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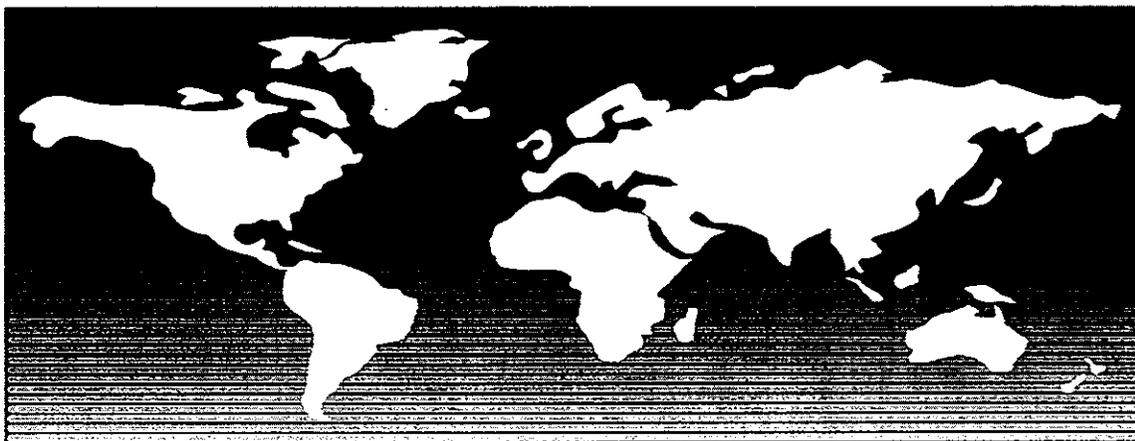
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FINAL REPORT:
Macedonia Accounting and Tax Reform Project
PCE-I-816-99-00006-00

June 14, 2002



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MACEDONIA ACCOUNTING AND TAX REFORM PROJECT

FINAL REPORT

Contractor: KPMG Consulting, Inc.
Contract Number: PCE-I-00-99-00006-00
Task Order: 816
Country: Macedonia
Reporting Period: September 5, 2000 - June 14, 2002

CONTRACTOR'S REPORT

A. OVERVIEW

The following report incorporates the accomplishments, lessons learned and recommended priorities in future courses of action of the Macedonia Accounting and Tax Reform Project. The report does not include historical background unless it is relevant to future task orders being considered or for the purpose of proposing alternative courses of action. There are four specific tasks:

1. Establishing a fully functioning legal and regulatory framework, including tax framework, for accounting and audit reform and development of the necessary procedures for conversion of enterprises to IAS and modern accounting practices;
2. Converting 250 enterprises to International Accounting Standards (IAS) systems and practices largely using the local SRO (Soyuz) members/member firms, including short-term training in the conversion process and IAS core standards;
3. Developing a GOM-approved certified auditor program based on IFAC education guidelines and producing certified auditors. Soyuz to be the owner of such program;
4. Assisting Soyuz in its development and its obtaining statutory authority for the certification of auditors.

In addition to work on the above contractual tasks, the project initiated a formal education program starting at the university level and supplemented by intensive training courses in IAS and review courses for candidates taking the auditor certification exam. It is this activity, **education**, that evolved as the most important activity, since it is clearly the essential building block to cultivate successful candidates into becoming certified auditors that would be the source of developing an effective self-regulating organization (SRO). With these goals accomplished to a sufficient degree, other tasks will have an excellent chance of being successfully implemented in the future.

B. BENCHMARKS

The following are benchmarks in support of the aforementioned tasks:

TASK I

- Within 45 days adoption of an IAS compliant Chart of Accounts and Conversion Manual adopted by the GOM.
- Book to tax reconciliation in place.
- Series of workshops to be held with the Public Revenue Office (PRO) and MoF staff to familiarize them with IAS, its tax implications and resolution of difficulties.

