

# **Corporate Governance Manual for Macedonian Joint Stock Companies**

**Skopje, 2007**

## **Corporate Governance Manual for Macedonian Joint Stock Companies**

*Authors:*

Olga Mihajlova Tikvarovska, M.Sc. Part I (A, B, C and D)

Samir Latif, Part I (D, E and F)

Zorica Semenкова, Part II (A, B, C, D)

Ilco Lazarevski, Part II (D)

*Editor:*

Olga Mihajlova Tikvarovska M.Sc.

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## FOREWORD

The Corporate Governance Program in Southern Europe is implemented by the International Finance Corporation (IFC) and funded with the support of the State Secretariat for Economic Affairs of Switzerland (SECO).

The program was launched in spring 2006 and is scheduled to run for three years, with the aim of assisting companies and banks in Albania, Bosnia and Herzegovina, the FYR Macedonia, Montenegro and Serbia to improve their corporate governance standards.

Why is corporate governance important? Good corporate governance will make a company more profitable, enable its growth and increase its access to external finance: domestic and international, public and private. A key factor when deciding to get involved with any business is trust. Without trust, which is reflected in good corporate governance, it is very hard to attract investors. Employees also want to be certain that they will obtain a fair share of return on their labor or expertise.

Our program aims to increase the trust between companies and their stakeholders. We are assisting companies and their stakeholders to create an environment based on responsibility and accountability, openness, transparency, performance evaluation and commitments, based on recognized standards of good corporate governance.

The program is also working with policymakers assisting them to draft new and amend existing legislation. We are working with stock exchanges to develop national corporate governance codes and universities to include corporate governance topics in their curricula.

By publishing this Manual, we want to contribute to the growing body of literature on the topic of corporate governance in FYR Macedonia. We also hope that this Manual will not only be used by academics and students but by shareholders, managers and board members to improve the practice of good corporate governance in their companies.

*Juan Carlos Fernandez Zara*  
*Regional Manager*

*IFC Corporate Governance Program in Southern Europe*



Schweizerische Eidgenossenschaft  
Confédération suisse  
Confederazione Svizzera  
Confederaziun svizra

Federal Department of Economic Affairs FDEA  
**State Secretariat for Economic Affairs SECO**

## **FOREWORD**

Corporate governance becomes an increasingly important issue for the Macedonian economy. It is being taken with greater consideration by the companies, regulators and government. There are two main reasons for this development. First, the strong wave of privatization programs from mid -90' have resulted in an altered business environment, and new legal and institutional frameworks have been established, including but not limited to Company Law, Law on Securities, Law on Take-over of Joint Stock Companies, and Law on Investment Funds. Second, the forces of globalization have contributed toward standardization of corporate governance practices in the countries around the world, and Macedonian economy does not have big margin of appreciation in deciding whether to accept these standards, but has only the opportunity to fine-tune them to the national needs.

Good corporate governance contributes to sustainable economic development by enhancing the performance of companies and increasing their access to external sources of capital. It will make a company more profitable and favour its growth.

In partnership with the International Finance Corporation (IFC), the Swiss State Secretariat for Economic Affairs (SECO) is implementing a three-year corporate governance project in Macedonia and other transition countries of Southern Europe. This project is part of Switzerland's long term cooperation with Macedonia, aimed at alleviating poverty and enabling a successful international, economic and social transition process. The Swiss-Macedonian cooperation, which has amounted to 100 million CHF over the last 12 years, serves to support democratic governance, basic infrastructure and social services and sound economic development in Macedonia.

The goal of the corporate governance project is i) to assist companies as well as banks to improve their corporate governance practices, ii) to support institutions from the public sector to establish effective corporate governance frameworks and iii) to help educational institutions to integrate corporate governance topics in their curricula. By supporting the development of good corporate governance practices in Macedonia, we are assisting Macedonia in becoming more attractive location for investors.

The overall objective of this Manual is to contribute to the promotion of good corporate governance in Macedonia. I hope that it will be used by shareholders, managers, board members and other stakeholders in their daily activities, as well as by Macedonian academics and students to further develop their knowledge and understanding of corporate governance principles.

**Romain Darbellay**  
Head of Cooperation



# USAID | MACEDONIA

FROM THE AMERICAN PEOPLE

## FOREWORD

Since the establishment of its mission in the Republic of Macedonia, the United States Agency for International Development (USAID) is actively supporting the development of a competitive, market-based business environment in the country. This entails a multi-faceted strategic approach which includes developing capital markets, creating a legal and regulatory environment which adheres to international standards and provides transparency and predictability for the investor and supporting good governance practices. The Republic of Macedonia, as it begins to integrate and compete in the global economy, is undergoing a process of economic growth and change in the ownership structure. The nature of the relationships between the private and public sectors is also fundamentally changing. These transitions offer the opportunity to institutionalize good corporate governance practices in Macedonia's businesses and as the practices are adopted and implemented by the private sector, companies' operations will be more transparent, efficient and attractive to the investor. Good corporate governance practices are the foundation for sound, competitive business, which in turn leads to sustained economic growth and job creation.

I am proud to note that with USAID assistance, the new Company Law, which is compliant with EU directives, was drafted. The law is a critical step towards increasing transparency, strengthening shareholder protection, and streamlining the business registration process, to make Macedonian companies more attractive to potential investors and partners, both domestic and foreign. With our assistance, a Corporate Governance Code was adopted early this year (February, 2007). As a result of these efforts, the importance of good corporate governance is being recognized within the Macedonian business and legal communities. However, there is still room for increasing the awareness and incorporation of corporate governance practices in Macedonia.

The publication of the Manual on Corporate Governance is an important part of building this awareness. It will be a valuable tool for Macedonian companies to understand the standards set forth in the Code and relevant legislation covering corporate governance issues. It provides information to all individuals on corporate governance principles and practices needed for today's Macedonian business leaders as they strive to bring their enterprises into the global economy. This will greatly facilitate companies' needs to meet their strategic goals and raise capital, which will inevitably result in a more developed, transparent, and competitive business environment. Further, this manual sends a strong message to both the local and international business community that the Republic of Macedonia understands the importance of Corporate Governance in today's global economy and is taking the appropriate measures to implement the necessary changes.

Patricia Rader  
Mission Director



# Macedonian Stock Exchange

## FOREWORD

Not so long ago, the issue of the corporate governance and its improvement in the Republic of Macedonia was a matter of interest to a very few subjects in the country. Mainly, it was a matter of discussion by individuals from the academic area, international projects for technical support and the newly established industry of securities. It all begun with round tables, a panel within a conference or an academic article presented in some specialized publications. At the round tables and at the conferences, well established guests from abroad were invited, who presented their experiences, and the domestic experts tried to "translate" the terms and logic of the corporate governance in the spirit of the Macedonian stakeholders reality. It was a huge challenge to gather relevant participants from the joint stock companies, and it was much bigger challenge to convince them to start implementing the principles of corporate governance in their daily activities. It usually ended up with a conclusion that it was a good thing to do, but still it was not for us or that there were no objective conditions and that we should wait a bit longer.

Some time later, the things started to move rather faster. Critical point of professional opinion was created, which resulted in implementing adequate changes in the laws and by-laws. The Company Law, Law on Securities, the Securities and Exchange Commission regulations and the internal acts of the Stock Exchange were amended. For a quite short period of time the regulations in the area of the company law and the security market in Macedonia were adjusted to the international standards. Finally, a legal difference between the public and closed joint stock companies was made. The Stock Exchange adopted the Corporate Governance Code for listed companies. What still remained, and, to be frank, is still necessary, is to achieve consensus for broad implementation of the above mentioned normative changes.

The fact that within the last two years the potential of Macedonian Stock Exchange and Macedonian joint stock companies was definitely discovered from both domestic and foreign investors, had a great deal of influence on the perception for the importance of the good corporate governance. The positive step forward regarding the volume of trading with securities, and by this, the public interest about the Stock Exchange and companies traded there, will initiate further improvement of the corporate governance in the coming future. This will indirectly contribute towards more efficient national economy.

In other words, the main battle for bigger corporate transparency, within which the Stock Exchange was one of the domestic leaders, was won. Many of the issues that a couple of years ago seemed unreachable nowadays are set as standards. The laws, by-laws and stock-exchange regulations are improved and most importantly, the majority of the companies have become aware that most of the requirements for disclosure can and should be used for their own benefit.

So, from strategic point of view, everything is under control. From operative point of view, adequate technical and technological tools should be implemented to ease the implementation and development of corporate governance within Macedonian companies. We believe that this Corporate Governance Manual belongs to that category of tools.

When it initiated the development of this Manual, but also throughout its active participation in the project, the Macedonian Stock Exchange has had the following considerations in mind:

- That the concept of corporate governance at a global level is no longer a subject of interest of the academic people only, but has become one of the main focuses of the company leaders;
- Businesses are facing with rapidly increasing demands from the regulators and other stakeholders on both the domestic and international market. With the progress of the security markets integration, the pressure for harmonization of the corporate governance standards is bigger;
- That the issue of enabling a better investment climate for the domestic and foreign investors has never been more important than today, when such a huge number of markets are demonstrating their thirst for capital and thus implement aggressive policies of attracting investment;
- That fair, transparent and efficient securities markets are those that are most attractive and safest for the investors. In this regard, companies with good corporate governance are the main creators of good image and quality of the national securities market;
- That the Republic of Macedonia, which in the transition period failed to achieve more significant investment activity, needs additional efforts to cope with the growing competition on the world market. Opening of the securities market, accepting high operational and financial rules in the corporate area, and implementation of good corporate governance practice should be the main priorities for strengthening the attractiveness of the domestic market.

The purpose of creating this Manual is to help Macedonian joint stock companies to recognize the benefits of good corporate governance and identify the risks from postponing its implementation. The Manual is created in a manner that enables its readers to use it as a guide through the procedures and standards of the corporate governance and it is expected that it will be used by the governance bodies, managers and all others whose mission is to increase the competitiveness of Macedonian companies.

*Ivan Steriev*

*CEO*

*Macedonian Stock Exchange, Skopje*





## FOREWORD BY THE AUTHORS

The members of the project team, which has produced this Corporate Governance Manual, have committed themselves to their task with a great deal of enthusiasm. As a result of the nature of their professional and working engagement in the past years, they have all faced with the numerous challenges that the process of privatization of socially and state owned enterprises has brought along, particularly those related to the newly established relations within the companies, but also the new relations between companies and the entire community. As practitioners in the area of capital markets, company law and company operations related to decision making, the team members unreservedly share the opinion that the concept of good corporate governance is a safe solution for arranging those relations in an optimal manner. This concept promotes new type of company culture, built and developed upon principles of ethics of the governance and management bodies, whose priority is the achievement of the best possible interest for the company shareholders and other stakeholders. Companies, whose management is characterized by attributes such as competence, integrity and responsibility, have good chances to achieve the standards of the “best practices”

The creation of this Manual was supported by the IFC Corporate Governance Project and by the USAID Business Environment Activity in Macedonia. In methodological sense, the basis for this Manual was the Russian Corporate Governance Manual, a project that was also financed by the IFC. The authors of this manual had the task to follow the content of the Russian manual to as higher degree as possible, and to properly adjust it to the domestic legislative and institutional framework.

The text presented here is just the first part of the planned scope of the entire project. It covers those areas that Macedonian Stock Exchange, as a direct participant in the project, has strived to be elaborated as soon as possible due to their current relevance, stressed by the dynamic developments of the securities market in the country. Therefore, this part of the Manual is composed out of the following topics:

1. *Introduction to the corporate governance*, part in which the concept of corporate governance is explained, also its development and its benefits;
2. *Legal and institutional framework for the corporate governance in the Republic of Macedonia*, part in which the most important issues of the corporate governance are explained from the standpoint of the current legislation;
3. *Data and information disclosure*, part where the importance of data disclosure is explained, but also the requirements that the legislation sets before the Macedonian companies are highlighted;
4. *Control and audit procedures*, part that deals with a very new subject from the standpoint of domestic companies since the regulation of this matter has not set yet and should be expected in the coming period.

The Manual is created to serve as a guide through the different areas, presented in the context of the relevant legislation for each of them separately. It makes the manual easy for use, helpful as a tool and thrifty with regard of the time needed for research, because it contains most of the information for the specific questions in one place. The biggest part of the topics covered is followed by appropriate examples from the best possible practices, which may serve as recommendations for the operations and behavior of the companies. We hope that this manual will be of a great benefit to the company leaders, governance bodies, managers and shareholders, as well as for all others interested in the area of corporate governance.

***Olga Mihajlova Tikvarovska, M.Sc.***  
***Project Leader***

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## Abbreviations

NBRM	National Bank of the Republic of Macedonia
MIS	Management Information Systems
US or USA	United States of America
IFAC	International Federation of Accountants
OECD	Organization for Economic Co-operation and Development
NACD	National Association of Corporate Directors
IOSCO	International Organization of Securities Commissions
IFC	International Finance Corporation
USAID	United States Agency for International Development
JSC	Joint Stock Company
LLC	Limited Liability Company
EU	European Union
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards
MD&A	Management's Discussions and Analyses
MSE	Macedonian Stock Exchange
GMS	General Meeting of Shareholders
MKD	Macedonian Denar
CEO	Chief Executive Officer
SEC	U.S. Securities and Exchange Commission

# **PART I**

## **INTRODUCTION TO CORPORATE GOVERNANCE**



## Corporate Governance Introduced

The corporate governance issue in Macedonian companies has been brought forward during the recent few years. The main reason is the fact that the completion of the privatization process of socially-owned, and partly state-owned, enterprises has put emphasis to the challenge to reasonably regulate relationships established within companies on one hand, and relationships between companies and larger society on the other. All market economies, including those with longest tradition, have faced this kind of challenge so far. The issue includes relationships adherent to capital ownership; decision-making related to manners in which capital is governed; procedures for assigning decision-making authorities; techniques of execution of the decisions made; and systems that provide control of the whole process, in order to protect ownership and capital owners' rights. Those relationships include systems developed and maintained by companies in order to support their communications with business partners, creditors, citizens, and the government. Thus, of concern is quite a wide scope of involved players ("stakeholders"), each pertaining to different company's goals and interests. Capital owners insist on permanent and increasing profit growth; managers and directors strive to maximize their compensations and express their abilities. Creditors are interested in both investing funds and ensuring returns at most favorable possible terms. The government is persistent in collecting taxes and duties, and investors attempt to assess company's suitability for their possible investments.

At first glance it seems complicated and even impossible for all these relationships to be arranged in a way acceptable to all players. That is, actually, not likely to be fully achieved anyway. However, by introducing good corporate governance, companies create conditions for reducing conflicts that exist between goals and interests of different involved players (stakeholders) to the lowest, or at least most acceptable extent.

Another reason for actualization of the corporate governance issue in Macedonia is opening up of the country's economy toward world markets, and therewith joining the globalization processes. Globalization, which understands free movement of capital, money, labor, and technology across countries, puts high pressure to the need for implementation of generally accepted principles and behavior practices in many areas, including, understandingly, corporate governance. In this context, corporate governance based on global standards may be seen as an introduction of a company behavior model, comprehensible to each global market participant, regardless of their origin.

Introduction of corporate governance is but standardization of companies' processes, procedures, and behavior that rests on principles of accountability, transparency, and control of companies' decision-making, day-to-day operations, and reporting obligations. As any other standardization, it is about reducing uncertainty and risk from involving with certain company, and in this case, of particular importance is the goal of increasing confidence in the company. The acceptance of such standardized approach to governance and conducting of

company's business, brings companies a specific kind of value added – one deriving from ethical operation. In companies with good corporate governance practices, decision-making is performed with a purpose of both achieving economic interests, and not violating interests of any of the stakeholders.

One of the most important characteristics of companies practicing good corporate governance is commitment to maintaining high level of transparency, demonstrated by ongoing reporting on companies' standing. Such transparency in corporate governance terminology is referred to as *information disclosure*. Companies implementing good corporate governance follow specific disclosure rules, which is particularly important when they go public. To be able to make a decision whether to invest in a company, investors want to make sure that such investment will not bring damages or losses. Standardized information disclosure systems, along with standardized company operation practices in general, provide investors with assurance that investment has been made at lowest possible risk.

With respect to the general objective of establishing fair, equitable and transparent market relations, a process of harmonization of corporate governance regulations has been put in place globally. This process may be seen as introduction of a corporate language that can be understood by all market participants. This is achieved by setting countries' regulations in accordance with principles, on which consensus has been reached in international realms. When developing own regulations, each country should respect own corporate ambience specificities, but, at the same time, should make as much effort as possible to found them on generally accepted standards and principles. Indeed, aligning national regulations with principles agreed upon globally means accepting common framework of good corporate governance.

The purpose of this manual is to explain the importance of corporate governance to interested public in Macedonia, and to help Macedonian companies increase their competitiveness by introducing systems of good corporate governance. The way in which different topics have been presented allows the manual be used as a tool for implementation of international standards of corporate governance by Macedonian companies. The manual uses materials prepared for *The Russia Corporate Governance Manual* by a team of international experts engaged by the International Finance Corporation, but is completely aligned with Macedonian laws and practices. It explains the ways in which national regulations address corporate governance issues, and suggests solutions for improvement of certain procedures and processes. Moreover, it includes thematic areas of practices that still need to be accepted by companies intending to enhance corporate governance practices. The manual should assist companies' officers make relatively simple checkouts of whether corporate governance concept is being implemented by following best practices, and complying with the applicable law, other regulations, and international standards. Other users, depending on their interests and needs, should find guidance in assessing the extent of corporate governance implementation in Macedonia, and/or proposing solutions for improvements.

### **The Chairperson's Checklist**

- ✓ Do all directors and key executives understand the concept of corporate governance and its significance to the company and its shareholders?
- ✓ Has the governing body (supervisory board or board of directors) developed a clear and explicit governance policy, and a plan for improving company's governance practices? Have steps been taken to implement this plan?
- ✓ Has the company formally appointed an individual (e.g. corporate secretary) or established a supervisory board committee (or similar body) responsible for supervising company's corporate governance policies and practices?
- ✓ Are key officers familiar with OECD Principles of Corporate Governance? Does the company follow legal obligations and recommendations for disclosure of information relevant to shareholders and other stakeholders in its annual report?
- ✓ Is the company familiar with the main institutions active in the field of corporate governance that may assist the development of its corporate governance practices?
- ✓ Does the company's legal form best reflect the interests of the owners? What are the alternatives to that form?
- ✓ In addition to the general meeting of shareholders and governing bodies, has the company established assisting bodies, particularly an internal control and audit committee? Have these bodies been provided with appropriate conditions and resources needed for normal operation?
- ✓ Does the company have a valid charter, which includes provisions on protection of shareholders rights, equitable treatment of shareholders, distribution of authorities among governing bodies, and information disclosure?
- ✓ How detailed is the charter and company's by-laws? Do they hold both to the letter and the spirit of the applicable regulations?
- ✓ Is the charter freely available to interested parties? Is the charter accessible on company's website?
- ✓ Has the company developed by-laws? Are these by-laws adopted by the relevant body?
- ✓ Has the company adopted a corporate governance code? If yes, is it based on principles of fairness, responsibility, transparency, and accountability? Does the code provide for recommendations regarding relationships between different governing and management tiers?
- ✓ Has the company identified its core values? Has the company, based on those values, adopted a code of ethics?

## A. Corporate Governance Explained

### 1. Defining Corporate Governance

The term corporate governance in its broader sense refers to the way in which balance of interests between various persons and entities related to a specific company is established. It points to the system of defining and achieving company's goals, assessing company's risks, and selecting tactics for attaining good performance. Companies implementing good corporate governance create value and provide accountability and control systems equivalent to the risk assumed. Those companies are committed to introducing and implementing governance practices based on integrity; practices that are beneficial to all stakeholders – including shareholders, employees, clients, suppliers, potential investors, and communities in which they operate. In other words, good corporate governance enables harmonious relationships among all players which have any interest relating to a company.

