit, with special emphasis on issues related to the material weakness in internal control of legal entity of public interest, in terms of financial reporting.

The objective of the formation of this body is to assist the Supervisory Board in providing a complete insight into the quality and integrity of accounting, internal control systems and financial practice of the subject.

3. BENEFITS OF GOOD CORPORATE GOVERNANCE

Corporate governance refers to the structures and processes for the direction and control of companies through strategic approach to relations between managers, directors, owners / shareholders and other stakeholders. Although some of the pillars that underpin corporate governance consist of laws and regulations, corporate governance is much more than compliance with general standards. Corporate governance brings substantial benefits for companies and financial institutions, and outlines a framework for defining and achieving corporate goals. Good corporate governance practices are integrated into business objectives, allowing companies and financial institutions to thrive and achieve their goals.

Figure 3. Corporate Governance Framework



Briefly, good corporate governance practices help companies in:

- Improving results, operation, competitiveness, profitability and creating long-term value
- Establishing clear roles, responsibilities and accountability
- Improving the decision-making process and the quality of decisions
- Definition and implementation of corporate strategy and direction
- Growth in a sustainable way
- Identifying and managing risks
- Increasing the internal control structures

- Creating appropriate incentives for employees in accordance with the business strategy
- Attracting capital, investments and business partners
- Building reputation by strengthening relationships with stakeholders
- Preparing the future generations

Corporate governance helps companies and financial institutions to meet the challenges of today's business environment, and create a structure through which the best possible decisions will be made, where it will be taken into account the diverse perspectives.

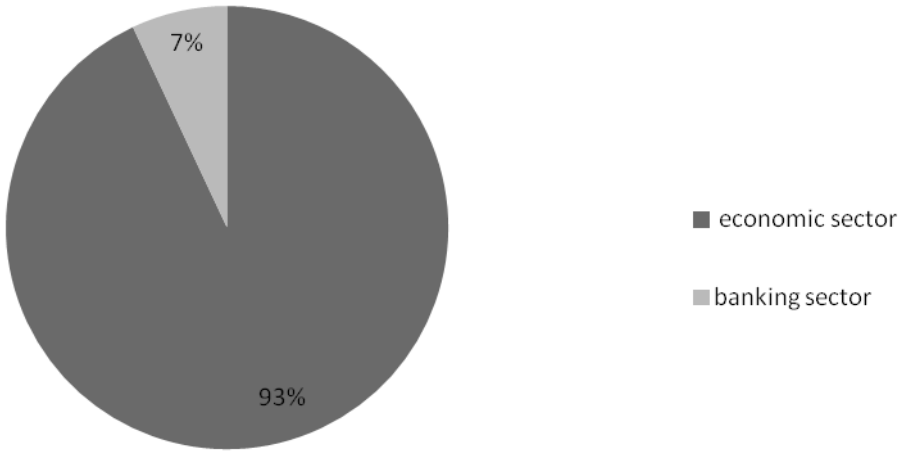
4. CORPORATE GOVERNANCE AND FINANCIAL REPORTING IN MACEDONIA THROUGH THE PRISM OF REPORTS OF INDEPENDENT AUDITORS

The main objective of this research is to analyze the quality of corporate governance and financial reporting in Republic of Macedonia, through the prism of the reports of the independent auditors for the years 2013 and 2014. For this purpose, audit reports of 100 Macedonian companies whose shares are traded on the Macedonian Stock Exchange, have been analyzed. The structure of the analyzed companies is the following: 93 companies are from the industry sector and 7 from the banking sector.

Table1. Analyzed companies by sector

By Sectors	**2013**	**2014**
Economic sector	93	93
banking sector	7	7
Total	100	100

Chart 1. Analyzed companies by sector



Source: Authors' research

The following types of an audit opinions have been identified in the analyzed 100 companies, for the business years 2013 and 2014:

- Positive opinion (unqualified opinion)
- Positive opinion by emphasizing the issue
- Qualified opinion
- A negative opinion
- Disclaimer of opinion
- Audit had not been done