TASK II

- Conversions will take place at the transaction level and the method will include mapping from codex to IAS, revisions to the Chart of Accounts and resolving impediments to conversion with the MoF and PRO when necessary.
- Preparation of a conversion manual prepared for training subcontractors and enterprise accountants.
- Implementation of conversions shall be implemented through the use of Soyuz and local accounting firms.
- Adequate pre-conversion training will be provided to Soyuz and firms contracted to perform conversions as well as to tax inspectors and accountants of the enterprises to be converted.
- Adequate conversion follow-up shall be provided to enterprises converted.

TASK III

- Continue to work with the MoF and Soyuz to establish legal framework for licensing and certification of auditors based on IFAC guidelines.
- Develop and implement a GoM-approved audit certification exam and related procedures.
- Create and put into place the foundation for continuing professional education (CPE) requirements for certified auditors.

TASK IV

No specific benchmarks are mentioned for this task.

C. PROJECT ACCOMPLISHMENTS

TASK I

Establishing a functional legal and regulatory framework to establish legal decrees for accounting and auditing reform that is generally accepted in developed countries could not be accomplished. Beginning in June of 2001, the GoM passed changes to the Trade Companies Law that pragmatically inhibited any meaningful endorsement of conversion to IAS and self-regulation of a professional organization. Subsequent revisions in May, 2002 effectively did little to counteract the damage caused the year before due mostly to time constraints in getting the legislation to Parliament before it adjourned. Given more time and a more organized approach there is little doubt that more salient strides could be made in the future.

Other benchmarks for this Task were accomplished.

- (1) A Chart of Accounts and conversion manual compliant with IAS were completed and adopted by the GoM, although the government still requires accounting records to be kept along the lines of their tax accounting methodology, requiring enterprises to keep two sets of books.
- (2) Tax to book reconciliation forms were completed and accepted by the PRO.
- (3) Five workshops were held on behalf of the PRO and accounting staff of the MoF to acquaint them with the basic standards of IAS and international standards on auditing (ISA). A total of 150 attended.

TASK II

The project completed 70 conversions with approximately 125 follow-up visits to enterprises that encountered subsequent problems due, for the most part, to lack of overall knowledge of IAS. Since conversions are performed at the transaction level and not the trial balance or financial statement level, enterprise accountants not knowledgeable in accounting at the rudimentary level will have subsequent problems. Part of this task that was completed is training enterprise accountants before the actual conversion takes place to acquaint them with the methodology of a conversion, basic differences between their accounting system and IAS, what to expect of the conversion team, and their responsibilities to both prepare for and sustain the conversion. The training course may be adequate in preparing for the conversion but the methodology to treat the activities and transactions that the enterprise encounters post conversion is radically different from the tax accounting-based systems they had been using. Only a fundamentally sound accounting curriculum could prepare them for such a radical change.

The project revised the chart of accounts to be compliant with IAS. Enterprises must use this new chart if they wish to convert. The GoM still holds to some old accounting tenets (for example, treasury stock treated as an asset) which is the reason for enterprises having to utilize two charts. This is a natural consequence to the Trade Company Act that the government imposed on the economic community. A revised and fully documented conversion manual that reflects the new chart is used for training purposes.

Implementation of conversions was planned to be done by the SRO (Soyuz) and indigenous accounting firms after sufficient training in both IAS and conversion methodology. Soyuz, though made an associate member of IFAC and given much support from the project from the outset, showed no interest in participating in the conversion effort nor in virtually any other activity that could be described as professional. Due to this circumstance, the project was forced to handle conversions with only five accounting firms, contracted for this purpose, to provide support.

A schedule of enterprise conversions is attached to this report.