Despite the growing popularity of this term in recent decades, it is not easy to choose from the series of definitions a comprehensive one, explaining precisely and concisely its substance. It is due to its complexity, abundance of different contents, each equally compound to be easily defined itself. The term corporate governance includes elements related to numerous different structures, systems, processes and responsibilities. There is always a risk that the definition disregards one element on the account of another, which is favored for that matter. Some definitions limit the meaning of corporate governance only to the relationships within a company, whereas others emphasize its meaning to the relevant social context as well. Some focus in the financial aspects of corporate governance, some in its legal background, while at the same time the number of definitions which attempt to specify the structure of corporate governance, in rather much detail and more comprehensive way, is growing. The following examples are illustrative of the foregoing:

- James D. Wolfensohn, the ninth president of the World Bank Group, who himself comes from the investment, and corporate/government consulting business, presents possibly the most concise a definition of corporate governance by saying that “corporate governance is about promoting corporate fairness, transparency and accountability.”<sup>1</sup>
- Professors Andrei Shleifer (from Harvard) and Robert W. Vishny (from the University of Chicago), reputable researchers in the field of finances and capital markets, both agree that “corporate governance deals with the

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<sup>1</sup> James D. Wolfensohn for Financial Times, June 21 1999.

way suppliers of finance assure themselves of getting a return on their investment.”<sup>2</sup>

- Professor Henrik Mathiesen from the Center for Corporate Governance of the Copenhagen Business School in 1999 sketched, and in 2002 summarized today’s quite often used a definition of corporate governance, according to which  
 “Corporate governance is a field in economics that investigates how to secure/motivate efficient management of corporations by the use of incentive mechanisms, such as contracts, organizational designs and legislation. This is often limited to the question of improving financial performance, for example, how the corporate owners can secure/motivate that the corporate managers will deliver a competitive rate of return.”<sup>3</sup>
- Sir Adrian Cudbary – promoter of the corporate governance debate, businessman, and longstanding director of the Bank of England, explains that  
 “Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society.”<sup>4</sup>
- Professor of corporate governance at Cambridge University Simon Deakin states that  
 “Corporate governance is about how companies are directed and controlled. Good governance is an essential ingredient in corporate success and sustainable economic growth. Research in governance requires an interdisciplinary analysis, drawing above all on economics and law, and a close understanding of modern business practice of the kind which comes from detailed empirical studies in a range of national systems.”<sup>5</sup>
- Margaret Blair, economist and professor of management law at the Vanderbilt University in the U.S.A., considers that corporate governance is about “the whole set of legal, cultural, and institutional arrangements that determine what public corporations can do, who controls them, how that control is exercised, and how the risks and return from the activities they undertake are allocated.”<sup>6</sup>

<sup>2</sup> Andrei Shleifer, Robert W. Vishny in Survey of Corporate Governance, The Journal of Finance, June 1997.

<sup>3</sup> Henrik Mathiesen, 2002.

<sup>4</sup> Sir Adrian Cudbary, “*Global Corporate Governance Forum*”, World Bank, 2000.

<sup>5</sup> <http://www.corpgov.net/library/definitions.html>.

<sup>6</sup> Margaret Blair, “*Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century*”, Brookings, 1995.

Inspired mostly by the approach of Sir Adrian Cudbary, OECD experts have promoted a corporate governance definition which is increasingly widely accepted by the circles close to the academia and business. This definition reflects systemic, but still structural a content of the term.

“Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions about corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.”<sup>7</sup>

Notably, different approaches to defining corporate governance depend on the field of major interest of the authors of definitions. As the purpose of the manual is to bring closer the concept of corporate governance to Macedonian companies and assist them achieve higher level of implementation effectiveness thereof, it holds to the fundamental principles of the global, worldwide corporate governance practices. It makes clear distinction among capital (shareholders), capital directing (board of directors), and management (executive functions, administering).<sup>8</sup>

- Corporate governance refers to relationships and roles established among all players that have any kind of interest in a particular company. They include shareholders, supervisory boards, management boards, managers<sup>9</sup>, employees, clients, suppliers, the government, and the local community. Effective corporate governance means that roles and relationships established in the framework of such constituted a company structure, are least conflicting and most ethical.
- The relationships of the management board<sup>10</sup> and the management with the shareholders should be based on honesty; their relationships with the employees should be characterized by justice; their relationships with the outside communities should function in a good civil ethics fashion; whereas their relationships with the government should rest on principles of compliance with the law.

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<sup>7</sup> OECD, April 1999.

<sup>8</sup> *Principles of Corporate Governance*, Business Roundtable, May 2002.

<sup>9</sup> The term management here refers to company's executive titles (chief executive officer, chief department officers etc.), i.e. administering functions.

<sup>10</sup> The specific roles and responsibilities of the management board and the board of directors in Macedonia will be explained later on, when differences between one-tiered and two-tiered governance systems will be discussed.

- Senior management, headed by the chief executive officer, is responsible for company's day-to-day operations, and is obligated to provide the board with relevant information on company's condition. Principal responsibilities of the management in that respect are: strategic planning, risk management, and financial reporting.
- The role of the board of directors (or the supervisory board) is to supervise management's work and monitor company's results on behalf of the shareholders. Its foremost responsibility is to select competent and virtuous chief executive officer, monitor her/his work, as well as the work of the rest of the management, and to scrutinize management's adherence to company's standards.
- The shareholders are normally not involved in company's day-to-day operations, but they effectuate their interest in capital multiplication through the right to elect the persons who direct it, i.e. the persons who manage the company. To be able to competently decide on important aspects of company's development, they also need to have quality information, which is to be provided by the board and the management.
- It is in company's interest that employees are treated in a just and fair manner. The company should have a policy of proper compensation and protection of the employees during the, and pertaining to work. Fair treatment of the employees is one of the essential prerequisites to their motivation. Democracy in relationships with employees is particularly important an element of good corporate governance.

Therefore, **good corporate governance structure is one in which a successful system is set up, in terms of setting goals and making decisions, as well as in terms of proper monitoring of goals achievement and decisions implementation. In this way, through such organized a structure of relationships and processes, the company can successfully face the changes in the environment, and react consequently, in a fashion that does not compromise the interests of any of its stakeholders.**

However, as already mentioned, the story of good corporate governance does not end by establishing solid internal structure. The company is an entity that both affects and is affected by the environment in which it operates, and therefore establishing harmonious relationships with its surroundings is critical as well.

## **2. Relationships with Stakeholders**

The relationships that a company is building with its external environment are of particular significance to good corporate governance. Suppliers, clients, potential investors, community in which the company is doing business, as well as the government, are key representatives of that environment.

Relationships with stakeholders from the external environment are of utmost importance to company's image and reputation. Good relationships with suppliers, permanent improvement of the products/services provided to clients, responsiveness toward interest expressed by potential investors, good communication with the government, and high responsibility before the local community, are all attributes of good corporate governance.

However, one of the key characteristics of companies implementing good corporate governance is their willingness to disclose data and information on company's operations on regular basis. The company should communicate with the shareholders, potential investors, and other stakeholders in such a fashion as to allow them acquire accurate, realistic, timely, and relevant information on company's condition, financial performance, objectives, and development matters.

With respect to the local community in which they operate, companies are responsible for their conduct, likewise any other member of that community. They are also responsible for the effects of their business, including those relating to population's health and safety. Companies should implement policies which require management to take responsible attitude toward the community in general, educative approach toward the citizens, and commitment to launching socially responsible projects.

Regarding relationships with the government and the state, company's main responsibility is to comply with regulations. Company's objectives and strategies must be in accordance with the existing legal and regulatory framework. Company's development programs must not be in conflict with government's goals and objectives. In fact, successful companies often act as initiators of modernization of country's legal framework and business practices.

### **3. A Brief History**

Good corporate governance should be regarded as one of the most useful tools for maintaining, growth, and prosperity of company's businesses. However, at times when external (particularly foreign) capital becomes ever more important source of companies' financing, the critical role of good corporate governance is, probably, to protect investors. On the other hand, regardless of national economy's development stage, in many cases investors give up from investing in certain companies because of lack of information on their performance, i.e. because of poor corporate governance. The capital "runs away" from companies that resemble a black box, and is directed toward those which implement good corporate practices.

Illustrative of the fact that poor corporate governance is frequently the main reason for collapses of powerful corporations are the examples of scandalous bankruptcies of companies in the corporate history, followed by revelation of mega frauds, mainly performed by the management structures. The following table outlines a rather informative calendar of events, important for the



development of corporate governance practices, which includes the emergence of corporate governance practices, dates of incidents that have labeled the global practice of corporate governance, and some well-known scandals about collapses of corporations due to poor structure of corporate governance.

**Table 1: Calendar of Corporate Governance Events**

Year	Corporate Event
<b>1600s:</b>	The <b>East India Company</b> introduces a Court of Directors, separating ownership and control (U.K., the Netherlands)
<b>1776:</b>	<b>Adam Smith</b> in the «Wealth of Nations» warns of weak controls over and incentives for management (U.K.)
<b>1844:</b>	First Joint Stock Company Act (U.K.)
<b>1931:</b>	<b>Berle and Means</b> publish their seminal work «The Modern Corporation and Private Property» (U.S.)
<b>1933/34:</b>	The Securities Act of 1933 is the first act to <b>regulate the securities markets</b> , notably registration disclosure. The 1934 Act delegated responsibility for enforcement to the SEC (U.S.)
<b>1968:</b>	The EU adopts the first <b>company law directive</b> (EU)
<b>1987:</b>	The <b>Treadway Commission</b> reports on fraudulent financial reporting, confirming the role and status of audit committees, and <b>develops a framework for internal control</b> , or COSO, published in 1992 (U.S.).
<b>Early 1990s:</b>	Polly Peck (£1.3bn. in losses), BCCI and Maxwell (£480m) <b>business empires collapse</b> , calling for improved corporate governance practices to protect investors (U.K.)
<b>1992:</b>	The <b>Cadbury Committee</b> publishes the first code on corporate governance; and in 1993, companies listed on <b>U.K.'s Stock Exchanges</b> are required to disclose governance on a «comply or explain» basis (U.K.)
<b>1994:</b>	Publication of the <b>King Report</b> (S. Africa)
<b>1994, 1995:</b>	<b>Ruttman</b> (on Internal Control and Financial Reporting), <b>Greenbury</b> (on Executive Remuneration), and <b>Hampel</b> (on Corporate Governance) reports are published (U.K.)
<b>1995:</b>	The Russian <b>Law on Joint Stock Companies</b> is adopted (Russia)
<b>1995:</b>	Publication of the <b>Vienot Report</b> (France)
<b>1996:</b>	Publication of the <b>Peters Report</b> (the Netherlands)
<b>1998:</b>	Publication of the <b>Combined Code</b> (U.K.)
<b>2001:</b>	<b>Enron Corporation</b> , then the seventh largest listed company in the U.S., declares bankruptcy (U.S.)
<b>2001:</b>	The <b>Lamfalussy</b> report on the Regulation of European Securities Markets (EU) is published
<b>2002:</b>	Publication of the <b>German Corporate Governance Code</b> (Germany)
<b>2002:</b>	Publication of the FCSM <b>Russian Code of Corporate Conduct</b> (Russia)
<b>2002:</b>	The <b>Enron collapse</b> and other corporate scandals lead to the <b>Sarbanes-Oxley Act</b> (U.S.); the <b>Winter</b> report on company law reform in Europe is published (EU)
<b>2003:</b>	The <b>Higgs</b> report on non-executive directors is published (U.K.)
<b>2004:</b>	The Parmalat scandal shakes Italy, with possible EU-wide repercussions (EU).

Source: IFC, March 2004

The busy agenda of corporate governance development in two recent decades is obvious. It is not hard to notice that this is a result of the extremely increased dynamics of capital flows in global realms, as a consequence of globalization, as well as of the opening up of emerging markets and transition economies. With a view to protecting investors against risks from entering unregulated environments, there is a growing tendency toward regulation of relationships in corporate governance area by specific legal (and other) regulations, i.e. toward standardization of corporate governance structure, systems, and processes, following unified principles.

## 4. Standardization of Corporate Governance

Among the events presented in the calendar of key moments in the history of corporate governance, notably eminent are those associated with adoption of various regulations, including corporate governance codes in particular countries. Certainly, the calendar does not list all countries that have introduced this kind of regulations. Actually, by the end of 2004 over 100 codes have been enacted worldwide, majority of them focusing in the role and functions of the top governing bodies in the companies.

At the same time, with a view to enabling unified approach toward corporate governance, both by policy makers and businesses, but also for the sake of building a unified framework of all of its aspects (shareholders rights, stakeholders, disclosure procedures, boards' operations, etc.), the *OECD Principles of Corporate Governance* have been launched. Published in 1999 and revised in 2004 they are aimed at providing guidance on good corporate governance. The OECD Principles will be discussed in much detail in the next chapter. Here the emphasis is only on the four core values on which OECD's corporate governance framework is built.

- *Fairness*: The corporate governance framework should protect shareholder rights and ensure equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violations of their rights.
- *Responsibility*: The corporate governance framework should recognize the rights of stakeholders as established by law, and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.
- *Transparency*: The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the company, including its financial situation, performance, ownership, and governance structure.
- *Accountability*: The corporate governance framework should ensure the strategic guidance of the company, effective monitoring of management by the board, and board's accountability to the company and shareholders.

Following the publishing of OECD Principles a number of countries, including Macedonia, have drafted their codes in accordance with them. The incorporation of these principles into corporate governance practices in different countries adds a great deal to the standardization of issues in this field.

## **5. Corporate Governance vs. Corporate Management**

It is very important to differentiate between corporate governance and corporate management. Despite their close relationship and terminological similarity, these two terms have completely different substance. Corporate governance, as already explained by definitions earlier, is about structures and processes in a company through which a fair, responsible, transparent, and accountable conduct is ensured. Corporate management on the other hand, is about the tools needed for running a business. Corporate governance is superior to the latter, and provides directions in the ways in which a company is to be governed in order to comply with the interests of the shareholders and all other stakeholders.

One area of overlap of corporate governance and corporate management is company's strategy. It constitutes both one of the critical elements of corporate governance, and one of the critical contents of corporate management.

Corporate Governance must also not be confused with public governance. Whereas corporate governance is appropriate to the companies from the private sector, public governance deals with the governance structures and systems within the public sector.

Several other terms, which are frequently identified with corporate governance, despite their complete difference in contents, have to be mentioned. Such terms are corporate social responsibility, good corporate citizenship, and business ethics. While corporate governance strongly encourages the kinds of corporate behavior promoted by these concepts, it still remains distinct from them.

## **B. Benefits of Corporate Governance**

Good corporate governance is important on a number of different levels.

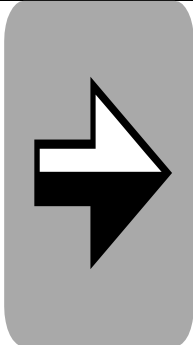
At the company level, well-governed companies tend to have better and cheaper access to capital, and tend to outperform their poorly governed peers over the long-term. Companies that insist upon highest standards of governance reduce many of the risks inherent to investment in a company. Companies that actively promote strong corporate governance practices need in key positions employees who are willing, and able, to devise and implement good corporate governance policies. These companies will generally value and compensate such employees better than their competitors that are unaware of, or ignore, the benefits of these policies and practices. In turn, such companies tend to attract more investors who are willing to provide capital at lower cost.

More generally, well-governed companies are better contributors to the national economy and society. These companies tend to be healthier and to add more value to shareholders, workers, communities, and countries, in contrast

with poorly governed companies that may cause job losses and loss of pensions, and may even undermine confidence in securities markets.

Some of the levels and specific benefits of good governance are summarized in Figure 1 and discussed in further detail below.

**Figure 1: Levels and Potential Benefits of Good Corporate Governance**

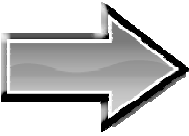
The Four Levels of Corporate Governance		Potential Benefits
Level 4: Corporate governance leadership		Improved Operational Efficiency
Level 3: Advanced corporate governance system		Access to Capital Markets
Level 2: Initial steps to improve corporate governance		Lower Cost of Capital
Level 1: Compliance with legal and regulatory requirements		Better Reputation of the Company, its Directors, and Managers

Source: IFC, March 2004

# 1. Stimulating Performance and Improving Operational Efficiency

There are several ways in which good corporate governance can improve performance and enhance operational efficiency, as illustrated in Figure 2.

**Figure 2: Advantages of Corporate Governance**

Better Oversight and Accountability		Increases Operational Efficiency and Stimulates Performance
Improved Decision-Making		
Better Compliance and Less Conflict		

Source: IFC, March 2004

Improvements in company's governance practices lead to the **improvement in its accountability system, minimizing the risk from fraud** or self-dealing by company's officers. Accountable behavior, combined with effective risk management and internal control, can bring potential problems to the forefront before a full-blown crisis occurs.

Corporate governance improves the management and oversight of executive performance, by linking for example executive remuneration to the company's financial results. This creates favorable conditions not only for planning a smooth succession and continuity in company's executive positions, but also for sustaining company's long-term development.

Adherence to good corporate governance standards may also be a device for **improvement of the decision-making process**. For example, managers, directors and shareholders are all likely to make more informed, faster and better decisions when the company's governance structure allows them to clearly understand their specific roles and responsibilities, as well as when communication processes are regulated in an effective manner. This, in turn, should significantly enhance the efficiency of company's financial and business operations at all levels. High quality corporate governance streamlines all company's business processes, and leads to better operating performance and lower capital expenditures, which, in turn, may contribute to the growth of sales and profits with a simultaneous decrease in capital expenditures and requirements.

An effective system of governance practices should ensure **compliance with applicable laws, standards, rules, rights, and duties of all interested parties**. Furthermore, it should allow companies avoid costly litigations, which include shareholder claims, and other disputes resulting from fraud, conflicts of interest, bribery, corruption and insider trading. A good system of corporate governance will facilitate the resolution of corporate conflicts that may arise between minority and controlling shareholders, executives and shareholders, as well as between shareholders and the rest of the stakeholders. Such system is beneficial to company officers as well, for it minimizes the risk from personal liability.

## 2. Improving Access to Capital Markets

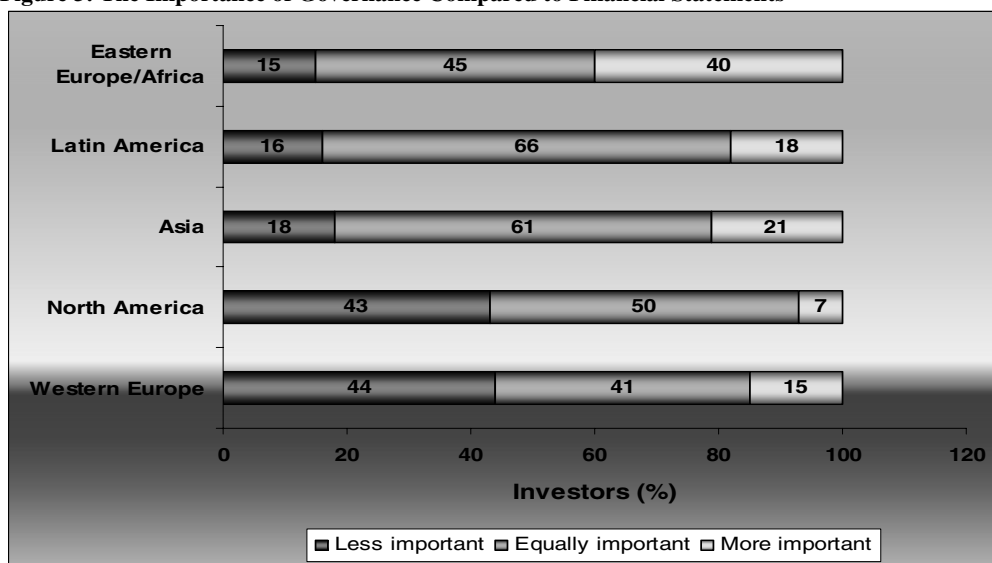
Corporate governance practices can determine the ease with which companies are able to access capital markets. Well-governed firms are perceived as investor-friendly, and spur greater confidence in their ability to generate returns without violating shareholder rights.