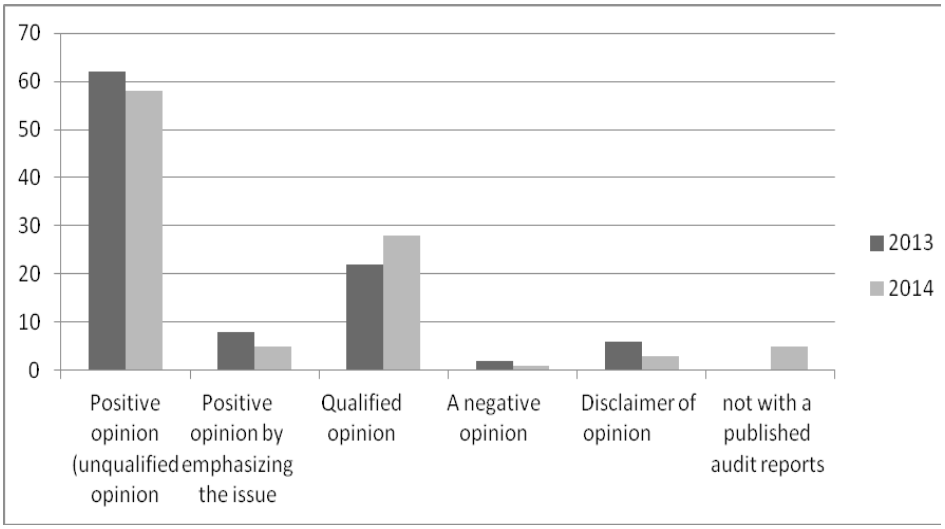
The above expressed opinions are analyzed by sector and by foundations to express a qualified opinion.

Table 2. Types of opinions:

Type of opinion	**2013**	**2014**	**% change 2014/2013**
positive opinion (opinion)	62	58	93.55
positive opinion by emphasizing the issue	8	5	62.50
qualified opinion	22	28	127.27

negative opinion	2	1	50.00
disclaimer of opinion	6	3	50.00
audit reports have not been published	0	5	0.00
Total	100	100	

Chart 2. Types of opinions



Source: Authors' research

From a total of 100 analyzed companies, opinions on the financial statements are as follows:

- Positive opinions in 62 companies in 2013 and 58 companies in 2014, showing noticeable decline of 6.45%
- Positive opinion with emphasizing the issue in 8 companies in 2013 and 5 companies in 2014, with a notable decline of 37, 5%.

- Qualified opinion in 22 companies in 2013 and 28 companies in 2014, with a noticeable increase of 27, 27%
- 2 negative opinions for the analyzed companies in 2013 and for 1 company in 2014, with a notable decline of 50%
- Disclaimer of opinion in 6 companies in 2013 and 3 companies in 2014, with a notable decline of 50%
- Audit have not been performed for 5 companies in 2014,

The analysis of the opinions expressed and their reasons follows :

Positive opinion (unqualified opinion) - is expressed when the auditor concludes that the financial statements give a true and fair view (or are presented fairly, in all significant aspects) in accordance with established financial reporting framework. Unqualified opinion, implicitly suggests that any changes in accounting principles' or methods of their application and their effects are properly determined and disclosed in the financial statements[14].

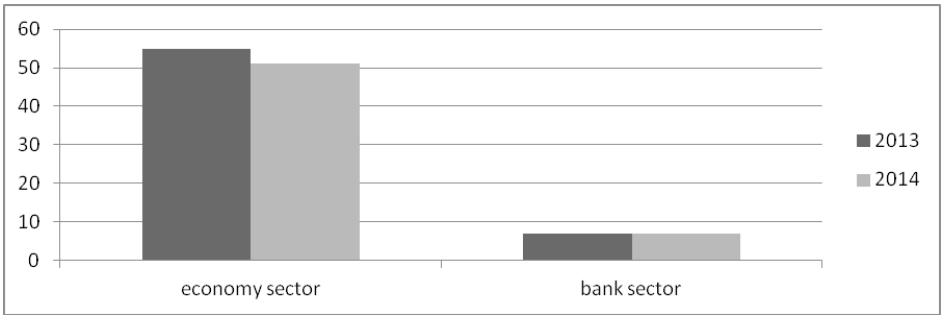
The structure of the positive opinion, as an indicator that the financial statements contain no material omission and errors, by sectors, is presented in Tables 3 and 4 .