TASK III

The initial certification examinations held in December of 2001 were marred by irregularities and the results annulled. To avoid a repetition of this situation, the Project's chief of party (COP) was asked by the Minister of Finance to create an examination committee to oversee the certification examinations scheduled for May and June of 2002. The COP chaired the committee whose membership included representatives from the MoF, university professors, and an international organization to oversee examination security. This committee was able to establish the legal framework for licensing and certification of auditors based on IFAC guidelines because of the committee's broad representation. Detailed plans were prepared and implemented in

the areas of examination content, grading, security, internal controls, candidate communication, and review courses to assist candidates in preparing for the examinations. Workable and well-respected procedures are now in place that can be built on for future exams. Soyuz was notably absent from participation due to the fact they wanted to administer the exam themselves with little or no participation from any other source. The examinations were noted by virtually all concerned to be fair, difficult by Macedonian standards, and suitable for use as a model.

A benchmark not completed in this Task was the creation and foundation setting of a CPE program that would set requirements for certified auditors. Due to the fact that prior to the May examinations there were only 16 licensed auditors and half of them were non-practicing professors from the university, it was not practicable to enjoin the effort, especially with other major activities then underway that carried a higher priority.

TASK IV

As previously noted, Soyuz has not shown any interest in participating or contributing to the professional financial community. Technically, it is a bankrupt organization whose bank accounts have been closed and membership has declined significantly. USAID suspended its support of Soyuz in January of 2001. Due to these circumstances, virtually no effort has been expended in assisting Soyuz.

D. LESSONS LEARNED

The lessons learned during the term of the project are both simple and complex. In addressing the activities of the project tasks intended to strengthen the private sector development program, the following comments are made on the efficacy of the efforts employed. The procedures utilized were excellent *per se* but, because of the circumstances encountered, some of these same procedures were compromised. Lessons learned are as follows:

- ◆ **Conversions.** It is necessary to reappraise the value of performing a prescribed number of enterprise conversions to IAS. Most of the enterprises are not ready to absorb the overall impact of the conversion process. Therefore, they implement the procedures only mechanically, limiting the long-term benefits that would result from better managerial control, consistency and credibility. Since the advantages of this approach are extremely short term in most cases, conversions should be "cherry picked," i.e., significant efforts should be expended on enterprises (1) that need international financial statements for a foreign investor, (2) are prepared to use IAS on a sustained basis to promote improved profitability and higher employment, and (3) can be shown as a good example of what can be accomplished utilizing IAS, as an impetus to create governmental and private sector enthusiasm.
- ◆ **Education.** Training courses are very necessary, but they must be viewed in proper perspective. The Project's experience has shown that the vast majority of enterprise accountants, MoF personnel and even local accounting firms do not have a basic knowledge of IAS; what they are learning at week-long training courses is a broad brush across the IAS but lacking in depth. We are helping to produce nominal knowledge that, of course, is not sustaining and, as in conversions, we are producing short-term benefits only.
- ◆ **Certification Exam.** Examination committees must be formed that represent the MoF, academia and indigenous accounting firms. Most importantly, the leadership of the project must be proactive. The most

important lesson learned in administering the May/June examinations is that there must be an international leader to maintain security and uphold the IFAC guidelines. Macedonians are not yet ready to assume this responsibility by themselves. Examination security and credibility are more important than the number of successful candidates.

- ◆ **SRO Development.** There is no professional group that is ready to assume the responsibilities of being responsive to the financial community and representing the fundamental IFAC tenets. In each organization, there are some members who are professionals but are unable to circumvent the current leadership. The lesson learned is that it is more efficacious not to attempt to work with present leadership but, rather, to identify those who have a professional commitment and reorganize from within. There was an attempt to merge the two existing organizations; but it became clear that combining two associations with ineffective leadership would be compounding an already unacceptable situation.

E. FUTURE PLANS of ACTION

Based on lessons learned and the perceived needs of the private sector development program, the following are the suggested priority plans of action.