Good corporate governance is based on the principles of transparency, accessibility, efficiency, timeliness, completeness, and accuracy of information at all levels. Investors benefit from the enhancement of company's transparency by being provided with an opportunity to gain insight into company's business operations and financial data. Even if the

information disclosed by the company is negative, shareholders will benefit from the decreased risk from uncertainty.

Recently, a trend is evident among investors to include corporate governance practices in their investment decisions as a key decision-making criterion. The reason behind may be in their perception that better corporate governance structure and practices increase the likeliness that assets are used in the interest of shareholders and are not tunnelled or otherwise misused by managers. Figure 3 shows how investors rate corporate governance across world regions. They have been asked how important are to them corporate governance practices versus financial matters (profit history, potentials for growth) in the decision-making process regarding investment in a particular company.

**Figure 3: The Importance of Governance Compared to Financial Statements**



Source: McKinsey & Company, Global Investor Opinion Survey, July 2002

Obviously, in the regions where shareholders are not provided with high level of protection (Eastern Europe, Africa, Latin America, and Asia) corporate governance constitutes a considerably important criterion for making investment decisions.

Finally, new listing requirements on many stock exchanges around the world require companies to adhere to increasingly strict standards of governance. Companies wishing to access both domestic and international capital markets will need to follow specific corporate governance standards.

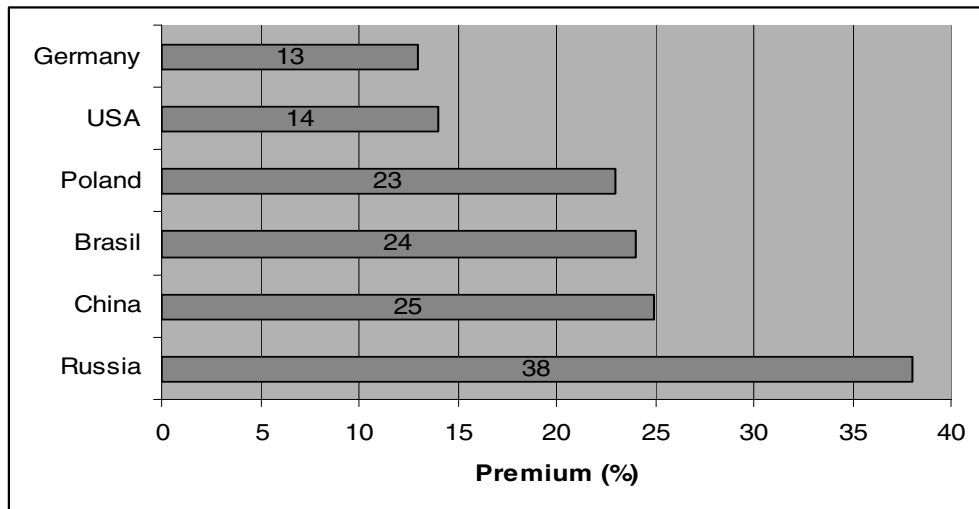
### 3. Reducing Company's Cost of Capital and Raising the Value of Assets

Companies committed to high standards of corporate governance are typically successful in obtaining better terms of debts, incurred for financing their operations, and in this way, they are able to decrease the cost of capital. The cost of capital depends upon the level of risk assigned to the company by investors: the higher the risk, the higher the cost of capital. This risk includes the risk from violations of investor rights. If investor rights are adequately protected, the cost of both equity capital and debt may decrease. It should be noted that recent tendency of investors placing capital via lending i.e. creditors has been to include company's corporate governance practices (for example transparent ownership structure and appropriate financial reporting) as a key criterion in their investment decision-making process. Therefore, setting a good corporate governance system should ultimately result in a significant long term benefit – the company will pay lower interest rates, and receive longer maturity on loans and credits.

The risk level and the cost of capital also depend on country's economic or political situation, institutional framework, and enforcement mechanisms. Corporate governance practices of individual companies thus play a crucial role in emerging market economies, which often have not yet reached the level of investor rights protection of the developed market economies.

This holds particularly true in countries where the legal framework of corporate governance is relatively new and is still being tested, and where courts do not always provide investors with effective protection when their rights are violated. This means that even modest improvements in company's corporate governance relative to other companies can make a large difference and encourage investors to reduce the cost of capital.<sup>11</sup> Figure 4 is rather demonstrative of the fact that the majority of investors are willing to pay a premium for a well-governed company. In some transition countries such as Russia this premium may reach 38%. At a country level, studies show that economies with weaker corporate governance systems have considerably higher borrowing costs than many other countries, as a result of corruption, poor legislation and judicial practices, weak corporate governance, uncertainty, and unpredictability.

<sup>11</sup> Leora F. Klapper, Inessa Love, Corporate Governance, Investor protection and Performance in Emerging Markets, World Bank Policy Research Working Paper 2818, April 2002.

**Figure 4: A Premium for Better Corporate Governance**

Source: McKinsey & Company Global Investor Opinion Survey, July 2002

At the same time, there is a strong relationship between governance practices and how investors perceive the value of company's assets (such as fixed assets, receivables, product portfolio, human capital, research and development, and goodwill).

From investors' point of view, recently has been introduced an additional indicator, which is used for measuring risk levels that investors face in different countries – *the opacity index*.<sup>12</sup>

<sup>12</sup> PricewaterhouseCoopers, The Opacity Index, January 2001.



### *The Opacity Index*

In order to enable thorough analyses of the investment conditions worldwide, PricewaterhouseCoopers' experts have developed a tool termed "opacity index", which measures the extent to which individual countries lack clear, accurate, easily discernable, and widely accepted practices governing relationships among businesses, investors, and governments, and which directly affects the generation of investment risks. The index is calculated on grounds of five different components: business and government corruption (cost raised by corruption); an ineffective legal system (functioning of the legal system, general effectiveness in the field of dispute settlement, protection of businesses); economic price of businesses (including losses which result from bureaucratic procedures, opaque tax system, cost instigated by organized crime and terrorism); inadequate accounting and governance practices (extent to which banking and accounting legislation deviates from international standards); and detrimental regulatory structures (security of capital investments). The index ranks 48 countries (Macedonia is not included) and, according to 2004 data, among the countries with highest opacity indexes are: Indonesia (59), Lebanon (59), Venezuela (50), China (50), India (48), and so on, whereas this index is lowest in Finland (13), Great Britain (19), Demark (19), Sweden (19), Hong Kong (20) etc. Data from some of the Central and Eastern European countries are also included, such as Poland (41), the Check Republic (41), Hungary (36), and Russia (46).

## **4. Building a Better Reputation**

In today's business environment, reputation has become a key element of companies' goodwill. In spite of the fact that they are not tangible assets, company's reputation and image constitute substantial parts of its overall value. Good corporate governance practices contribute to and improve company's reputation. Thus, companies that respect the rights of shareholders and creditors, and ensure financial transparency and accountability, are regarded as ardent advocates of investors' interests. As a result, such companies enjoy more public confidence and gain in goodwill.

This public confidence and goodwill, on the other hand, lead to higher trust in the company and its products, which in turn may lead to higher sales and, ultimately, higher profits. Moreover, affirmative image or goodwill is known to play a significant role in company's valuation. In accounting terms, **goodwill is the amount of the purchase price that exceeds the fair value of the acquired company's assets.** It is the premium that a company pays in order to acquire another company.

## C. The Costs of Corporate Governance

Good governance entails real costs. Some of the costs include hiring dedicated staff such as corporate secretaries<sup>13</sup>, experienced and independent directors, internal auditors, or other governance specialists. It may possibly require payment of fees to external counsellors, auditors, and consultants. The costs of additional disclosure, to the legally required one, can be significant as well. Furthermore, it consumes considerable amount of management's and supervisory board's time, especially during the initial stage. These costs tend to make implementation considerably easier to larger companies that have large resources at their disposal than to smaller ones, the resources of which may be quite limited.

**Best Practices:** Corporate governance is most applicable to larger, publicly traded joint stock companies. A large, dispersed shareholder base, where controlling shareholders and managers can wield extraordinary powers and potentially abuse shareholder rights, often defines such companies. Moreover, large companies are important elements of a country's economy and thus require close public scrutiny and attention.

However, corporate governance is beneficial to all companies, irrespective of their size, legal form, number of shareholders, ownership structure, or other characteristics. Of course, a one-size-fits-all approach should be avoided and companies should carefully apply corporate governance standards. For instance, smaller companies may not require a full set of supervisory board committees or a full-time corporate secretary. On the other hand, even a small company may benefit from an advisory body.

A company will not always see instant improvements to its performance as a result of better corporate governance practices. However, returns, while sometimes difficult to quantify, generally exceed the costs, particularly over the long term. This is especially true when one takes into account potential risks from losses in jobs, pensions, and invested capital, and the disruption that may be caused to communities when companies collapse. In some cases, systemic governance problems may undermine the confidence in financial markets and jeopardize their stability.

Finally, it must be noted that corporate governance is not a one-time exercise but rather an ongoing process. No matter how many corporate governance structures and processes the company has in place, it is advisable to regularly update and review them. Markets tend to value long-term commitment to good governance practice rather than single actions or “box-ticking” exercises.

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<sup>13</sup> Or internal legal advisors.

## D. Notes on Corporate Governance Environment in Macedonia

Despite the presence of the processes of approximation to global corporate governance models, cross country differences still remain significant. Each country has its own history, culture, and legal and regulatory framework, which affect country-specific corporate governance models. Regarding the Macedonian corporate sector, its main characteristics may be summarized as follows:

*Gradual concentration of ownership.* The majority of Macedonian socially-owned enterprises were privatized in the nineties, by models that favored employee ownership of companies. That resulted in rather dispersed ownership structure of companies. The assessments refer to more than 300,000 individuals that have become shareholders through the privatization process. During the post-privatization stage, on the other hand, an ownership concentration process has got underway, leading to decrease of the number of shareholders from over 255,000 in 2004 to 105,000 in August 2007. In some instances the ownership concentration was occurring under the pressure of companies' governing structures, given the weaknesses in the legal framework relating to minority shareholders protection. In that respect, part of the 1996 Company Law provisions were actually in favor of companies' governing structures. In other cases the concentration was a result of voluntary decisions of shareholders to sell their shares on the Macedonian Stock Exchange, and make earnings in that way. The insider domination in terms of ownership, and the low level of investor protection during a lengthy period of time, were the possibly major impediments to the development of country's securities market. Even today the number of companies listed on the Macedonian Stock Exchange is quite small. Nevertheless, the legislation that regulates the areas of companies and securities, along with the presence of the Central Securities Depository – the state authority for securities registration, have all led to the entirely new quality in this field.

*Twofold role of both company shareholder and company employee.* As large numbers of companies' employees are at the same time companies' shareholders, it is common for these individuals to be incognizant of the rights and duties that derive from each of their two, entirely opposite, roles. Below are several examples:

- Many of the employees that are at the same time company's shareholders believe that owning certain number of company's shares

makes them absolute and unequivocal owners of the company, and as such resistant to lay offs on any grounds.

- It may occur that these individuals, when unsatisfied with company's affairs, act merely in the capacity of employees and organize strikes or protests, without seeing that company's operations are as much their responsibility, and that the general meeting of shareholders is the means through which they can initiate procedures for changes in company's governing bodies and policies.
- Occasionally, the concurrent positions of both a shareholder and an employee of the same company result in conflicting situations for such individuals – whereas the position of an employee presses for job protection, the position of a shareholder urges to cutting costs, downsizing, and increasing share value. Conflicts as such preclude effective decision-making in the company.

*Lack of separation of company's ownership from company's control.* Despite the possibility of separation of company's ownership from its control, as provided for by law<sup>14</sup>, the practice is showing something completely opposite. Majority vote shareholders most often hold companies' top positions (either the position of chief executive officer, or management board chairman, or both concurrently) and have tremendous influence on company's day-to-day operations. These companies suffer from lack of control and oversight systems, as well as systems for regular and accurate information disclosure, needed by both existing shareholders and potential investors.

*Inadequate oversight of management's work.* Very often members of companies' supervisory boards are insufficiently competent or inexperienced individuals, close to the controlling shareholders or to the management, or individuals that are under direct control of persons, who are supposed to be controlled by them. That results in improper oversight of companies' top decision-making structures.

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<sup>14</sup> Company Law, Article 383.

## **E. Legal and Institutional Framework of Corporate Governance in Macedonia**

### **1. Legal Framework**

Likewise other transition countries, since the beginning of nineties Macedonia has embarked on a complex process of setting an appropriate environment for doing business, in conditions of private ownership and free market economy. Drafting a legal framework, which would clearly define the grounds on which companies operate and establish internal relationships, has been one of the highest priorities. To that end, the first challenges had been laid by the privatization of socially-owned enterprises, which were the early leaders in the ownership transformation process, although the design of an appropriate legal framework was important to newly established companies as well, for it was a precondition for their start-up and future operation.

In 1996 was enacted the first Company Law. Because of its insufficient correspondence to the Macedonian market realities, it failed to respond to the needs of companies' day-to-day operations. Therefore, in the drafting process of the new Company Law were involved relevant representatives of both public and private sector. Its enactment took place in May 2004. Regarding the process of its implementation in the three years that followed, it may be concluded that the new law basically satisfies the needs of the private sector as a whole, but in particular those of the joint stock companies.

Unlike some other national legislations, which regulate different forms of doing business by separate laws (U.S.A., Germany, Russia), in Macedonia all forms of doing business fall under the same law – the Company Law. Regarding the corporate governance regulations, beside the Company Law, the legal framework includes the Securities Law, the Law on Takeovers, the Bankruptcy Law, as well as the Macedonian Stock Exchange's corporate governance code and listing rules.

According to the opinion of the experts in the field, the corporate governance regulations in Macedonia at this point constitute a solid base for full implementation of corporate governance practices by companies.<sup>15</sup> They have been aligned with the respective regulations of the European Union to a

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<sup>15</sup> The term "company" is used further in the text with the same meaning as earlier, but with a view to the needs of relevant contexts, as well as to the specificities of the Macedonian legislation, the terms "joint stock company", "commercial entity" and "partnership" will also be frequently used.

high extent, and they incorporate the corporate governance principles accepted by the larger international business community. However, given the fact that the corporate governance practices in the country are undergoing the initial development stage, the challenges of raising the awareness about the benefits of their implementation still lay ahead. At the same time, it is not hard to expect that the process of practicing corporate governance in the country in the coming period will result in various initiatives for improvements of, and changes in the existing legal framework.

The following table is a summary of the Macedonian corporate governance legal framework.

<b>Table 2: Legal Framework of Corporate Governance Practices in Macedonia</b>		
<b>Law/Regulation</b>	<b>Applicable to</b>	<b>Explanations</b>
Company Law	All commercial entities	Regulates company forms and legal capacities
Securities Law	Joint stock companies and limited partnerships by shares, which have issued securities that were publicly offered	Regulates the manners of securities issuance and trading
Law on Takeovers	All public joint stock companies	Regulates takeovers, and in particular minority shareholders protection
Corporate governance code	Joint stock companies on the Macedonian Stock Exchange's super listing, but other joint stock companies are not excluded	Complements the Company Law and the Securities Law
Other regulations (bankruptcy, taxes, etc.)	All commercial entities	Regulate company-specific situations
Listing Rules of the Macedonian Stock Exchange	All joint stock companies, listed on the Macedonian Stock Exchange	Regulates companies' access to and participation in the stock exchange

In order to promote the concept of good corporate governance and stimulate commercial entities to embark on the process of implementing the best practices in this field, in 2006 the Macedonian Stock Exchange has adopted the *Corporate Governance Code for Companies Listed on the Macedonian Stock Exchange*.

**Best Practices:** The *Corporate Governance Code for Companies Listed on the Macedonian Stock Exchange* has been prepared in order to be implemented in combination with the new Company Law. Although the code should not be a replica of the standards provided for by the Company Law, because of the early stage of country's corporate governance development, it has been drafted based on corporate governance provisions of that law.

The code has been prepared in accordance with the recent OECD's *Corporate Governance Guidelines*, the OECD's *White Paper on Corporate Governance in South East Europe*, and the EU *Action Plan for Company Law and Corporate Governance*. Further documents that constitute the code's foundation are the code of conduct prepared by the Macedonian Corporate Governance Council, and the corporate governance codes of other countries (e.g. the *Corporate Governance Code of Netherlands*).

The main objective of the Macedonian corporate governance code is to provide a set of practical guidelines for implementation of corporate governance practices in accordance with best management practices. The code is designed for the managers and shareholders of joint stock companies listed on the Macedonian Stock Exchange, whereas companies that are not on the market at this point are also encouraged to consider soon implementation of the code. The code has been prepared such as to emphasise the matters relating to the importance of impartial (equitable) treatment of all shareholders; information disclosure; management's and directors' integrity and accountability; and other aspects of good corporate governance, which act in favour of enhancing investors' confidence in companies.

## 2. Institutional Framework

Building a system of institutions, which play a key role in the development of the Macedonian corporate governance framework, is of utmost significance regarding the implementation of this concept by companies. The Securities Commission and the Macedonian Stock Exchange (established in mid-nineties), along with the Central Securities Depository (established in the beginning of the millennium), are key institutions that ought to respond to the challenges brought about by recent corporate governance trends.

Below are listed some of the institutions and organizations which have directly or indirectly participated, or have somehow been engaged in setting up the Macedonian corporate governance milieu.

**Table 3: Institutions and Organizations Relating to Corporate Governance Issues in Macedonia**

<b>Public Sector</b>
Securities Commission Ministry of Economics Central Securities Depository Judiciary (all levels of jurisdiction) Ministry of Finance National Bank of the Republic of Macedonia
<b>Private Sector</b>
Macedonian Stock Exchange Chamber of Commerce Chambers of Commerce Association
<b>Other Organizations</b>
Shareholders Rights Protection Union "Shareholder 2001" Union of Jurists Corporate Governance Council Macedonian Trade Union Consumers Union Institute of Chartered Auditors
<b>Universities</b>
Law Faculty, University of Ss Cyril and Methodius, Skopje Faculty of Economics, University of Ss Cyril and Methodius, Skopje Institute of Economics, University of Ss Cyril and Methodius, Skopje
<b>International Organizations</b>
International Finance Corporation (IFC) United States Agency for International Development (USAID) World Bank Organization for Economic Co-operation and Development (OECD)



## F. Joint Stock Companies and their Governance Structure

### 1. Forms of Commercial Entities

The Macedonian legislation specifies and regulates the following forms of commercial entities:

- General Partnership;
- Limited Partnership;
- Limited Liability Company;
- Joint Stock Company; and
- Limited Partnership by Shares.<sup>16</sup>

**Best Practices:** At this point more than 95% of the Macedonian companies are registered as limited liability companies. This form is most appropriate for small and medium-sized businesses. Furthermore, 548 companies have been registered as joint stock companies, a form which is relevant to larger businesses. Of the joint stock companies total, 147 constitute joint stock companies subject to specific disclosure obligations (referred to as public joint stock companies), on which the Securities Commission holds a special registry. Securities of 41 companies have been listed on the Macedonian Stock Exchange, out of which 4 have been admitted to the super listing.

### 2. Joint Stock Company

**A joint stock company is a company in which shareholders participate with contributions in the charter capital that is divided into shares. The shareholders are not liable for the liabilities of the joint stock company.<sup>17</sup> The company may have one or more shareholders.<sup>18</sup>**

The minimum nominal value of the charter capital when a company is founded simultaneously without a public offering for shares underwriting is EUR 25,000 in MKD counter value. When a company is founded successively by way of public offering for shares underwriting, the minimum nominal value of the charter capital is EUR 50,000 in MKD counter-value.

<sup>16</sup> Company Law, Article 20.

<sup>17</sup> Company Law, Article 270.

<sup>18</sup> Company Law, Article 272.

The nominal value of a share may not be lower than EUR 1 in MKD counter-value.<sup>19</sup>

### 3. Joint Stock Company Types With Respect to Corporate Governance

Depending on certain criteria, such as matters relating to charter capital amount; number of shareholders and number of shares owned publicly; and in particular to disclosure obligations, the Macedonian legislation differentiates between several types of joint stock companies:

- **Joint stock companies listed on an authorized securities market.** For these companies the disclosure obligations are stipulated by the listing rules of the Macedonian Stock Exchange.
- **Joint stock companies subject to specific disclosure obligations (public joint stock companies).** The disclosure obligations of these joint stock companies are provided for by the Securities Law and the by-laws deriving from it.
- **Other joint stock companies.** The disclosure obligations for these joint stock companies are set in the Company Law.