Table 3. Positive opinions by sectors

Positive opinion	**2013**	**structure**	**2014**	**structure**	**% change 2014/2013**
economy sector	55	88.71	51	88	92.73
banking sector	7	11.29	7	12	100.00
Total	62	100%	58	100%	93.55

[14] Professor. Dr. Janka Dimitrova Audit (theoretical and practical aspects) University Goce Delchev Stip 2013, p. 122

Chart3. Positive opinions by sectors



Source: Authors' research

From the table above it is evident that the banking sector's positive opinion is expressed in all analyzed 7 banks in the years 2013 and 2014, while in the economic sector the decrease of 7.27% in 2014 is recorded.

Table 4. Positive opinion sectors in terms of total

positive opinion by sector from the total	**Total**	**2013**	**2014**	**2013 / total**	**2014 / total**
economic sector	93	55	51	59.14	55
banking sector	7	7	7	100	100
Total	100	62	58	62	58

In the economic sector positive opinion presents 59.14% in 2013 and 55% in 2014, while in banking sector positive opinion is expressed in all analyzed 7 banks in 2013 and 2014.

It is characteristic to emphasize that from a total of 62 positive audit opinions in 2013, within 55 companies were positive in 2014 too, while 7 companies in 2014 expressed qualified opinion.

Positive opinion by emphasizing the issue - the audit report may be modified by providing passages that highlight issues affecting the financial statements included in the notes to the financial statements in which these issues are widely explained. The addition of such a passage highlighting an issue does not affect the opinion of the auditor.

From a total of 8 opinions by emphasizing the issue**,** given in 2013, in 2014 in 3 companies the opinion is positive, in 2 companies the opinion remained unchanged and in 3 companies the opinion transformed into qualified opinion.

Qualified opinion - is expressed when the auditor concludes that he cannot express an opinion without reservation, but when the effect of any disagreement with management or limitation on scope is not material or distributed to impose adverse opinion or disclaimer of opinion.

From a total of 22 qualified opinions in 2013, within 20 companies the opinion remained the same in 2014, with all flaws and errors listed.

Negative opinion - is expressed when the effect of the disagreement is so material and widespread in the financial statements, that the auditor concludes that the reserve report does not correspond to disclose the fact that the financial statements suggest incorrect conclusions or incomplete.

In 2013, 2 negative opinions were expressed from which 1 with the same reasons repeated in 2014.

Disclaimer of opinion - is expressed when the possible effect of limiting the scope is so significant and widespread that the auditor was unable to obtain available appropriate audit evidence, and therefore was unable to express an opinion on the financial statements.

There is disclaimer of opinion in 2013 in 6 companies and in 2014 in 3 companies.

Not published audit reports - in 2014, in 5 companies audit reports have not been published. It is characteristic that some of these companies went into bankruptcy and others are working with huge losses and risk of impaired business continuity.

The main reasons for modification of the audit opinion are:

- An assessment of the fair (market) value of property, plant and equipment in accordance with IAS 36 - Impairment of Assets, has not been made
- Inoperative assessment of the net realizable value of old stock
- Registered land for which there is no title deed
- Trade receivables and liabilities to suppliers are not confirmed

- Litigation - impairment loss on advances for capital expenditures
- Overvalued assets and financial position
- Overstated operating income
- Shown net investments on the sidelines instead of retained earnings
- Correction is not made on the value of claims and liabilities towards suppliers
- Overstated inventory
- Underestimated costs and liabilities Interest
- Obsolete receivables and trade payables towards suppliers
- Uncertainty about the reality of accrued interest
- Inoperative assessment of the fair value of investments available for sale
- Incompatibility of the equity of the Company to that in central register RM
- The absence of physical inventory report
- Overstated costs, other operating expenses and retained earnings from previous years, etc.

Conclusion

The state of corporate governance in the country is improved in the past few years, but there is considerable scope for further action. The state of corporate governance in general is a moving target and it should be run continuously, because the areas of corporate governance, such as planning for succession of senior positions, do not allows occasional or ad hoc action. In this context, the financial sector (banks) may be pointed, because there is a significant quality and presence of good practices in the field of corporate governance, which reflects their positive performance.

It is evident that in the economic sector in the country, there is still the need for improving the organizational structure of companies and the introduction of quality control systems that will contribute to quality corporate governance and financial reporting. Considering the fact that in spite of the auditor's indications for correcting and detecting the mistakes, in the next years the same findings are repeated, the need for continuing educa-

tion and upgrading of accounting and finance workers in the field of international financial reporting standards and other legal financial reporting framework should be emphasized.

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