I. Education

Future projects in accounting reform must respond to the glaring deficiency in the education process and its consequential results. The Project's perception is that the *results* of mediocre education have been addressed rather than the *causes*. Initially, expatriates with university teaching experience should be reintroduced to the universities in Macedonia. Their role would be to lecture to the students and also work with the current professors who are still teaching from outdated textbooks and employing outmoded teaching styles. Curricula should not only be reviewed and modified for content but should also be monitored as to how the material is being taught. In almost all cases, resistance will occur from incumbent professors who are unwilling to be trained in IAS. They cannot be realistically removed, which leaves no alternative other than to have the expatriate lecture as much as possible with the residing professor monitoring the class. This was done in the spring of 2001 with great success. We should support much more of this type of training throughout Macedonia. Gradually, faculty educated in IAS will take the place of the professors who will retire. Sending the current group of professors to the US did not achieve the desired results in the past because they did not take advantage of the opportunities to learn and adopt new pedagogies.

At present, there are no modern accounting textbooks in the Macedonian language. So, another important priority would be to translate all or parts of current texts in Financial Accounting, Managerial Cost Accounting, Auditing and Finance into Macedonian. The expatriates should have discretion as to the content to be translated. The incumbent professors could not teach from this new material because they are not familiar with it. Therefore, they would have to assume a monitoring role.

As noted previously, training courses are necessary but have limited utility. They should not be less than one week in length and should concentrate on a few targeted areas, rather than cover many areas superficially. Students should be from the PRO and enterprises, professional accountants in need of honing skills and MoF personnel.

Review courses to prepare candidates for the certification exam proved to be very effective and should be continued.

II. SRO

Macedonia is without a self-sustaining organization to administer certification exams, conduct professional continuation courses and, in general, provide the technical and administrative leadership any profession would expect to have. Approximately three years ago, Soyuz was granted an associate membership in IFAC and received an official endorsement from USAID and the GoM to carry out its charter. It never came close to realizing its promise and is now a bankrupt, divisive and negative organization. Its counterpart, the Macedonian Association of Certified Auditors (MACA) has professional members but its leadership lacks progressive vision and enjoys little political support from any sector of the government. The overriding goal is to create a professional body like MACA, retain IFAC membership, and support new leadership that is responsive, visionary, and professionally competent. Approximately 15 people passed the last certification exam. There are about 25 professionals in MACA presently with extended licenses. It seems logical to develop an effective SRO from this nucleus with additional membership coming from the successful candidates of the next exam. Similar to his active role in the certification exam, the chief of party of the succeeding project must play a very active role in the formation of this new organization by, at the very least, becoming a member of the board and taking a leadership role in all future activities. The new SRO would be self-sustaining through membership dues, fees charged from sponsored training and review lectures and courses.

III. Integration

Since accounting is one of the more critical areas to employ in capital markets, pension administration, public revenues and banking, it is imperative that accounting reform activities work very closely with these other parts of the financial sector to maintain consistency, accuracy and credibility in all financial data. A pro-active posture from accounting must be ensured rather than wait for requests from these other areas.

IV. Conversions

As stated previously, conversions of enterprises other than to respond to requests from foreign investors, for membership on the stock exchange or direct assistance using IAS to help manage a more profitable business tend to have very short-term benefits. The LOE expended on the 70 conversions and 125 follow-up visits in this project could for the most part have been more advantageously used providing more training, overall education and SRO development.