The table below summarizes the differences between these companies with respect to specific criteria.

**Table 4: Joint Stock Company Types in Macedonia According to Specific Corporate Governance Criteria**

	Listed Companies		Public Companies	Other Companies
	Super Listing	Stock Exchange Listing		
<b>Number of Shareholders</b>	At least 200	At least 100	At least 100	At least 1
<b>Charter Capital Size</b>	At least EUR 10 mil	At least EUR 0.5 mil	At least EUR 1 mil	At least EUR 25,000/50,000
<b>Shares Available to the Public</b>	At least 20%	At least 15%	No restrictions	No restrictions
<b>Disclosure Scope</b>	Maximum – the MSE's code is required	Maximum – the MSE's code is optional	Lesser requirements	According to the Company Law

<sup>19</sup> Company Law, Article 273.

## 4. Governance structure

All companies in Macedonia, regardless of the number of shareholders, must have the following governance structure:

- General meeting of shareholders; and
- Governing body/bodies.

**The governing of a company may be organized according to either one-tiered system (board of directors) or two-tiered system (management board or manger, and supervisory board).** The governance system is chosen by the company. By relevant amendments of the charter a one-tiered system may be replaced by a two-tiered system and vice versa.

### 4.1. General Meeting of Shareholders

The general meeting of shareholders is the highest governing body of a company. Each shareholder registered in the company's shareholder register, as of the day of entry in this register, is entitled to participation in general meeting's operations and to certain voting rights depending on the type and class of the shares owned.<sup>20</sup> The general meeting is an exclusive forum through which shareholders act on their rights in the company.

The general meeting of shareholders makes decisions about the following company issues:

- Amendments of the charter;
- Approval of the annual accounts and financial statements, and of the annual report of company's operations for the preceding business year, as well as of the resolution for profit distribution;
- Election and dismissal of board of directors and supervisory board members;
- Approval of company's operations and company's management, performed by the governing bodies;
- Changes in the rights attached to particular types and classes of shares;
- Increasing or decreasing the charter capital;
- Issuance of shares and other securities;

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<sup>20</sup> For types and classes of shares see Article 277 of the Company Law.

- Appointment of a certified auditor for the annual accounts and other financial statements audit, if the company is obliged to prepare them;
- Company's transformation into another form, as well as any changes in company's articles of incorporation; and
- Company's termination.<sup>21</sup>

The general meeting of shareholders may not decide about matters related to company's governance or to management of company's operations, which are under the competence of the governing bodies.<sup>22</sup>

The relevant governing body must call the general meeting of shareholders at least once annually, no later than 3 months after the completion of the annual accounts and financial statements, and of the annual report of company's operations for the preceding business year, and no later than 6 months following the end of the calendar year, or 14 months after the most recent annual meeting.<sup>23</sup>

The activities of the annual meeting of shareholders include the following:

- 1) Review and adoption of the annual accounts and financial statements, and of the annual report of company's operations in the preceding business year;
- 2) Decision about the net profit usage or loss coverage; and
- 3) Approval of the management and supervisory board members' work.<sup>24</sup>

General meeting of shareholders may be called extraordinary, or within the period between two annual meetings by different parties, whenever company's and shareholders' interests require so.<sup>25</sup> The governing body, the supervisory board, or the non-executive members of the board of directors can decide to call the general meeting of shareholders, either on their own initiative, or upon request by a shareholder. The decision must be passed with majority vote and in accordance with the Company Law. A request for calling the general meeting of shareholders can be submitted by shareholders that own at least 10% of the voting shares. If the general meeting of shareholders is not called within 7 days after the submission of a request, the decision for its convening can be passed by the authorized court.

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<sup>21</sup> Company Law, Article 383.

<sup>22</sup> Ibid.

<sup>23</sup> Company Law, Article 384.

<sup>24</sup> Ibid.

<sup>25</sup> Company Law, Article 385.

## 4.2. Governing Bodies

As already mentioned earlier, the company's governance may be organized according to either one-tiered (board of directors), or two-tiered (management board or manager, and supervisory board) governance system. The company chooses the governance system individually. The governance system may be changed following relevant charter amendments.

### 4.2.1. Governing Body of the One-Tiered System

#### *Board of Directors*

This governance system is represented by a single governing body, referred to as board of directors. It must have at least 3, but no more than 15 members. All members of this body are elected by the general meeting of shareholders. The board of directors is constituted of two types of members – non-executive and executive. The number of executive members must always be lower than the number of non-executive ones. At least one fourth of the non-executive members must be independent.<sup>26</sup> Within one business year, the board of directors meets at least four times.

*The board of directors plays the leading role in respect of corporate governance. It sets company's mission and objectives, thereby representing company's interests and making sure that each shareholder is protected. It also has the function of control and oversight of company's executive directors and managers.*

Non-executive board members control and supervise the work of executive board members. They are entitled to review and inspect company's books and documents, and its property, particularly its treasury, securities, and merchandise. Non-executive board members may assign any of the company's officers, or other available experts, to conduct specific professional activities related to supervision. The board's chairperson is elected from among the board's non-executive members.

Executive board members manage the company's business and have broad authorities to undertake all actions related to company's management, execution of board's decisions, and company's day-to-day activities, as well as to act on company's behalf in all situations. If more than one executive member have been elected, one of them is appointed chief executive officer

<sup>26</sup> Article 3 Clause 25 of the Company Law provides for the persons that may be elected as independent non-executive members of the board of directors, i.e. the supervisory board.

and is in charge of managing the work of all executive directors. On proposal of the chief executive officer, the board of directors defines the internal organization structure, and the ways in which coordination of company's operations is performed.

#### **4.2.2. Governing Bodies of the Two-Tiered System**

This governance system is constituted of two separate bodies: supervisory board and management board.

##### ***Supervisory Board***

The members of this body are elected by the general meeting of shareholders. It has to be constituted of at least 3, but no more than 11 members. At least one fourth of its members must be independent. Within one business year, the supervisory board meets at least four times.

*The supervisory board is the key body in respect of the corporate governance system. It defines company's mission and objectives; represents company's interests; makes sure that each shareholder is protected; and performs control and oversight of the work of the management board members and managers.*

##### ***Management Board***

The management board is constituted of at least 3, but no more than 11 members. Companies, the charter capital of which is lower than EUR 150,000 in MKD counter-value, instead of management board may appoint a manager, who has all the rights and duties as assigned to a management board. The supervisory board elects the management board members, or as the case may be the manager. The resolution for election of management board members also provides for one of them to be appointed chairperson of the management board. The supervisory board may at any time dismiss the management board's chairperson, and appoint a new one. No one may serve simultaneously as management board member or manager, and supervisory board member.

### 4.3. Company's Management and Representation

#### 4.3.1. Chief Executive Officer and Company Directors

Company's management and representation, regardless of the adopted governance system, are typically awarded to a person who is to be company's "general director" or "chief executive officer"<sup>27</sup>. This individual is responsible for company's management, and organization of day-to-day activities. The chief executive officer is obliged to work in accordance with the Macedonian legislation, the company's by-laws, and the contract (referred to as "CEO contract") concluded between the chief executive officer and the company. The chief executive officer is directly accountable to the governing body (board of directors, or management and supervisory boards), as well as to company's shareholders.

With a purpose of more efficient and effective accomplishment of their authorities, the chief executive officer or the management board as the case may be, may appoint officers (referred to as "directors") whose task is to take part in day-to-day management of company's business, in accordance with the decisions, guidelines, and orders of executive directors i.e. the management board. Thus, the company may have a chief sales officer/director, a chief marketing officer/director, a chief financial officer/director, and so on.

#### 4.3.2. Committees and Other Bodies

Company's governing body, i.e. the supervisory board, can decide to establish various committees, the activities of which would focus in building up of a decision making system of best possible quality, based on the principles of clearly and competently prepared information. Notwithstanding the fact that such committees are not required, the Company Law is encouraging Macedonian companies to at least start deliberating their putting into practice.<sup>28</sup>

The corporate governance code goes even deeper in this respect. It lists precisely the committees which should be established with respect to corporate governance practices, as well as their scope and rules of operation. These are above all an audit committee, a remuneration committee, and an

<sup>27</sup> The English term for this position, which has been increasingly used in our country.

<sup>28</sup> Company Law, Article 359.

election and nomination committee. Regarding the need for ensuring support in the process of passing decisions of crucial importance to companies, they can certainly establish additional committees and bodies, the scope of operation of which will be approved by the relevant governing bodies.

Along with committees, companies may also appoint individuals assigned to provide internal legal advice (corporate secretaries)<sup>29</sup>, who would take care for the proper implementation of legal and charter provisions by the governing body. The corporate governance code even defines and regulates the position of the internal legal counsel, entitling this individual to special authorities and responsibilities with the company. The internal legal counsel assists the governing body in its day-to-day activities, such as organization of governing body's meetings, organization of general meetings of shareholders, internal and external informing, and so on.

## **G. Internal By-laws and Documents**

### **1. The Charter**

The charter is the founding document of the company. Within the procedure of incorporation, companies adopt it and file it with the state registration authority – the Central Registry of the Republic of Macedonia. In Macedonia, equal legal treatment have charters of the companies that came out of the process of privatization of socially-owned enterprises, in which they were transformed into joint stock companies, as well.

In the period of company's duration only one charter can be enacted (adopted). However, once enacted, regardless of the way in which the company has been founded, the charter may be amended unrestricted number of times, by following an appropriate procedure. Therefore, the company cannot enact (adopt) a new charter – once there, the charter becomes a lifelong companion of the company.

The charter must be adopted in writing format, likewise its amendments and addenda. Company's founders define the charter's content in accordance with the law. Charter amendments and addenda that involve data entered in the commercial register must be published. Any amendment or addenda must be followed by a revised version of the charter, which includes the amendments and addenda done. A copy of the revised version of the charter must be filed with the

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<sup>29</sup> The practice of appointing corporate secretaries was frequent in former Macedonian enterprises (socially-owned and state-owned).



Central Registry of the Republic of Macedonia, which holds the country's commercial register.

## 1.1. Charter Contents

The charter is an internal by-law that regulates the fundamental issues related to the company, both pro-internal and pro-external. The Macedonian Company law provides for a minimum of requirements regarding charter contents. Pursuant to Article 287 of this law, the charter must contain provisions on the following:

- Company's business name and registered office;
- Scope of operations;
- Charter capital amount;
- Shares' nominal value and number by type and class, as well as rights, liabilities, restrictions, and privileges attached to them;
- Company's duration, if it is being founded for a definite period of time;
- Privileges that the founders retain for themselves;
- Procedure for calling and convening general meetings of shareholders;
- Founder's full name, unique ID number, passport number, or ID number if the founder is a foreign natural person or number of any other identification document valid in their country of origin, as well as citizenship and place of residence, or if the founder is a legal person, business name, registered office, and registration number;
- Type, composition and manner of election of the governing body i.e. the supervisory board, and its competencies;
- Full names of the initial members of the governing bodies, i.e. the supervisory board, their unique ID number, passport number, or ID number for a foreign natural person or number of any other identification document valid in their country of origin, as well as citizenship, place of residence, or business name, registered office, and registration number, if they are appointed by the company's charter; and
- Form of company's announcements, and manner of their dissemination.

Along with these provisions, the charter may also contain provisions related to other issues, which pursuant to the law ought to be regulated by the charter. The charter may additionally contain other provisions important to the company, as far as they are not prohibited by law. The remainder of the issues that are of importance to the company, but have not been regulated by the charter, may be regulated by other company's by-laws, in accordance with the law.

## **1.2. Charter Amendments**

All changes in charter content, i.e. in charter provisions, are considered charter amendments.

## **1.3. When to Amend the Charter?**

The charter is mainly amended at company's desire and will in the events of substantial shifts, both inside the company and in its environment, or when additional regulation of specific issues is needed. For instance, the charter is amended in the event of change in company's articles of incorporation (acquisition, merger, split-up); change in company's charter capital (its increasing, or decreasing); changes in the rights attached to different types and classes of company's shares; and so forth.

The charter is also amended in certain events that do not depend on company's will whatsoever. For instance, charter amendments are required when companies' charters need to be brought into conformity with changes in legislation relating to companies' ways of doing business.

## **1.4. Who Can Amend the Charter?**

The charter is amended by a resolution adopted by the general meeting of shareholders, with majority vote. The majority vote should amount no less than two thirds of the voting shares represented at the general meeting of shareholders, unless the charter provides for higher amount of votes.

The procedure of charter amendments may be initiated by the governing body i.e. the supervisory board, as well as by the shareholders owning at least one tenth of the total amount of voting shares. The initiative is submitted in a form of amendments to the governing body and, if provided for by law, to the supervisory board.

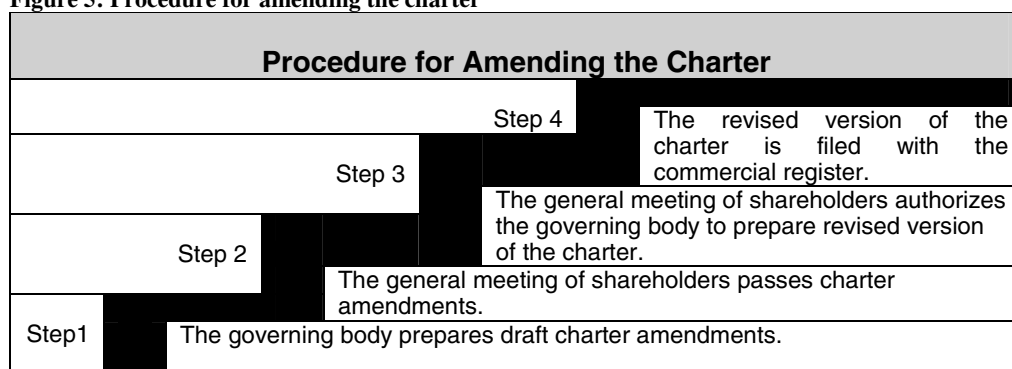
## **1.5. How to Amend the Charter?**

The draft resolution for charter amendments, which specifies the amendments proposed, is prepared by the governing body, and if provided for by law, by the supervisory board, regardless of the character of charter amendments (amendments, addenda, or editing of a new, revised version) or their initiator. The draft resolution for charter amendments must be explained by its nominator. The general meeting of shareholders, on the other hand, passes the resolution for

charter amendments that entitles the board of directors i.e. the supervisory board to prepare a revised version of the charter, which will include the changes introduced by this resolution, as well as the provisions of all other decisions that have the character of a resolution for charter amendments.

The figure below illustrates the procedure for amending the charter.

**Figure 5: Procedure for amending the charter**



Source: IFC, March 2004

## 1.6. Registration of Charter Amendments

Charter amendments and addenda that involve data entered in the commercial register must be published. Any new amendment or addenda entails preparation of a revised version of the charter, which will include all amendments and addenda done. A copy of the revised version of the charter must be filed with the Central Registry of the Republic of Macedonia, which holds the country's commercial register.

## 1.7. Coming Into Effect of Charter Amendments

For the company and its shareholders, charter amendments become effective on the day when the resolution for charter amendments is passed, if the resolution does not provide for another date (pro-internal). On the other hand, for the general public, i.e. the third parties, charter amendments become legally effective on the day following the date of publishing in the "Official Gazette of the Republic of Macedonia", in order to provide for maximum information and protection of the third parties.

## 1.8. Access to and Disclosure of the Charter

Regarding the fact that the charter is the most important source of information for both company's existing shareholders and potential investors, it is important to mention that the access to this document must be maximum flexible and liberal. This sensitive issue is appropriately addressed by the Macedonian legislation, in that it provides for free access to the charter and to all other key documents, which must be kept at all times in the company's offices. For information and documents provided to applicants, the company may charge an appropriate fee, which is not to be higher than the real cost entailed by the provision of these information and documents.

**Best Practices:** It is a usual practice of the companies worldwide to provide charter information or copies of the charter to shareholders free of charge.

Most recent trends point to the increasing number of companies that practice posting of their charters on their internet sites.

## 2. Other Company By-Laws

The remainder of company's by-laws, such as *rule books, resolutions, and rules of procedure*, constitute company's internal regulations, and according to national legislation are not mandatory, except in case when such regulations are required by law or by the charter. The purpose of these regulations is to facilitate company's operations, and in particular the operation of its bodies. They are enacted in accordance with the charter, mainly as its supplements. These regulations address and explain in more detail the relevant operation processes that have been defined by the charter. If any of the provisions of these internal regulations fails to comply with the charter, relevant charter provisions are to be followed.

The adoption and amendments of these regulations are conducted in manners as provided for by the charter.

## 3. Company Codes of Corporate Governance

**A company-level corporate governance code is a principle-based statement on the company's corporate governance practices.** Its purpose is to make the company's governance structure more transparent and

demonstrate the company's commitment to good corporate governance by developing and furthering:

- Responsible and principle-based governance;
- Effective supervisory board and executive bodies that act in the best interests of the company and its shareholders – inclusive of minority shareholders, and are determined to enhance company's stock value in a sustainable manner; and
- Appropriate information disclosure and transparency, as well as an effective system of risk management and internal control.

When adopted, followed, and updated on a regular basis, a corporate governance code confirms the company's intention to promote and implement good corporate governance. To foster the confidence of its shareholders, employees, investors, and the public, a company-level corporate governance code should, however, go beyond the established legal and regulatory framework, and embrace both nationally and internationally recognized best corporate governance practices.

The majority of companies' corporate governance codes are brief and simple statements. Basically, they express the will of the governing body and of the management that company's activities be performed in an honest, fair, legal, and socially responsible manner. It should be emphasized that in practice, in addition to the codes, companies prepare manuals for corporate governance as well.

**Best International Practices:** Company corporate governance codes and manuals may cover a vast number of topics, including:

• **General corporate governance issues:**

- Company's goals and objectives;
- Relationship between the shareholders and the governing body;
- Relationship between the governing body and the chief executive officer; and
- Relationship between controlling and minority shareholders.

• **Good governing body practices:**

- Governing body composition, including the number of independent members/directors;
- Structure and number of governing body's committees;
- Governing body's general operating procedures; and
- Remuneration of non-executive directors.

• **Good Practices of Executive Directors:**

- Executive directors remuneration; and
- Interaction and relationship with the governing body.

- **Shareholders Rights related to:**

- Organizing and conducting the general meetings of shareholders;
- Minority shareholders protection;
- Disclosure the related party transactions; and
- Company's dividend policy.

- **Disclosure and Transparency Issues:**

- Internal control function, including risk management;
- Policy on the use of audit and consulting services, and external auditor rotation; and
- Accounting and disclosure policies and standards.

- **Accountability of the Company to Stakeholders:**

- Communications with investors and investor relations.

The extent of coverage of these topics by the code will depend on their relevance to the company.

As a rule, company codes are approved by the governing body, communicated to shareholders and investors, and released on the company's website. Company codes and manuals must be consistent with legislation on one hand, and with the charter and by-laws on the other. However, the code cannot replace the charter and company by-laws, and other regulations.

## 4. Company Codes of Ethics

### 4.1. Code of Ethics Definition

A Code of Ethics (also referred to as a code of conduct, or ethics, or responsibility statement) is a basic guide of conduct of company's officers and employees toward their stakeholders, including among others colleagues, customers and clients, business partners (e.g. suppliers), the government, and the society in general.

### 4.2. Benefits of Adopting a Code of Ethics

A company may wish to adopt a code of ethics because it:

- *Enhances the company's reputation/image:* Company's reputation and image constitute integral, if intangible, parts of its assets. Introducing a

code of ethics is an effective way to communicate the value that a company places on good business practices.

- *Improves the company's risk and crisis management:* A code of ethics can bring potential problems to management's and directors' attention before a full-blown crisis occurs, as it encourages employees to react to ethical dilemmas.
- *Develops a corporate culture and brings the corporate values to the forefront:* A code of ethics widely accepted by company's officers and employees can help build a cohesive corporate culture, based on a shared set of values that is reflected in the daily work of all employees.
- *Advances the communications with stakeholder:* A code of ethics has a strong effect on all company's stakeholders, especially during times of crisis, for in moments as such it communicates the company's commitment to ethical behavior, underlining that possible transgressions are exceptions rather than a rule.
- *Avoids litigation:* A code of ethics, in combination with effective ethics training, can help minimize litigation risk resulting from fraud, conflict of interest, bribery, corruption, and insider trading.

### 4.3. Code of Ethics Implementation

Every company is different in terms of size and industry, and each has a different business culture, set of values, and ethically sensitive operational areas. A code of ethics should respect these differences.

A company's code of ethics should go beyond simple rules of conduct, and focus, instead, on core values. Before drafting a code of ethics, it is critical that a company has identified and formulated its values.<sup>30</sup>

Drafting a code of ethics goes beyond paper work. The code as a final product is at least as much important as the process in which it has been developed. In assessing the need for a code of ethics, the company should begin by studying its internal ethics climate, the type and amount of ethical guidance its employees and officers receive, and the risk the company might face in the absence of such code.<sup>31</sup> As a second step, the company should insist on code's buy-in by every part and employee of the organization, ranging from top management to workers, if the code is to truly guide the company's ethical

<sup>30</sup> For more information on how to draft, manage, and implement a code of ethics, see Kenneth Johnson and Igor Abramov, *Business Ethics: A Manual for Managing a Responsible Business Enterprise* (Washington, D.C.: U.S. Department of Commerce, 2004. See also: [www.mac.do.gov/ggp](http://www.mac.do.gov/ggp).

<sup>31</sup> Ibid, pp. 45-46 and 93-97.

practice.<sup>32</sup> Most importantly, the company should ensure that a broad internal process of consultations precedes code's adoption.<sup>33</sup> By the time the code of ethics is submitted for governing body's approval, every employee should be familiar with its contents and have taken part in its drafting — an act that is a prerequisite to buy-in and untroubled implementation.

It should also be recognized that the conduct of company's top officials matters a lot, if not the most. Following of the code of ethics by senior management and directors stimulate other employees to do the same.

A code of ethics should be user-friendly, and to provide practical guidance to the company's management and employees on how to handle ethics problems that may arise in day-to-day business activities.<sup>34</sup> To support code of ethics' implementation, the company may wish to organize training programs in ethics,<sup>35</sup> as well as appoint an ethics officer, create an ethics office and/or establish a governing body ethics committee to advise and educate officers and employees, and provide guarantees for confidentiality of private counselling.

The code of ethics should be subject to continuous revision, and improvements.

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<sup>32</sup> Ibid, pp. 53-56.

<sup>33</sup> The first draft of the code is often produced by a task force. The draft code is then submitted for supervisory board or other relevant governing body review and approval. For more on this see also Kenneth Johnson and Igor Abramov, *Business Ethics: A Manual for Managing a Responsible Business Enterprise*, pp. 57-61.

<sup>34</sup> Ibid, pp. 138-144

<sup>35</sup> Such practical training should include issues and problems derived from company's day-to-day operation, and be organized in an interactive fashion. See also Kenneth Johnson and Igor Abramov, *Business Ethics: A Manual for Managing a Responsible Business Enterprise*, pp. 157-165.



## **PART II**

### **INFORMATION DISCLOSURE, AND PROCEDURES OF CONTROL AND AUDIT**

### **The Chairperson's Checklist**

- ✓ Does the company have written disclosure policy and procedures? If yes, do they fully express the company's commitment to transparency? Are the disclosure policy and procedures easily available to market participants and other interested parties?
- ✓ Does the company fully comply with its legal disclosure obligations? Have internal control systems been established to ensure that full and timely disclosure of material information occurs?
- ✓ Are executives and directors fully aware of the personal and corporate repercussions of non-disclosure and false or incomplete disclosure? Are executives and directors determined to ensure transparency and good disclosure?
- ✓ Is the company's ownership structure transparent?
- ✓ Is the disclosure fair? Does the company ensure that all stakeholders receive information at the same time without a selective approach, allowing thereby equitable treatment to all individual and institutional investors?
- ✓ Does the company have written policies and procedures of insider trading and does it enforce them? Have systems of control of the flow of insider and other sensitive information been established?
- ✓ Does the company truly understand the definition of commercially sensitive information? Or, does it, in contrast, interpret commercially sensitive information in a way that allows withholding important material facts from the markets?
- ✓ Is the company fully aware of the advantages of voluntary disclosure?

## A. An Introduction to Information Disclosure

### 1. Definition and Rationale

Information disclosure understands **presenting information and data on a company publicly, which is particularly relevant for investors interested in purchasing company's stock**. This includes company data and information that provide investors with knowledge, needed for making informed investment decisions. Such information companies disclose in their annual, semi-annual, quarterly, and prompt reports; in their prospectuses; as well as within the framework of other reporting requirements in accordance with applicable regulations.

The disclosure of accurate, comprehensive, and timely information contributes to creating, strengthening, and maintaining investors' trust in a company. Insight in company's data allows investors make informed assessment of company's performance and get a clear picture of its financial condition. In addition to enhancing trust, disclosure acts toward increasing the overall market efficiency as well, for *efficient market is one where the market price is an unbiased estimate of the true value of the investments*.

Availability of material information and data on companies helps investors make assessment of risks from investment in those companies, estimate their current condition, and foresee their future performance. Disclosure of material information and data is of benefit to share issuers as well: it increases shareholders and public trust in the company; it raises the responsibility of company's management and directors toward the company and its shareholders, ensuring that they are prone to transparent behavior; it advances company's competitiveness and reputation; and it reduces the cost of capital. Finally, the importance of information disclosure is not confined to the shareholders and potential investors only. It also applies to other stakeholders, including the securities markets regulator, employees, clients, suppliers, and all other individuals and entities that have any kind of relationship with the company.

## 2. Principles of Disclosure

Good information disclosure is grounded on the following principles:

1. *Disclosure is provided on a regular and timely basis;*
2. *Information is easily and widely available;*
3. *Information is correct and complete;*
4. *Information is comprehensive and compatible; and*
5. *Information is consistent, relevant, and documented.*

## 3. Disclosure Versus Transparency

Disclosure should not be confused with transparency. These two terms are frequently and erroneously used interchangeably, but though at first glance they appear to be identical, they are essentially different.

Companies/securities issuers may disclose an enormous amount of information that is of no particular value to investors, whereas at the same time important pieces may be withheld. Disclosure can be irrelevant or, worse, it can be manipulative in such a way as to conceal the true picture of the company's standing. In this context the value of transparency is much appreciated. *Transparency understands permanent presenting of information about company's operations to the public. Disclosure, on the other hand, is about providing regular, correct, and timely information to the investors and the public about all relevant aspects of companies' standing, based on principles of consistency and documentation.*

## 4. Commercially Sensitive Information and their (Non)Disclosure

Securities legislation requires publicly held companies to disclose a wide range of both financial and non-financial information. Occasionally, information disclosure required by regulations can have a harmful effect on company's business and financial situation. On the other hand, small groups of individuals can profit from the command of such information in the process of market price formation of the company's shares. **Such information, the disclosure of which can influence the price of company's shares, constitutes commercially sensitive information.**

With a view to ensuring protection of securities markets participants, commercially sensitive information should be delivered to the securities markets regulator and the stock exchange in order to be publicly released, which should be done in close co-operation with the company, and in a way that is fair for both the company and the investors. Exceptionally, commercially sensitive information can be withheld upon company's request, after a relevant assessment provided by the regulator and the stock exchange.

*Trading with securities based on the knowledge of commercially sensitive information whereby extra profit is earned (in own favor or in favor of third parties) is subject to sanctions.*

In Macedonia, treatment of commercially sensitive information is granted to information of specific nature, directly or indirectly linked with the company – share issuer, the disclosure of which could affect:

- The price of company's shares; or
- The decision of investors to buy, sell or retain company' shares.

In order to prevent the exclusivity inherent to the command of commercially sensitive information, the companies are obliged to disclose such information. For instance, as commercially sensitive information subject to obligatory disclosure is considered one, which is relating to the following situations:

- Acquiring or disposing of substantial proportions of company's assets;
- Replacing the authorized auditor;
- Resigning by or dismissing of governing bodies' members;
- Concluding or terminating contracts, or other legal matter that can instigate changes in company's main activity;
- Any event that can cause untimely, or early settlement of company's financial liabilities;
- Filing of bankruptcy or liquidation petitions against the company;
- Not fulfilling liabilities deriving from bonds issued by the company;
- All litigations in which the company is involved; and
- All changes in the rights attached to shares of certain type.

A company can submit a request to the Securities Commission for waiving its information disclosure obligations in the following circumstances:

- When public presentation of the information could seriously compromise company's important business interests;
- When public presentation of the information is adverse to the public interest; and
- When the company is able to guarantee the confidentiality of such information.

**Best Practices:** Today's corporate governance problems are related less to excessive transparency and over-disclosure than lack of transparency and under-disclosure.

Companies should not interpret widely the provisions of the law that define conditions under which non-disclosure of commercially sensitive information is allowed. In the event of occurrence of conditions that according to regulations allow non-disclosure, the company should go through the commercially sensitive information non-disclosure procedure before the Securities Commission.

**Useful Advice to Companies:** In order to prevent damages from non-disclosure, or disclosure for that matter, of commercially sensitive information, companies are well advised to develop written policies and procedures for handling such situations. In their internal by-laws they should define which information should be considered commercially sensitive and disclosed as such, as well as which information will be withheld as confidential. Certainly, these company by-laws must be consistent with the applicable legislation.

## 5. Insider Information and Insider Dealing

Despite the fact that the legislation mainly prohibits the insider trading, it can nevertheless be completely legal. Namely, insider trading takes place legally, every day, when corporate insiders (officers, directors, or employees) buy or sell shares in their own companies, following the company policy, law, and regulations. But, on the other hand, when individuals provided with access to privileged and confidential information use their knowledge to reap benefits or avoid losses on the securities market, insider dealing has an illegal connotation, and is as such prohibited by law. The damages from insider dealing are mainly at the expense of investors lacking access to such privileged information.

Insider dealing may cause an additional damage, which is far greater, and that is the loss of credibility of the securities markets. One of the main reasons that capital is easily available on the world's most successful stock markets is that investors by and large trust them, and perceive them as fair. Conversely, the common belief in some countries that privileged investors should be allowed to profit from their access to confidential information may explain, in part, the relatively low public share ownership in these countries.

Governments cannot afford to ignore insider dealing if they hope to promote an active securities market and to attract foreign investments. Therefore, companies should avoid this kind of trading. If the companies want to attract new investments and ensure protection of their shareholders, they should develop a proper internal control system that can prevent such illegal activity.

**In Macedonia insider information is defined as any commercially sensitive information about a company which has not been released in the press or electronic media.**<sup>36</sup> Individuals that may have access to insider information include:

- Shareholders;
- Members of management and supervisory boards, or boards of directors; and
- Employees or external associates who have access to insider information due to their professional association with the company.

Individuals who have access to insider information must not buy or sell securities or otherwise profit from the use of such information. Except in the events as specified by law, they must not disclose insider information to third parties, nor must they advise third parties to sell or buy securities on basis of such information. *A legal or natural person that is aware that the information received is an insider one, must not buy or sell securities, or otherwise profit from that information.*<sup>37</sup>

Individuals provided with access to insider information are legally obliged to notify about the transactions concluded further to insider information. If these individuals acquire knowledge that a legal or natural person buys or sells securities as a result of insider information, they are obliged to inform on that fact the issuer, the securities commission, and the stock exchange on which the securities are listed.<sup>38</sup>

**Best Practices:** Disclosure of insider information may substantially affect the market value of company's shares and other securities. Therefore, persons who have access to insider information must not use it to effectuate transactions, nor must they transfer insider information to third parties, as illegal use of insider information can harm shareholders interests and adversely affect company's financial standing and reputation, as well as securities markets credibility in general.

<sup>36</sup> Securities Law, Article 2 Paragraph 1 Clause 5.

<sup>37</sup> Securities Law, Article 173.

<sup>38</sup> Securities Law, Article 174.

**Useful advice to companies:** Companies should have written insider dealing policies in place, and vigorously enforce them. The internal auditor should monitor whether directors, management and supervisory board members, or board of directors members, as well as other persons who have access to insider information follow the law, the regulations, and the internal rules and procedures of insider dealing.

## 6. Disclosure Items by Company Type

Disclosure duties of Macedonian companies vary depending on the type which the company belongs to. In general, there are three types of companies with respect to disclosure obligations:

- Listed companies;
- Companies subject to specific disclosure obligations; and
- All other companies.

*Most stringent and detailed are the disclosure obligations of listed companies, followed by companies subject to specific disclosure obligations. The rest of the companies need to fulfill a certain minimum of disclosure requirements.*

The disclosure requirements for listed joint stock companies and joint stock companies subject to specific disclosure obligations are wider in scope in order to ensure greater protection of shareholders, particularly the minority ones, as these companies have large numbers of shareholders, and potential fraud could cause damages of wider scope. The increased number of disclosure obligations for these companies is actually the price which they pay to provide access to the large funds available on capital markets.

*In Macedonia, the disclosure obligations of listed joint stock companies are specified in the listing rules of the Macedonian Stock Exchange, whereas the disclosure obligations of the joint stock companies subject to specific disclosure obligations are set in the Securities Law and its by-laws. The disclosure obligations of the rest of the joint stock companies derive from the Company Law.*

### 6.1. Listed Companies

The largest in scope are information and data which need to be disclosed by companies, the shares of which are admitted to trading on a regulated market.



*Listing stands for placement of a specified class of securities by a securities market on a specific trading tier, on basis of an agreement concluded between the licensed stock exchange and the securities issuer that regulates mutual rights and obligations.*<sup>39</sup> The decision for listing is made by company's governing body, whereas the decision for delisting is passed by the general meeting of shareholders.<sup>40</sup>

The authority to stipulate the listing conditions, procedures, and methods is attributed to the licensed stock exchange, which enacts, to that end, listing rules.

The Macedonian Stock Exchange defines listing as *procedure for admitting of specified securities to the official market, in accordance with the listing criteria, which are set forth in the listing rules.*<sup>41</sup> **The official market is a market where securities of listed companies are traded. It is divided into two tiers – super listing and stock exchange listing. Joint stock companies listed on the Macedonian Stock Exchange have different disclosure obligations depending on the tier which they are listed on.**

Listed joint stock companies disclose all commercially sensitive information via an internet application designed for listed companies' reporting – SEI-NET. The Stock Exchange makes the disclosed information available to the public. The listing Rules provide for an ongoing disclosure of all information critical for assessment of company's current condition, as a general obligation of listed companies. Any commercially sensitive information about a listed company has to be disclosed on SEI-NET prior to its public release.

Listed companies must disclose:

- **Information about business operations;**
- **Information about changes in equity capital;**
- **Information about substantial changes in financial condition;**
- **Dividend calendar;**
- **Information on publicly held shares; and**
- **Statements on major shareholdings.**

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<sup>39</sup> Securities Law, Article 2 Paragraph 1 Clause 21.

<sup>40</sup> Securities Law, Article 80.

<sup>41</sup> Macedonian Stock Exchange, Listing Rules.

### **6.1.1. Companies Admitted to Super Listing**

A company admitted to super listing has specific disclosure obligations according to the listing rules. Therefore, it must:

- Disclose all its reports and financial statements, in both Macedonian and English;
- Disclose full consolidated audited financial statements (auditor's opinion, balance sheet, income statement, cash flow statement, report of equity capital changes, and notes to the financial statements) within 30 days after their adoption by the general meeting of shareholders;
- Disclose quarterly, semi-annual, and three-quarterly cumulative, unconsolidated, non-audited income statements, within 45 days following the end of the period covered by the income statement, as well as an annual non-audited cumulative, consolidated and unconsolidated income statement within 60 days following the end of the calendar year for which the income statement is made;
- Disclose its annual reports within 30 days after their adoption by the general meeting of shareholders;
- Submit annually reports of company's compliance with the corporate governance code of the Macedonian Stock Exchange on "comply or explain" basis;
- Publish a notice about the convening of the general meeting of shareholders at least 21 days in advance. The public notice for the general meeting of shareholders must be published in at least one national daily newspaper. If the notice has been published in a daily newspaper, without being disclosed on SEI-NET, the Stock Exchange can republish it on its own discretion;
- Disclose the content of the following draft resolutions, if they have been stated as agenda items in the public notice for convening of the general meeting of shareholders:
  - Resolution for adoption of financial statements;
  - Resolution for distribution of profits;
  - Resolution for dividend distribution and constitution of a dividend calendar;
  - Resolution for changes in rights attached to securities that have been issued;
  - Resolution for governing bodies' members replacement; and

- Resolution for changes in company's articles of incorporation.

*If the content of the foregoing draft resolutions has not been disclosed in the public notice for convening of the general meeting of shareholders, the Stock Exchange temporarily terminates the trading of company's stock in the interim period between publishing of the public notice and disclosure of the draft resolutions content.*

- Disclose the content of the following resolutions, if they have been adopted by the general meeting of shareholders:
  - Resolution for adoption of financial statements;
  - Resolution for distribution of profits;
  - Resolution for dividend distribution and constitution of a dividend calendar;
  - Resolution for changes in rights attached to securities that have been issued;
  - Resolution for governing bodies' members replacement; and
  - Resolution for changes in company's articles of incorporation.

*If the content of the foregoing resolutions has not been disclosed on the first trading day following the date of their adoption by the general meeting of shareholders, the Stock Exchange temporarily terminates the trading of company's stock in the interim period between adoption of the decisions and disclosure of their content.*

### **6.1.2. Companies Admitted to Stock Exchange Listing**

The listing rules of the Macedonian Stock Exchange provide for specific disclosure obligations for the companies admitted to stock exchange listing. These companies are obliged to:

- Disclose consolidated audited financial statements (auditor's opinion, balance sheet, income statement, cash flow statement, and report of equity capital changes) within 30 days after their adoption by the general meeting of shareholders;
- Disclose quarterly, semi-annual, and three-quarterly cumulative, unconsolidated, non-audited income statements, within 45 days following the end of the period covered by the income statement, as well as an annual non-audited cumulative income statement within 60

days following the end of the calendar year for which the income statement is made;

- Publish a notice about the convening of the general meeting of shareholders at least 21 days in advance. The public notice for the general meeting of shareholders must be published in at least one national daily newspaper. If the notice has been published in a daily newspaper, without being disclosed on SEI-NET, the Stock Exchange can republish it on its own discretion;
- To disclose the contents of the following resolutions, if they have been adopted by the general meeting of shareholders:
  - Resolution for adoption of financial statements;
  - Resolution for distribution of profits;
  - Resolution for dividend distribution and constitution of a dividend calendar;
  - Resolution for changes in rights attached to securities that have been issued;
  - Resolution for governing bodies' members replacement; and
  - Resolution for changes in company's articles of incorporation.

If the content of the foregoing resolutions has not been disclosed on the first trading day following the date of their adoption by the general meeting of shareholders, the Stock Exchange temporarily terminates the trading of company's stock in the interim period between adoption of the decisions and disclosure of their content.

## **6.2. Companies Subject to Specific Disclosure Obligations**

**A joint stock company subject to specific disclosure obligations is a company which has made public offering of securities, or has a charter capital of EUR 1,000,000 in MKD counter value and more than 100 shareholders, or is listed on a stock exchange. Joint stock companies listed on a certified stock exchange are subject to specific disclosure obligations by default, and are as such bound to higher disclosure duties than the rest of the joint stock companies that are also subject to specific disclosure obligations, but are not on the stock market.**

The joint stock companies subject to specific disclosure obligations are required to make a disclosure of the following:

- Audited annual report of the financial results, legal status, and operations within 4 months following the end of the calendar year;
- Semi-annual report for the first semester of the calendar year;
- Quarterly financial statements for the first and the third quarter of the calendar year; and
- Regular announcements and documents for shareholders meetings.

Companies subject to specific disclosure obligations file these disclosure data with the Securities Commission, which holds a *register of joint stock companies subject to specific disclosure obligations*. All data submitted by these companies to the Commission are held in the register in electronic format, and are made publicly available on the Commission's website.