Appendix 1

Summary of Conversions

of

Macedonian Enterprises

SUMMARY
STATUS OF CONVERSIONS
As of June 14, 2002

No.	Company Name	Initial	Final	Company Sign Off	% of Completion of Conversion Work	Probability for follow up	Work done by		
		Visitation	Visitation				Project	Subcontractors	Both
1	Ading - Skopje	August	26.11	Yes	100%	low		X	
2	Zora - Gevgelija	August	27.11	Yes	100%	low			X
3	Nemetali - Ograzden	July	28.11	Yes	100%	low			X
4	Manaki - Skopje	July	26.11	Yes	100%	low			X
5	Zito Vardar - Veles	September	05.12.	Yes	100%	medium		X	
6	Skopski Pazar - Skopje	December	19.12.	No	90%	low	X		
7	Makpetrol - Skopje	November	18.12.	No	90%	medium	X		
8	Alkaloid - Skopje	December	21.12	No	90%	low	X		
9	Fersped - Skopje	December	26.12	No	90%	medium			X
10	Fustelarko Borec - Bitola	December	31.12	No	90%	low	X		
11	Minel Cer - Skopje	December	24.12	No	90%	low	X		
12	Zito Skopje	Feb.28.02	28.02	No	90%	high	X		
13	Rade Koncar - Skopje	Feb.19.02	19.02	No	90%	medium	X		
14	Kontaktors and relays	Feb.19.03	19.02	No	90%	medium	X		
15	Repairs and services	Feb.19.04	19.02	No	90%	low	X		
16	Electric appliances	Feb.19.05	19.02	No	90%	low	X		
17	Smelting, cutting and automat.	Feb.19.06	19.02	No	90%	low	X		
18	Manufacturer of tools	Feb.19.07	19.02	No	90%	low	X		
19	Commerce	Feb.19.08	19.02	No	90%	low	X		
20	Toplifikacija - Skopje	Feb.26.02	26.02	No	90%	medium	X		
21	Makedonija Turist - Skopje	March 7,02	7.03	Yes	90%	low		X	
22	Evropa - Skopje	March 7,03	7.03	Yes	90%	low		X	

**SUMMARY
STATUS OF CONVERSIONS**

No	Company Name	Initial Visitation	Final Visitation	Company Sign Off	% of Completion of Conversion Work	Probability for follow up	Work done by		
							Project	Subcontractors	Solbit
24	Learnica - Ohrid	Jan-02	Jan.22,02	No	90%	low	X		
25	EMO - Ohrid	Dec.11,01	Jan.23,02	No	90%	high	X		
26	Transfer Ilc - Ohrid	Dec.11,01	Jan.23,02	No	90%	high	X		
27	Vior Rostfrei - Ohrid	Dec.20,01	Jan.21,02	No	90%	low	X		
28	Galeb - Ohrid	Dec.10,01	Jan.21,02	No	90%	medium	X		
29	Zastava AGP - Ohrid	Dec.11,01	Jan.22,02	No	90%	low	X		
30	Metropol - Ohrid	Dec.10,01	Jan.23,02	Yes	90%	low	x		
31	Zito Skopje	Feb.28,02	Mar.08,02	No	90%	high	X		
32	Teteks - Tetovo	March 7,02	Mar.08,02	No	90%	medium	X		
33	11 October Factory -Kumanovo	May 15,02	Jun.01,02	Yes	90%	low	X		
34	Zito Bitola	May 23,02	Jun.01,02	No	90%	high	X		
35	Solbit - Bitola /subsidiary	May 23,03	Jun.01,02	No	90%	high	X		
36	Vita Pela - Bitola/subsidiary	May 23,04	Jun.01,02	No	90%	high	X		
37	Bakery Krusevo/ subsidiary	May 23,05	Jun.01,02	No	90%	high	X		
38	Bakery Resen/ subsidiary	May 23,06	Jun.01,02	No	90%	high	X		
39	Kiro Dandaro - Prilep	May 23,02	Jun.01,02	No	90%	low	X		
40	Tabacoo industry - Prilep	May 29,02	Jun.01,02	No	90%	high	X		
41	Marble industry - Prilep	May 30,02	Jun.01,02	No	90%	low	X		
42	Makemall - Struga	June 6,02	Jun.12,02	No	90%	medium	X		
43	Kimiko Gardine - Struga	June 6,02	Jun.12,02	No	90%	medium	X		
44	Kimiko - Struga	June 6,02	Jun.12,02	No	90%	medium	X		
45	EMO - Ohrid/ 26 subsidiaries	June 7,02	Jun.12,02	No	90%	medium	X		
70	EMO - Ohrid/ 26 subsidiaries	June 7,03	Jun.12,02	No	90%	medium	X		