Companies subject to specific disclosure obligations are required to provide copies of their annual, semi-annual, quarterly, and prompt reports upon request of the following persons:

- Any of the shareholders, whereby the company cannot charge for the printing or copying costs; and
- Any of the stakeholders, whereby the company can charge a fee no higher than the printing or copying costs.

Companies subject to specific disclosure obligations must provide the certified stock exchange on which they are listed with electronic versions of their annual, semi-annual, quarterly, and prompt reports.

These companies are obliged to publish in at least one of the national daily newspapers the following information:

- Summary of the audited annual report, together with the certified auditor's opinion;<sup>42</sup> and
- Prompt report of obtaining commercially sensitive information.<sup>43</sup>

### 6.3. Other Companies

Companies not belonging to either of the aforementioned groups disclose information which for there is a charter requirement to be published in a company's communication, a daily newspaper, on internet or otherwise. The company's governing body decides about the manner of disclosure, as well as

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<sup>42</sup> Securities Law, Article 155.

<sup>43</sup> Securities Law, Article 158 Paragraph 3.

about the data and information which are to be disclosed in addition to those required by the Company Law.

The company must hold in its offices, and allow all shareholders an access to the following documents:

- Charter and other company by-laws with all their additions and addenda, and the revised versions of these documents;
- Minutes and all supporting documents of shareholders meeting;
- Minutes and decisions of governing body i.e. supervisory board meetings;
- Annual reports and financial statements;
- Annexes (legal papers and supporting documents), filed with the commercial registry;
- All public notices and prospectuses for issuing shares and other securities of the company;
- The complete correspondence of the company with its shareholders;
- Updated list of names and addresses of all elected members of the governing body i.e. the supervisory board;
- Documentation on collaterals and mortgages;
- Certified auditor's and certified valuator's reports;
- Voting ballots and proxies for participation in shareholders meetings (original or copy);
- The company-level collective agreement; and
- Other by-laws and documents, as set forth in the law or the charter.

The shareholders can act on their rights to be informed, and access the company documents in the company's offices in the manner as specified by the charter. The shareholders effectuate their rights to be informed on the minutes and decisions of the governing bodies' meetings through the non-executive members of the board of directors, or through the supervisory board. The company can demand previous notification from the shareholders seeking access to information, which is to be submitted at least three days in advance. The company can also charge the shareholders, but the fee should not exceed the real expense made.

Regarding *financial reporting* obligations, the obligation to prepare and submit financial statements in accordance with the international accounting standards is stipulated for large and medium commercial entities, and other commercial entities as specified by law, as well as commercial entities in the banking and insurance sector, listed commercial entities, and commercial entities the financial statements of which are included in the consolidated

financial statements of the aforementioned commercial entities. These entities must prepare and submit their financial statements in accordance with the adopted international accounting standards, published in the “Official Gazette of the Republic of Macedonia”. Other commercial entities can prepare and submit their financial statements in accordance with the international accounting standards if required on other legal grounds, or if stipulated by other regulation based on the law, as well as on their own decision.

Commercial entities that hold controlling stakes in one or more other companies must, likewise, pursuant to the international accounting standards prepare consolidated financial statements. The consolidated financial statements must hold the same date as the financial statements of the controlling company.

The financial statements required for the foregoing commercial entities include:

- Balance sheet;
- Income statement;
- Report of charter capital changes;
- Cash flow statement;
- Applied accounting policies; and
- Other explanatory notes prepared in accordance with the international accounting standards that are published in the “Official Gazette of the Republic of Macedonia”.

The financial statements are signed by the executive member of the board of directors, i.e. the officer appointed by the management board, or in absence of such title, by the chairperson of the management board. Along with the personal signature the signatory states the date on which financial statements were completed and signed.

Large and medium commercial entities organized as joint stock companies, as well as listed companies, both required to produce financial statements in accordance with the international accounting standards, are subject to audit requirements, and obliged to audit their financial statements. The certified auditor of the financial statements submits a report on his audit in accordance with the international auditing standards published in the “Official Gazette of the Republic of Macedonia”. These standards are being updated on annual basis in order to comply with the currently valid standards, such as they are amended or adopted by the International Federation of Accountants (IFAC).

Large companies, listed companies, and companies in the banking and insurance sector must publish their financial statements within 15 days after the shareholders meeting, omitting the notes on applied accounting policies and additional explanatory notes. The statements have to be published in a daily newspaper with a circulation on the entire territory of the country, and, mandatorily, in the “Official Gazette of the Republic of Macedonia”.

A company can publish its financial statements in a daily newspaper even when there is no such obligation. In such instance it must publish the statements in combination with the certified auditor’s report, both in form that is identical to the one that have been adopted by the general meeting of shareholders, without any changes or additions.

Along with financial reporting, companies must disclose information about events relating to its operating activities. For example, in the event of changes in the articles of incorporation, companies must publish notices on concluded agreements, i.e. on adopted split-up plans in the “Official Gazette of the Republic of Macedonia” and in at least one daily newspaper. Companies also have disclosure obligations in the event of charter capital decrease, whereby the chairperson of the board of directors or the management board as the case may be, must disclose the company’s intention of decreasing its charter capital in the “Official Gazette of the Republic of Macedonia”, and in at least one daily newspaper. Furthermore, if a company acquires majority share in other company it must publish that information in the “Official Gazette of the Republic of Macedonia”. All these events constitute material information which can have impact on the entire operation of the company, and can consequently affect the price of company’s shares on the stock market, which is the reason of their mandatory disclosure provided for by the legislator.

## **7. Liability for Non-Disclosure**

*According to the law, companies are liable for damages caused to shareholders prevented from legitimate access to information. Companies are also liable when they cause damages to third parties by providing false, incomplete, or distorted information.*

For the accuracy of data, disclosed by the joint stock companies subject to specific disclosure obligations in their annual, semi-annual, quarterly, and prompt reports, are responsible the chairperson of the board of directors or the management board as the case may be, and the chief executive officer of the company. These individuals must sign all company’s reports, whereby their names and titles have to be clearly indicated. They verify that data



included in the reports reflect the company's real condition, and that the reports do not suffer deficiencies which could affect their relevance.<sup>44</sup>

Non-compliance with disclosure obligations by companies subject to specific disclosure obligations is considered misdemeanor, and is fined monetarily.<sup>45</sup>

In the event of public offering of securities, if the prospectus contains false and inaccurate data on commercially sensitive information, or if commercially sensitive information are omitted, and therefore in the light of circumstances can be misleading, persons who have bought securities unaware of such circumstances can file a suit to recover the consideration paid, together with interest, less the amount of any income received thereon, as well as for the profit lost as a result of not owning the security. The suit can be filed against:

- The company which have issued the security;
- The persons who have signed the prospectus;
- The members of the management and supervisory boards or the board of directors at the time when the prospectus was published; and
- The accountant or certified auditor who has with her/his consent been named as having prepared or approved any part of the prospectus, or as having prepared or approved any report, valuation or financial statement used in the prospectus.

These persons are jointly and severally liable for the damages caused.<sup>46</sup>

Liability for false and misleading financial statements is also borne by a certified auditor or accountant, who has signed false or incomplete, and therefore misleading financial statement, which is in conflict with the international financial reporting standards and international auditing standards. In such case the auditor or accountant is liable for damages to persons who suffered losses because of the false, incomplete, and therefore misleading financial statements.<sup>47</sup>

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<sup>44</sup> Securities Law, Article 164.

<sup>45</sup> Securities Law, Article 242.

<sup>46</sup> Securities Law, Article 179.

<sup>47</sup> Securities Law, Article 176.

## B. Globalization of Disclosure Standards

### 1. OECD Principles of Corporate Governance

The introduction to this manual points out the importance of standardization to company behavior on the market, in conditions of globalization. The *OECD Principles of Corporate Governance* constitute an approach toward such standardization that alongside member countries starts to be implemented by the rest of the world as well.

Regarding disclosure issues, the OECD Principles suggest that

“...timely and accurate disclosure be made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.”<sup>48</sup>

The key concept that underlies OECD’s recommendation is the concept of materiality. Material information is information, the omission or misstatement of which could affect economic decisions taken by the users of that information.

The implementation of the materiality concept allows companies avoid overly detailed disclosure that is ultimately irrelevant to shareholders. It should, however, be realized that materiality is a relative concept that depends on the context. For example, damage of MKD 250,000 (approximately U.S. \$ 6,000) in a large publicly traded company is, clearly, of little importance to the investor. It may, on the other hand, be material to a small family-owned business. Therefore, materiality is often difficult to define with great precision in practice.

**Best Practices:** The OECD principles call for disclosure of all material information in the following areas:

- Financial and operating results of the company;
- Company objectives;
- Shareholdings and ownership structure;
- Directors and key executives, as well as their remuneration;
- Material foreseeable risk factors;
- Material issues regarding employees and other stakeholders; and
- Governance structure and policies.

<sup>48</sup> OECD Principles, Principle IV on Disclosure and transparency. See also: [www.oecd.org/dataoecd/32/18/557724.pdf](http://www.oecd.org/dataoecd/32/18/557724.pdf).

## 2. IOSCO Principles

On international level, securities commissions (national regulatory bodies in the field of securities) are organized in the International Organization of Securities Commissions (IOSCO). The objectives of this organization are: to promote high standards of regulation in order to maintain efficient securities markets, to exchange information, to establish an effective surveillance of international securities transactions, and to promote the integrity of the markets by a rigorous application of the standards. Macedonia is ordinary member of this organization, and is therefore obliged to respect its principles.

The document *Objectives and Principles of Securities Regulation* constitutes the foundation for development of the securities markets regulation. It sets out 30 principles of securities regulation, which are based upon three objectives of securities regulation. These are:

- Protection of investors;
- Ensuring that markets are fair, efficient, and transparent; and
- Reduction of systemic risk.

The chapter of the document which discusses investor protection gives particular attention to disclosure, suggesting that:

“Full disclosure of information material to investors’ decisions is the most important means for ensuring investor protection. Investors are, thereby, better able to assess the potential risks and rewards of their investments and, thus, to protect their own interests. As key components of disclosure requirements, accounting and auditing standards should be in place and they should be of a high and internationally acceptable quality.”<sup>49</sup>

According to IOSCO principles for issuers:

- There should be full, accurate and timely disclosure of financial results and other information which is material to investors’ decisions;
- Holders of securities in a company should be treated in a fair and equitable manner; and

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<sup>49</sup> Objectives and Principles of Securities Regulation, OICU-IOSCO, May 2003. See also: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf>. (p. 5)

- Accounting and auditing standards should be of a high and internationally acceptable quality.<sup>50</sup>

**Best Practices:** The Technical Committee of the International Organization of Securities Commissions (IOSCO) has developed more detailed, high-level principles for ongoing disclosure and material development reporting for listed entities. These principles are:

- Materiality of information for an investor's investment decision;
- Disclosure on a timely basis — immediate or periodic;
- Simultaneous and identical disclosure in all jurisdictions in which the entity is listed;
- Dissemination of information by using efficient, effective, and timely means;
- Disclosure criteria fairness, without misleading or deceptive content and containing no material omission;
- Equal treatment of disclosure — no selective disclosure to investors and others before public disclosure; and
- Compliance with disclosure obligations.

### 3. Transparency Directive

The Transparency Directive of the EU<sup>51</sup> (*Directive on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market*) is aimed at establishing fundamental principles on which the unique securities market of the Union should be based. The improved harmonization of Union's national legislations regarding provisions relating to requirements for periodic and ongoing disclosure by securities' issuers, should add to higher investor protection in the Union.

The disclosure information required by the Transparency Directive includes:

- Annual financial statements;
- Semi-annual financial statements;
- Information on major shareholders; and
- Additional information.

<sup>50</sup> Objectives and Principles of Securities Regulation, OICU-IOSCO, May 2003. See also: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf>. (p. 22)

<sup>51</sup> On December 15 2004 were enacted the amendments of the 2001 directive. Currently is in effect the Directive 2004/109/EC on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC.

The principles of this directive have been incorporated in Macedonia securities markets regulations.

## 4. Prospectus Directive

The aim of the Union's Prospectus Directive<sup>52</sup> (*Directive on the prospectus to be published when securities are offered to the public or admitted to trading*) is to harmonize the requirements for preparing, approving, and distributing the prospectus that needs to be published when securities are offered to the public or are admitted to trading on a regulated market which operates in an EU member country. It ensures both higher investor protection and market efficiency.

The principles of this directive have been incorporated in the Macedonia Securities Law and in the listing rules of the Macedonian Stock Exchange.

## 5. Disclosure Regulations in Macedonia

The main Macedonian statutes relevant to disclosure are the Company Law and the Securities Law, along with the by-laws related to them. In that respect, the Law on Takeovers is also worth of mentioning, as it stipulates the disclosure requirements relating to takeover procedures (see Table 5 in section E of this chapter).

Regarding the regulations in this area, of particular importance are, certainly, the regulations of the Macedonian Stock Exchange, as a self regulating institution: the listing rules and the corporate governance code.

## C. Disclosure Items by Category

Data and information subject to disclosure by companies generally belong to one of the following categories:

- Financial data and information; and
- Non-financial data and information.

<sup>52</sup> Currently is in effect the 2003 Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC.

Further on, each of them is discussed in detail.

## 1. Financial Disclosure

Disclosure of financial data includes publishing and disclosure of information and data about company's financial results and operating activities. These data and information are of utmost importance to shareholders, potential investors, creditors, and other stakeholders. Their disclosure is referred to as *financial reporting*.

### 1.1. Presenting Financial Information

The following list constitutes the most typical forms of, and additions to, financial reporting:

- The **balance sheet** provides a snapshot of company's assets, capital, and liabilities on a particular date. To skilled analysts, it provides important information on, *inter alia*, the degree of risk an investment in the company carries or the company's ability to pay creditors.
- The **income statement** provides information on company's performance over a specified period of time. Income statements may be organized in a number of different ways. According to internationally recognized practice, income statements must show: 1) revenues or sales; 2) results of operating activities; 3) financing costs; 4) income from associates and joint ventures; 5) taxes; 6) profit or loss from ordinary activities; and 7) net profit or loss. The income statement demonstrates company's business sustainability.
- The **report of charter capital changes** points to all changes in equity, additional paid-in and reserve capital, as well as retained earnings. In addition, it provides information on changes in statutory and additional funds, and briefs on net assets.
- The **cash flow statement** illustrates company's sources and uses of cash. It lists all changes affecting cash in three areas: 1) operations; 2) investments; and 3) financing. For example: net operating income increases cash; the purchase of a plant is an investment that decreases cash; and the issuance of shares or bonds is a financing activity that increases cash.

- The **notes to the financial statements** help company's financial statements be explained by providing important details and insight into how the company prepared its accounts.
- **Explanations to financial statements** briefly describe the features of company's activities, its main performance indicators and factors that have affected company's financial results, as well as decisions for the review of financial statements and distribution of net profits. This refers to any relevant information that would enable users to receive a complete and realistic picture of company's financial condition, financial results for the reporting period, and any changes thereof.

**Best Practices:** International practice also calls for the Management's Discussion and Analysis (MD&A), which provides management's view of the performance and future prospects of the company. The MD&A, which is typically disclosed in the company's annual report, should: 1) complement as well as supplement financial statements; 2) have a forward-looking orientation; 3) focus on long-term value creation; 4) integrate long- and short-term perspectives; 5) present information that is significant to the decision-making needs of users; and 6) embody the qualities of reliability, comparability, consistency, relevance, and understandability. The MD&A presents a more analytical and qualitative view than the rest of the financial statements.

There is one additional form of reporting – the **external auditor's report and opinion**. It is a document wherein an independent external auditor expresses an opinion on whether or not company's financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework, and whether they are reliable. This provides shareholders, managers, employees, and market participants with an independent opinion about the company's financial position and about the compliance of financial statements with the established international accounting standards.

## 1.2. Preparing Financial Information

Macedonia started the implementation of International Accounting Standards (IAS) on January 1, 2005. They were published in the Rulebook on Accounting Practices ("Official Gazette of the Republic of Macedonia" No. 94/2004). Amendments and addenda to this rulebook as of February and December 2005 ("Official Gazette of the Republic of Macedonia" No. 11/2005, and 116/2005) provide for implementation of International Financial Reporting Standards (IFRS) as well. Moreover, they include International Financial Reporting Standards 1, 2, 3, 4, 5, 6, and 7. That ensures the highly needed transparency of companies' accounting practices, and advances the harmonization of the

Macedonian financial reporting system with the globally accepted standards in this field.

The Macedonian legislation<sup>53</sup> related to financial reporting defines the following fundamentals of preparing financial statements:

- **Accrual based accounting**, according to which the effects of transactions and other events are recognized at the point of occurrence, and not at the point of payment or fund remittance. Therefore, they are recorded in accounting records and reported in financial statements on accrual basis, taking into account the point of occurrence, regardless of the point in which the pertaining amounts have been paid or received. The advantage of accrual based financial statements is that they inform both on past transactions followed by respective payments or remittances, and on outstanding liabilities and receivables.
- **Going concern**, according to which financial statements are prepared on the assumption that the company is operational, and will continue its operation for the foreseeable future, and that there is no intention or need for its liquidation, or material restriction of the scope of its activities. If such intention or need exists, it should be disclosed.

Pursuant to Macedonian legislation, financial statements information should be attributed with certain qualitative features, which make it useful to users. The four qualitative features of the financial statements are as follows:

- **Clarity**. Information included in financial statements should be easy comprehensible to users that are assumed to have enough knowledge on business and economic activities and on accounting, and who wish to thoroughly examine the financial statements data. Occasionally, there are complex issues and information, which need to be included in the financial statements because of their relevance for informed decision making expected from users, but regarding their character might not be understandable to all users. This information, however, should not be excluded from the financial statements merely for the reason that some users might find it too hard to understand.
- **Relevance (significance)**. Financial statements information should be relevant to users, who need it for making business decisions. Relevant information is one, which affect users' business decisions in that it enables them to assess past, present, or future business events, and to confirm or correct their past assessments. With respect to information relevance, of importance are information nature and materiality.

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<sup>53</sup> The Company Law and the Rulebook on Accounting Practices (Official Gazette of the Republic of Macedonia, No 94/2004, 11/2005, and 116/2005).



Sometimes, information nature is sufficient, but at other times both its nature and materiality are important. Material information is considered one, the omission or false presentation of which can affect users' business decision-making.

- **Reliability.** Reliable is information that does not contain material errors and bias, and which users can rely upon, because it ensures that the situation has been presented realistically. Reliability understands:
  - *Truthful presentation* of transactions and other business events;
  - *Substance over form*, meaning that transactions and business events are to be calculated and presented considering their essence and economic reality, and not merely their legal form.
  - *Impartiality*, according to which information should be neutral and free of bias.
  - *Prudence (conservatism)*. Financial statements should be prepared based on prudent evaluations and judgments of the expected effects of the future events on company's financial condition. Prudence understands caution with judgments made under uncertainty conditions, whereby assets or profit are not overvalued, and liabilities and expenses are not undervalued. Prudence, however, should not be taken with excessiveness, so that assets or profit will be undervalued, and liabilities and expenses overvalued, for that would violate information impartiality, and consequently its reliability.
  - *Completeness*. In order to be reliable financial statements information should be complete. Companies should disclose all material information on business events and results (actual and potential) that might affect business decisions made by financial statements users. Omission of important data may lead to information inaccuracy, and consequently to wrong conclusions. Such information becomes unreliable and irrelevant.
- **Compatibility.** Financial statements users need to be able to compare data of company's operation in different periods. Furthermore, they need to be able to compare company's financial statements with financial statements of other companies. In that way, financial statements users can identify trends in company's operation, changes in its financial condition and its business successfulness.

In order to achieve financial statements compatibility, companies should disclose accounting policies implemented in financial statements preparation, possible changes in those policies, and the effects of those changes. In that way, users will be able to identify differences between accounting policies implemented to similar transactions and events, both of the very company in different periods, and different companies within an identified period of time.

Important principles of financial statements provided for by law, which may act as *limitations to information relevance and reliability*, are:

- *Timeliness*. Companies should disclose financial information promptly, for timely information is more useful to financial statements users compared to old information that might not reflect the real situation anymore. Therefore, if there is unjustified disclosure delay, information may lose its relevance.

Financial statements should be attentive to establishing balance between information relevance and reliability, while paying highest respect to the needs of users who are to make certain business decisions.

- *Balance between benefits and costs*. Information disclosure benefits should be greater than the costs for their providing.

To allow financial statements achieve their purpose, companies need to establish *balance of the qualitative characteristics* in practice. The purpose of financial statements is to provide information on company's financial condition, business success, and changes thereof, which is necessary to financial statements users in the process of taking business decisions.

Legislation, accounting and other standards, affect the financial statements contents and format. Nevertheless, financial statements, along with management's discussion and analysis (management's letter), should provide full, accurate, and realistic presentation of company's operation.

**Best Practices:** If companies plan to access international capital markets in order to attract capital, they will need to make available to potential investors clear and unambiguous information on company's financial and general condition. The financial reporting in accordance with internationally accepted standards responds exactly to this challenge, as financial statements of a national company can be understood by investors from each corner of the world.

Along with the IFRS, the most recognized standards in the field of financial reporting are the U.S. Generally Accepted Accounting Principles (U.S. GAAP).

### 1.3. Disclosing Financial Data

Financial information will typically be presented in different forms and at different times throughout the financial year. Financial and operating results appear in the prospectus, and in annual and quarterly reports.

**Best Practices:** Companies should disclose all material information, and do so on a timely basis and in such a manner as to make the information as clear and understandable to users as possible. Companies should adhere to the spirit of the law, not just the letter, and should not limit themselves to the minimum standards of statutory disclosure, but should present information and data in a way that is demonstrative of the company's intention to comply with the spirit of the law and to embrace the need for achieving high level of transparency.

## 2. Non-financial Disclosure

Along with financial data, of crucial importance to shareholders, investors, and all other stakeholders, are company's non-financial data and information. These data relate to company's "non-material" features, which often have critical effect on its profitability and market perspectives. This subsection discusses the most important ones.

### 2.1. Information on Governing Bodies Members, Directors, and Employees

#### a) Personal Data

Investors and shareholders should have access to relevant information about the key individuals that govern and administer the company, and about their rights and responsibilities. To evaluate the experience and qualifications of directors and senior executives, interested parties need to know about their educational background, current occupation, and professional experience. It is also important that shareholders and investors have information about any (existing or potential) conflicts of interest due to the involvement of particular persons in the essential business processes. That is particularly valid for supervisory and management board, i.e. board of directors members, the independence of who is critical for making unbiased and objective decisions.

In their annual reports, Macedonian *joint stock companies subject to specific reporting obligations* have to include information on members of the management and supervisory boards, or the board of directors as the case may be, as well as on their ownership stakes in the company.<sup>54</sup> Moreover, companies are obliged to update this information in their semi-annual reports.

<sup>54</sup> Securities Law, Article 154.

Members of the supervisory and management boards, or the boards of directors, and chief executive officers of the joint stock companies subject to specific reporting obligations have an obligation of ongoing disclosure of information on company's ownership structure i.e. of publishing ownership reports. Within 15 business days after being appointed as members of supervisory boards, management boards, or boards of directors, these persons must file a report with both the Securities Commission and the company, stating the amount of company's securities in their possession. These persons must also report on all changes in the ownership of company's securities held by them, be they related to disposing of or purchasing, and they must fulfill this obligation within 5 business days after the transaction.<sup>55</sup>

*Listed joint stock companies* must disclose data on governing bodies in the prospectus for listing. These data include:

- Full name and title of each of the governing bodies members; and
- Amount of ordinary shares or bonds, held by each of the governing bodies members in the company, or in another entity related to the company.

In addition to these data, the corporate governance code of the Macedonian Stock Exchange requires *joint stock companies admitted to super listing* to disclose in their annual reports additional data on governing and supervisory bodies members, such as: age, gender, profession, data on material compensation and other benefits deriving from employment contracts, citizenship, date of initial appointment and current term of service, and data on membership in governing or supervisory bodies of other legal entities.

Companies that issue securities via public offering disclose data on executive and supervisory bodies members, directors, and employees. These data have to be published in the prospectus, and in the public notice for underwriting and purchase of company's shares.

## **b) Remuneration**

Most of the companies in developed countries have in place incentive remuneration schemes for key officers (supervisory and management boards or boards of directors members, executives etc.) in an effort to motivate them to align their interests with the interests of shareholders. Most of the time these schemes include performance based bonuses. In order to avoid the risk

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<sup>55</sup> Securities Law, Article 165.

from unrealistic and unjustified remuneration, incentive remuneration schemes should always be subject to careful legal and financial scrutiny and approval of the supervisory board and/or the general meeting of shareholders.

In their annual reports, Macedonian *joint stock companies subject to specific reporting obligations* have to include information on all contracts for remuneration of management and supervisory boards or board of directors members, i.e. officers entitled to special responsibilities and authorities. They are also obliged to update this information in their semi-annual reports.

According to the corporate governance code of the Macedonian Stock Exchange, *joint stock companies admitted to super listing* should disclose data about remuneration and incentives of the supervisory bodies members and of the executives in a separate report (Remuneration Committee Report), which should be part of the annual report.

**Best Practices:** In some countries the remuneration of supervisory board members and key executives is disclosed on an individual basis, whereas in others, this obligation is applicable only for selected companies, as a device for providing better information to shareholders, and consequently, better protection of their rights and legal interests.

**Useful Advice:** Companies should not only be transparent with respect to the levels of remuneration but also the methods for determining it. Shareholders are as such in a better position to assess the extent to which an individual's remuneration is justified in view of her/his responsibility and/or performance. It also allows shareholders to hold executives and supervisory board members fully accountable for the performance of their duties.

## 2.2. Information on Shareholders

It is important that shareholders are informed about company ownership structures and to understand their rights, role, and authority in governing the company, and influencing its policy. It is vital to know who is in a position to make (or influence) decisions within a company. For this reason, full information on the amount and number of the shares issued, i.e. the amount of the charter capital, its increasing and decreasing, the rights attached to shares of different types and classes, and the number of shareholders, should be disclosed permanently and on ongoing basis. Shareholders that participate with large stakes in company's capital have the opportunity to exercise control over its decision-making processes.

Securities legislation requires disclosure of shareholdings once their size reaches or exceeds specific thresholds. What, where, when, and to whom disclosure needs to be made depends upon the thresholds.

Shareholders in Macedonian *joint stock companies subject to specific reporting obligations* are required to disclose ongoing information on their holdings in the company, and to file ownership reports at the point of acquisition of more than 5% of any security class issued by the company. The required ownership reports include:<sup>56</sup>

- Initial shareholding report

When a legal entity or natural person, together with related parties, purchases or otherwise acquires company's securities in an amount that entitles that legal entity or natural person together with related parties, directly or indirectly, to ownership of more than 5% of any class of securities issued by the company, that legal entity or natural person must file a report with both the Securities Commission and the company, disclosing the amount of its/her/his shareholding, within 5 business days after the trading transaction settlement or the realization of the non-trade transfer.

- Report of changes in shareholding

A legal entity or natural person that together with related parties holds in a company, directly or indirectly, more than 5% of any class of securities issued by the company, must file reports with both the Securities Commission and the company for every successive trading transaction settlement or realization of non-trade transfer of securities issued by the company, within 5 business days after the official registration of the change.

- Final report of changes in shareholding

When a shareholder that sells or otherwise disposes of company's securities, whereby together with related parties it/she/he no longer holds more than 5% of any class of securities issued by the company, that shareholder must file a report of the changes in shareholding.

Securities entitle a legal entity or natural person to a shareholder status if they are:

- Owned by the legal entity or natural person;

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<sup>56</sup> Securities Law, Article 166.

- Owned by a party related to the legal entity or natural person; and
- Available for purchase to the foregoing entities/persons through option agreements.

The shareholding report filed by a shareholder with a *joint stock company subject to specific disclosure obligations* includes:

- Full name, unique ID or registration number, and address of the entity/person that has acquired or disposed of securities;
- Legal grounds for securities acquisition or dispose of;
- Amount of acquired or disposed of securities; and
- Date of securities acquisition or dispose of.

In their annual and semi-annual reports these companies disclose information about natural persons and/or legal entities that hold more than 5% of company's voting shares.

*Listed companies* are also required to disclose data on shareholdings, the amount of which exceeds 5% of the voting shares. According to the listing rules of the Macedonian Stock Exchange, listed companies are required to disclose the names of this category of shareholders in their prospectuses. Moreover, listed companies must notify on all changes in securities ownership that have resulted in shareholdings in an amount of at least 5% of the voting shares. The notification should state the identity of the new owners of the shares, the amount of their shares, and the new proportion of the voting rights. Notification is mandatory in opposite cases as well, i.e. when there is a decrease of the shareholdings participating with 5% or more in the voting shares. *Joint stock companies admitted to super listing* should disclose these data in their annual reports of operations.

Joint stock companies that issue shares through public offering, disclose data about shareholders that participate with more than 10% in company's charter capital in the prospectus, i.e. in the public notice for share underwriting and purchase.

## **2.3. Information on Related Parties Transactions**

Apart from majority ownership (direct control), control over companies may also be established indirectly, through pyramid structures and/or cross shareholdings. These forms of alliances are mostly associated with the efforts to avoid takeovers by external investors. Relationships with related parties may also alter the control structure of the company. For these reasons,

information on indirect ownership, related parties, and related party transactions should be fully disclosed, particularly in the annual report, quarterly reports, material events report, and other notifications to regulators or creditors.

In Macedonia, *joint stock companies subject to specific reporting obligations* are liable for disclosing (in their annual reports) and updating (in their semi-annual reports) information on related party transactions.

## **2.4. Information on Risk Factors**

Risk (along with return) is one of the most important considerations of any investor. Along with the company-specific risks, investors face additional risks, which include industry-specific risks, political, market, and interest and currency fluctuation risks. It is self understanding that business activity normally carries risks, thus what really matters investors is their prediction.

Risk is, by its very nature, forward looking and therefore extremely difficult to quantify. Nevertheless, companies are required to describe material risks in their annual reports. On the other hand, industry- country- and region-specific risks, as well as financial, legal, and institutional risks, all need to be disclosed in prospectuses.

Macedonian *joint stock companies subject to specific disclosure obligations* may voluntarily include in their quarterly reports valuations of future operations (own as well as of their related parties), at least for the period through the end of the calendar year, including therewith assessments of significant unforeseeable circumstances and risks, which can affect business activities.

According to the corporate governance code of the Macedonian Stock Exchange, *joint stock companies admitted to super listing* should timely disclose data on material risk factors. In their annual reports, these companies also disclose data from executive or supervisory board's report, which discusses issues relating to assessments of company's strategy and operating risks.

In the prospectus and/or the notice for securities underwriting and purchase, the issuer is acquired to disclose information on risk factors. If the issuer is cognizant of specific risk factors related to investment in securities offered, that information needs to be disclosed in the public notice for securities underwriting and purchase. This information should be presented in an open, clear, and precise manner, and be explained for each individual risk separately. It should particularly consider any risks arising from absence of



company operation history, negative financial results in preceding years, and financial instability.

## 2.5. Information on Stakeholders

Company's attitude toward its stakeholders is of particular importance to good corporate governance practices. Indeed, stakeholders have an important role in company's long term building of success, and, therefore, requirements for preparing and disclosing information related to them are gaining increasing attention in global realms.

In Macedonia, the corporate governance code of the Macedonian Stock Exchange advises *joint stock companies admitted to super listing* to arrange their relationships with stakeholders by a specially introduced policy. They should disclose their stakeholder relations policy on their websites.

All *listed companies*, inclusive of companies that issue securities via public offering, must disclose data on employee number and skills in their prospectuses, or public notices for securities underwriting and purchase.

Pursuant to the Company Law, *joint stock companies* must disclose in their annual reports data on the number and nominal value of shares distributed by the company to its employees, and the proportion of these shares in company's charter capital.

**Best Practices:** Notwithstanding legal requirements related to stakeholder disclosure, it is good practice to disclose data on employees and other stakeholders.

Data on workforce policies, such as labor development and training programs, schemes through which employees can acquire company's shares, insurance against labor related risks, and so on, may constitute important information to market participants and point to company's competitive advantages.

Disclosure of data on company's stakeholders and stakeholder policies may be beneficial in that it increases public confidence in the company and company's reputation.

## 2.6. Information on Corporate Governance Structure and Policy

When assessing a company's governance structure, market participants may want to obtain information about company's governing bodies, including the separation of authorities between shareholders and management, as well as information about company's compliance with law and regulations.

The rules and procedures of company's governance system are stipulated by the charter. It is a fundamental document of the company, and is to be made publicly available. Company-level corporate governance codes are an additional resource for obtaining information on company's governance systems and structures. Finally, internal by-laws provide more detailed information about company's operating processes.

In Macedonia, *joint stock companies admitted to super listing* must file annual reports of their compliance with the corporate governance code of the Macedonian Stock Exchange on "comply or explain" basis. Compliance with the code is not mandatory, but the companies are obliged to explain the reasons of a possible non-compliance. Data on consistency of company's operation and governance processes and procedures with the code should be presented in a separate chapter of the annual report. The annual report is filed with the Macedonian Stock Exchange and posted on the websites of both the company, and the Macedonian Stock Exchange.

Information about company's corporate governance structure, including the authority of each governing body and internal control mechanisms, is part of the annual reports and prospectuses, whereas some of the data are disclosed in prompt reports. In Macedonia, *joint stock companies admitted to super listing* should disclose on their websites data about board of directors or supervisory board chairperson's duties and responsibilities.

Companies should also disclose their corporate governance policies and provide interested parties with an easy access to this information. The corporate governance code of the Macedonian Stock Exchange advises joint stock companies admitted to super listing to enact an internal by-law that would ensure regular, timely, and duly dissemination of information to all shareholders and the broader public.

## **D. Mandatory vs. Voluntary Disclosure**

### **1. Data Subject to Mandatory Disclosure**

#### **1.1. Annual Reports**

Companies must provide shareholders with company information regardless of the amount of shares that they hold. One of the most important documents that is to be provided to shareholders is company's annual report, along with

annual accounts and financial statements. The specific data that need to be included in annual reports have already been discussed. However, in context of this matter, the discussion in this section constitutes a summary of annual reports contents.

The company's annual report is prepared by the governing body. In the annual report of company's operations in the preceding business year, the governing body must realistically present and explain the main factors and circumstances that have affected company's results. The annual report includes data related to:

- Changes in company's environment, their effects on company's business and the company's response to them;
- Investment policies aimed at sustaining and supporting successful operations, including policies on dividends, financing resources, debt to equity ratios, and risk management; large transactions and related parties transactions; and company assets, the value of which has not been recorded in the balance sheet in accordance with international accounting standards;
- Future development prospects of the company and its business venture;
- Research and development activities;
- Compensation of board of directors executive members, or management board members (salary, fringe benefits, bonuses, insurances, and other benefits), and remuneration of board of directors non-executive members, or supervisory board members; and
- Information regarding acquisition of privately owned shares, depending on relevant circumstances, such as following:
  - Reasons for acquiring shares in private ownership during the reporting year;
  - Number and nominal value of privately owned shares acquired and disposed of on any grounds in the preceding financial year, the proportion of these shares in the charter capital, and their purchasing value;
  - Total number and price of privately owned shares acquired and disposed of in the recent years, and the proportion of these shares in the charter capital; and
  - Number and nominal value of privately owned shares acquired by employees and their proportion in the charter capital.

In the annual report, the governing body must additionally inform the shareholders on the following:

- Acquisition of shares in other companies, in proportion higher than 10% of the total votes of those companies' general meetings of shareholders or members meetings, as well as ownership of significant controlling or mutual interest in other companies;
- Identity of the individuals and legal entities that hold, directly or indirectly, more than 5% of company's charter capital, or more than 5% vote of company's general meeting of shareholders. The report should also disclose information on the changes in this context, which occurred during the reporting year.

Additionally, an integral part of company's annual report is the report of company's relations (when it is dependent of another company) with the controlling company during, the preceding business year. This report is prepared by company's governing body, as well.

Approved financial statements, together with the annual report of company's operations, are to be filed by the governing body, in transcript, with the annual accounts register of the Central Registry. The deadline for filing is 30 days following date of approval at latest, but in no way later than June 30. These documents must also be made available for review in company's business or other premises, and every shareholder has the right to review them.

Annual accounts and financial statements data are public and should be made available to everyone, within a procedure and in manners as stipulated by law. Pursuant to the Central Registry Law, the Central Registry provides information, Xerox copies of accounting documents, and specific data from its electronic database. Companies from the banking, crediting and insurance sector, as well as large companies, and companies listed on the securities market, must publish their annual accounts and financial statements, omitting the notes on implemented accounting policies and other explanatory notes. These documents have to be published within 15 days following the date of the general meeting of shareholders, in a daily newspaper, and, mandatorily, in the "Official Gazette of the Republic of Macedonia". They have to be accompanied by the audit report, whereby both these documents and the audit report will be published in a form that is identical to the one approved by the general meeting of shareholders, without any changes or additions.

The *joint stock companies subject to specific disclosure obligations*, along with the duties derived from the Company Law, have additional ones according to the Securities Law. Those duties refer to the content of the annual report, which is filed with the Securities Commission and to deadlines thereof. Thus, a joint stock company subject to specific disclosure obligations

must file with the Commission an annual report of its financial results, legal status, and operations, within 4 months after the end of every calendar year.<sup>57</sup> The annual report includes:

- Financial statements prepared in accordance with international financial reporting standards, including balance sheet, income statement, cash flow statement, and report of equity capital changes, together with the certified auditor's opinion prepared in accordance with international auditing standards;
- Analysis and interpretation of company's business results and development program;
- Data on management and supervisory board members, or board of directors members, including data on the proportion of their holdings in company's charter capital;
- Data on individuals and/or legal entities that hold more than 5% of the company's voting shares;
- Data on all remuneration contracts with management and supervisory board members, or board of directors members, and with officers entitled to special responsibilities and authorities;
- Data on company's transactions with related parties;
- Company's dividend distribution policy;
- Data on shares acquired by the company; and
- Data on any significant changes that have been included in the prospectus, if the company has issued one in the preceding 12 months.

The annual report is filed in electronic format, and is available to the public via the Securities Commission website. Along with this report, the responsible officer of the joint stock company subject to specific disclosure obligations additionally submits a written statement, testifying to the accuracy and truthfulness of the data disclosed.

The joint stock company subject to specific disclosure obligations must publish a summary of the audited annual report, together with the certified auditor's opinion, in at least one national daily newspaper, within 15 calendar days after filing of the audited annual report with the Securities Commission. The summary must state that the financial statements are fully available both in company's offices and in Commission's premises.

*Companies admitted to super listing*, on the other hand, have specific disclosure obligations related to the annual reports. They must post their

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<sup>57</sup> Securities Law, Article 154.

annual reports on their websites within 30 days after their adoption by the general meeting of shareholders. These companies file copies of their annual reports with the Macedonian Stock Exchange, which discloses them on its website. They are additionally obliged to publish the notes attached to their financial statements. Regarding the contents of their annual reports, the Macedonian Stock Exchange's corporate governance code recommends inclusion of the following information:

- Outlines of the rules according to which the company is managed and controlled, with reference to the principles and best practice provisions of the code, clearly indicating the extent to which principles or best practices provided for by the code have been implemented and, explaining the reasons and extent to which they have not been implemented, if such is the case;
- Rights attached to all types and classes of shares issued by the company;
- Identity of shareholders holding at least 5% of company's charter capital, as well as number of shares held, broken by types and classes;
- Data on management and supervisory body members, such as: age; gender; profession; material compensation and other rights deriving from employment contracts; citizenship; date of initial appointment and current term of service; membership in management and supervisory bodies of other legal entities, which are relevant to the performance of the individual members of the management or supervisory body; as well as remuneration paid to board members;
- Data on management and supervisory body meetings, and on the attendance or non-attendance by the members;
- Management or supervisory body's report, which assesses company's strategy and business risks, and discusses the assessments of executive directors or of management board members related to carrying out company's strategy, structure and operation of internal risk management and control systems, as well as any significant changes thereto;
- Management or supervisory body's activities during the financial year;
- The name of the management or supervisory body's non-executive member, who is a financial expert;
- Election and replacement plan for the management or supervisory body members, based on a principle of previously arranged rotation;
- The name of the audit committee's member, who is a financial expert;

- Remuneration committee's report on the remuneration and incentives granted;
- Key points of the reports of the board of directors executive members or management board members, submitted to the board of directors or the supervisory board respectively, referring to company's objectives, strategy, and thereto associated risks, as well as the mechanisms needed for control of financial risks linked to financial indicators used in these reports;
- Report of the operation of the internal risk management and control systems during the reporting year;
- Declaration of the adequacy and effectiveness of the internal risk management and control systems, supported by the rationales behind; and
- Major transactions and interested party transactions.

These companies disclose their annual reports through the internet application designed for listed companies' disclosure SEI-NET. The Macedonian Stock Exchange makes the information disclosed by companies on SEI-NET available to the public.

Company's annual report, along with its annual accounts and financial statements is approved at the annual general meeting of shareholders. Prior to that, it has to be adopted and approved by company's governing body or supervisory board.

## 1.2. Semi-Annual Reports

The *joint stock companies subject to specific disclosure obligations* must prepare and file with the Securities Commission semi-annual reports covering the first semester of the calendar year, no later than 45 calendar days after semester's termination. The semi-annual report contains:

- a. Detailed explanatory statement on company's operations, which updates the information provided in the recent annual report; and
- b. Non-audited financial statements prepared in accordance with the international financial reporting standards, including a balance sheet, income statement, cash flow statement, and report of equity capital changes.<sup>58</sup>

<sup>58</sup> Securities Law, Article 156.

These statements are filed in electronic format, and are available to the public via the Securities Commission's website. Along with these statements, the responsible officer of the joint stock company subject to specific disclosure obligations additionally submits a written statement, testifying to the accuracy and truthfulness of the data disclosed.

*Listed companies*, on the other hand, must disclose their semi-annual income statements, within 45 days after the termination of the reporting period. Semi-annual income statements are disclosed through the internet application designed for listed companies' disclosure SEI-NET. The information disclosed by companies on SEI-NET is made available to the public by the Macedonian Stock Exchange.

### 1.3. Quarterly Reports

*Joint stock companies subject to specific disclosure obligations* must file with the Securities Commission quarterly financial statements covering the first and the third trimester of the calendar year, within 30 calendar days after trimesters' termination. The quarterly report should contain at least following information:

- a. Consolidated numerical data covering the relevant trimester, summarised in tables, and indicating total revenues and profit or loss before and after taxation;
- b. Detailed explanatory statement on company's operations, and company's profit or loss during the relevant trimester.<sup>59</sup>

A company may choose to include in this report an assessment of both own and related parties future operations, covering at least the remainder of the calendar year, indicating any significant uncertainties and risks which may affect company's operation. These statements are filed with the Securities Commission in electronic format, and are available to the public via Commission's website. Along with these statements, the responsible officer of the joint stock company subject to specific disclosure obligations additionally submits a written statement, confirming the accuracy and truthfulness of the data disclosed.

*Listed companies* must disclose their non-audited income statements for the first trimester, as well as their cumulative non-audited income statements for the period of the first three trimesters. The deadline is 45 days after the termination of the reporting periods. These income statements are disclosed

<sup>59</sup> Securities Law, Article 157.



through the internet application designed for listed companies' disclosure SEI-NET. The information disclosed by companies on SEI-NET is made available to the public by the Macedonian Stock Exchange.

#### **1.4. Prompt Reports**

*Joint stock companies subject to specific disclosure obligations* must provide immediate disclosure to the Securities Commission whenever specific events occur. Board of directors' executive members or management board members must prepare reports on these events, and the company must submit them to the Commission, within 5 days following the date of their preparation. These events include:

- a. Recorded losses, the amount of which exceeds 30% of company's assets;
- b. Charter capital decrease to an amount lower than the one set in company's charter; and
- c. Appearance of a need for preparing special reports of company's operations, or for reporting on other specific matters relating to company's operations.

Additionally, the company must prepare prompt reports whenever it has at its disposal commercially sensitive information that has not been publicly available. The company is obliged to immediately notify the Commission about this information and to release a report on the developments that resulted as a consequence of this information. The report must be published in at least one national daily newspaper, as soon as possible, but in no way later than 10 calendar days following the date of obtaining the commercially sensitive information.

Commercially sensitive information is discussed in more detail in section A. title 4. of this chapter.

#### **1.5. Disclosure During Public Offering**

The procedure for issuing new shares requires from companies certain information disclosure, depending on the nature of the offering, or depending on whether the offering is public or private. Disclosure obligations required for private offering of securities are notably smaller than those required for public offering. This, however, should not deter companies from public offering of securities, for the benefits of disclosing larger amounts of data are

rather significant. The public offering constitutes an efficient way of attracting new capital from outside of the company, and of using multiple resources for that action. Notwithstanding financial, there also are commercial reasons for public offering of securities by companies. It increases company's publicity, and enhances its competitiveness on the market.

**Public offering is a public notice for underwriting and purchasing securities, which is published in the media.**<sup>60</sup> A company that issues securities through public offering discloses information to the public in a prospectus. **A prospectus is a written document that contains all relevant data, which allow buyers of the securities described therein, make assessments of issuer's legal, financial, and business operations, the investment risk, and the rights attached to the securities offered.**<sup>61</sup> The prospectus discloses information on company's business operations (its incorporation, equity capital, business activity, financial standing), and development policy, as well as data relating to securities issuance, management's comments, risk factors, and other material information about the issuer.<sup>62</sup>

Public offering of securities is conducted on basis of prior Securities Commission approval. The company must commence the procedure of securities underwriting and payment through a public offering within 30 calendar days following the date of receipt of the Securities Commission approval.

The table below is a summary of the events that need to be disclosed during the public offering of securities, the disclosure deadlines, and the disclosure location. Similar disclosure requirements apply in cases when public offering terms are changed in the course of the public offering process.

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<sup>60</sup> Securities Law, Article 2 Paragraph 1 Clause 16.

<sup>61</sup> Securities Law, Article 2 Paragraph 1 Clause 25.

<sup>62</sup> Rule Book on the Format and Content of the Public Notice for Underwriting and Purchasing Securities (Official Gazette of the Republic of Macedonia, No 16/2001)

**Table 1: Information Disclosure During Public Offering of Securities**

Event	Disclosure Location	
	Daily newspaper published on Macedonian national territory	Macedonian Stock Exchange's website
Invitation for underwriting and payment	14 calendar days prior to the start of securities underwriting	14 calendar days prior to the start of securities underwriting
Prospectus		14 calendar days prior to the start of securities underwriting
Notification on the public offering closing upon attaining success margin	At least 15 business days prior to the date specified by the issuer as public offering closing day	
Notification on the outcome of the public offering	Within 15 calendar days after the closing day of the public offering	

During the public offering, the prospectus is made available to all interested parties, in the premises of the issuer and at all locations designated for underwriting and payment of the securities. The final version of the prospectus that is subject to disclosure must not differ from the prospectus approved by the Commission's resolution for approval of the securities issuance.

The company must notify both the general public and the Securities Commission on the closing of the public offering and on its outcome.

All companies that have carried out public offering of securities, automatically pass into the category of joint stock companies subject to specific disclosure obligations, and must, therefore, fulfil the disclosure duties required from that category of companies. The disclosure duties of the

joint stock companies subject to specific disclosure obligations are discussed in section A. title 6.2. of this chapter.

## 2. Voluntary Disclosure

Voluntary disclosure of material information to an extent that goes beyond formal legal requirements is considered good corporate practice. This holds particularly true for companies operating in emerging markets that are often marked by weak regulatory environment, and poor enforcement mechanisms. Companies should be encouraged to the highest possible extent to use the existing forms of disclosure (e.g., prospectuses, and quarterly, annual, and material events reports) and adhere to the quality standards that are demanded for these forms of reporting. They should also be encouraged to use the existing channels of communication, such as the internet and the press.

Today an individual website should be a must to every company. Likewise companies in the developed countries, Macedonian companies should have their own websites that can be used *inter alia* for information disclosure. Corporate websites are easily accessible to the public at low cost, and may serve as an exceptionally powerful means of communication.

The internet has already been used as an official information disclosure channel of Macedonian companies. Such is the case of the joint stock companies subject to specific disclosure obligations and the listed companies, the disclosed information of which is placed on the websites of both the Securities Commission and the Macedonian Stock Exchange.

In the Macedonian practice, the press still remains a most useful communication channel for companies, with respect to both mandatory and voluntary information disclosure. Although information disclosure through the press may entail significant expenses, it has the advantage of being a channel of active dissemination of information to the public, in contrast with the internet, through which the information dissemination is passive. Through the press, companies disclose a variety of information, such as information about new products, major contracts, acquisitions, financial results, production plans, and securities issuance.

Voluntary disclosure of corporate data and information promotes good corporate governance practices.

## Summary of Disclosure Obligations According to Company Category

The following tables summarize the disclosure obligations of Macedonian companies, disclosure deadlines, as well as disclosure location, depending on the category to which they belong.

**Table 1: Disclosure Obligations of Listed Companies**

Disclosure Information	Disclosure Deadlines	Disclosure Location
Information on business operations	Ongoing	SEI-NET
Capital related information	Ongoing	
Information about major changes in financial standing	Ongoing	
Dividend calendar	The day following the date of approval of dividend distribution by the general meeting of shareholders	
Information about publicly owned shares	Ongoing	
Notifications on major holdings	Ongoing	

**Table 2: Disclosure Obligations of Companies Admitted to Super Listing**

Disclosure Information	Disclosure Deadlines	Disclosure Location
Full consolidated audited financial statements <ul style="list-style-type: none"> <li>- Auditor's opinion</li> <li>- Balance sheet</li> <li>- Income statement</li> <li>- Cash flow statement</li> <li>- Report of equity capital changes</li> <li>- Notes to the financial statements</li> </ul>	30 days following the date of their adoption by the general meeting of shareholders	SEI-NET
Quarterly, semi-annual, and three-quarterly cumulative, non-consolidated, non-audited income statements	45 days after termination of the reporting period	SEI-NET
Annual non-audited, cumulative, consolidated, and non-consolidated income statement	60 days following the end of the calendar year covered by the income statement	SEI-NET
Annual report of operations	30 days following the date of its adoption by the general meeting of shareholders	SEI-NET
Report of compliance with the Macedonian Stock Exchange's corporate governance code	In annual terms	SEI-NET
Public notice on convening general meeting of shareholders	At least 21 day prior to the general meeting of shareholders	SEI-NET, and at least one national daily newspaper.

<p>Draft resolutions, if they have been included as items in the general meeting of shareholders' agenda:</p> <ul style="list-style-type: none"> <li>- Resolution for adoption of financial statements;</li> <li>- Resolution for distribution of profits;</li> <li>- Resolution for dividend distribution and constitution of a dividend calendar;</li> <li>- Resolution for changes in rights attached to securities that have been issued;</li> <li>- Resolution for governing bodies' members replacement;</li> <li>- Resolution for changes in company's articles of incorporation.</li> </ul>	<p>Together with the public notice on convening general meeting of shareholders</p>	SEI-NET	
<p>Resolutions adopted by the general meeting of shareholders:</p> <ul style="list-style-type: none"> <li>- Resolution for adoption of financial statements;</li> <li>- Resolution for distribution of profits;</li> <li>- Resolution for dividend distribution and constitution of a dividend calendar;</li> <li>- Resolution for changes in rights attached to securities that have been issued;</li> <li>- Resolution for governing bodies' members replacement;</li> <li>- Resolution for changes in company's articles of incorporation.</li> </ul>	<p>The first trading day after the date of their adoption</p>	SEI-NET	
<p>All notifications and financial statements are disclosed both in Macedonian and in English.</p>			

**Table 3: Disclosure Obligations of Companies Admitted to Stock Exchange Listing**

Disclosure Information	Disclosure Deadlines	Disclosure Location
<p>Consolidated audited financial statements</p> <ul style="list-style-type: none"> <li>- Auditor's opinion</li> <li>- Balance sheet</li> <li>- Income statement</li> <li>- Cash flow statement</li> <li>- Report of equity capital changes</li> </ul>	30 days following the date of their adoption by the general meeting of shareholders	SEI-NET
Quarterly, semi-annual, and three-quarterly cumulative, non-consolidated, non-audited income statements	45 days after termination of the reporting period	SEI-NET
Annual non-audited, cumulative income statement	60 days following the end of the calendar year covered by the income statement	SEI-NET
Public notice on convening general meeting of shareholders	At least 21 day prior to the general meeting of shareholders	SEI-NET and at least one national daily newspaper
<p>Resolutions adopted by the general meeting of shareholders:</p> <ul style="list-style-type: none"> <li>- Resolution for adoption of financial statements;</li> <li>- Resolution for distribution of profits;</li> <li>- Resolution for dividend distribution and constitution of a dividend calendar;</li> <li>- Resolution for changes in rights attached to securities that have been issued;</li> <li>- Resolution for governing bodies' members replacement;</li> <li>- Resolution for changes in company's articles of incorporation.</li> </ul>	The first trading day after the date of their adoption	SEI-NET



**Table 4: Disclosure Obligations of Joint Stock Companies Subject to Specific Disclosure Obligations**

Disclosure Information	Disclosure Deadlines	Disclosure Location
Annual report of the financial results, legal status, and business operations	Within 4 months following the end of the calendar year	Securities Commission's website, Macedonian Stock Exchange's website.
<p>Audited annual financial statements</p> <ul style="list-style-type: none"> <li>- Auditor's opinion</li> <li>- Balance sheet</li> <li>- Income statement</li> <li>- Cash flow statement</li> <li>- Report of equity capital changes</li> </ul>		
Summary of the audited annual report, together with the certified auditor's opinion	Within 15 calendar days following date of submission to the Securities Commission	Securities Commission's website; Macedonian Stock Exchange's website; and national daily newspaper.
Semi-annual report (non-audited semi-annual financial statements)	No later than 45 days following the last day of semester	Securities Commission's website, and Macedonian Stock Exchange's website.
Quarterly reports	No later than 30 days following the last day of relevant year's quarter	Securities Commission's website, and Macedonian Stock Exchange's website.
Prompt reports	Within 5 business days after their preparation	Securities Commission's website, and Macedonian Stock Exchange's website.
Commercially sensitive information	Promptly, but in no way later than 10 calendar days following the date of its obtaining	Securities Commission's website; Macedonian Stock Exchange's website; and national daily newspaper.

**Table 5: Information Disclosure Required for Takeovers**

Acquisition of 5% of company's voting shares (and every additional 5%)	Investor's obligation	Company's obligation	
	Information disclosure	Information publishing	
	Securities Commission	The Company	In the daily newspaper with highest circulation
Intended acquisition		Deadline	Immediately after receipt of notification
	Bidder's obligation	Information publishing	
	Information disclosure	Information publishing	
	Securities Commission	Competition Commission	In the daily newspaper with highest circulation
		Before announcement of acquisition bid, i.e. immediately after acquisition of 25% of voting shares	
	Deadline		1 business day after the disclosure

Beginning of negotiations	Obligation of the company's governing body	Information disclosure	Information publishing
		Securities Commission	In the daily newspaper with highest circulation
		Deadline	2 business days after receipt of announcement about the intention Deadline
Placement of acquisition bid	Bidder's obligation	Information disclosure	Information publishing
		x	In the daily newspaper with highest circulation On MSE's website
			Immediately after Securities Commission' approval, but no later than 1 business day Deadline

Excerpt from the prospectus	Bidder's obligation	Information disclosure	Information publishing
	x	In the daily newspaper with highest circulation	Immediately after Securities Commission's approval, but no later than 1 business day
	Deadline		
Prospectus	Bidder's obligation	Information disclosure and submission of copy	Information publishing
	Company's governing body	Competition Commission	x
		MSE, Central Securities Depository, and all authorized securities market participants	
	Deadline		Immediately after Securities Commission' approval, but no later than 1 business day

Opinion supported by explanation	Obligation of the company's governing body	
	Information disclosure	Information publishing
	x	In the daily newspaper with highest circulation
		7 business days after publishing the excerpt from the prospectus
		Deadline
Disclosure of acquisition bid's outcome	Bidder's obligation	
	Information disclosure	Information publishing
	Securities Commission	In the daily newspaper with highest circulation
	Competition Commission	
	Central Securities Depository	
		No later than 3 <sup>rd</sup> business day after expiration of the bid acceptance deadline
	Deadline	Deadline
		No later than 3 <sup>rd</sup> business day after expiration of the bid acceptance deadline

Announcement of acquisition bid's successfulness	Bidder's obligation	Information disclosure	Information publishing
		x	
		In the daily newspaper with highest circulation On MSE's website	Immediately after Securities Commission's approval, but no later than 1 business day
		Deadline	

### **The Chairperson's Checklist**

- ✓ What is the relationship between the internal audit department and the supervisory board's audit committee?
- ✓ Is the internal audit department fulfilling its functions and duties? Has the internal audit department ever found, and reported on, possible misstatements or other violations?
- ✓ Who are the members of the internal audit department? Is the internal audit department enough independent in its dealing?
- ✓ Does the internal audit department report regularly?
- ✓ Does the company have an independent external auditor? Does the external auditor provide other, non-audit services to the company that could compromise her/his independence?
- ✓ How is the external auditor selected? Does an open tender procedure take place, and if so, who is in charge of it?
- ✓ To whom does the external auditor report?
- ✓ Does the external auditor participate in the annual general meeting of shareholders and answer all questions asked by shareholders?
- ✓ Should the company's supervisory board have an audit committee? What are the costs and benefits?
- ✓ If the company has an audit committee, is it staffed with individuals who are independent, able, and willing to do the job properly and effectively?
- ✓ Does the chairperson of the audit committee have the requisite professional and human relations skills? Are audit committee members professionally recognized financial experts?
- ✓ Does the audit committee meet often enough to perform its duties effectively? Does it place the necessary and appropriate issues on the agenda?

## F. Control and Audit Procedures

Internal and external control and audit systems are important tool both for management and oversight of a company. They provide knowledge of the extent in which information on management operations, finances, and other business aspects of a company are realistic and integrated, and of the degree to which the organization of company's systems and structures constitute a foundation for compliance with laws, regulations, policies, and procedures.

Companies with good corporate governance establish special units, or form special bodies that handle the matters of internal control and audit, which provide shareholders and supervisory bodies with access to independent and objective assessment of company's management and officers' performance, through presentation of analyses, recommendations, advices, and information regarding the audited activities and processes.

### 1. Internal Audit Department

An internal audit department is a unit within company's structure, established to control company's operations, particularly its financial operations. Its primary objective is to provide independent opinion on the accuracy and relevance of company's financial information that is handed or presented to shareholders, and on the compliance of company's operations with the law and relevant regulations. In some countries, according to the legislation, this function is being performed by *revision commissions* – special bodies, which are mainly founded by supervisory boards.

**The existing Macedonian corporate legislation provides for establishment of internal audit departments only in the Law on Banks.**<sup>63</sup> Such legal requirement does not exist for other companies. However, with respect to the importance of this function for good corporate governance, regardless of the industry, further in this chapter are discussed examples of best practices relating to organization, structure, authorities, and duties of internal audit. Particular attention is paid to the solutions related to internal

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<sup>63</sup> The new Law on Banks has been published in the "Official Gazette of the Republic of Macedonia" No. 67/2007.



audit departments provided for by the Macedonian Law on Banks.<sup>64</sup> As best practices examples are pointed exactly companies from the country's banking sector. However, with certain adjustments these practices may be applied in other companies as well. Regarding international practices, examples of operation of revision commissions are included and discussed.

## **1.1. Internal Audit Department Structure**

As already mentioned, the practices of internal audit departments in Macedonia are illustrated through companies in the country's banking sector. Regarding the structure of internal audit departments, the Macedonian Law on Banks provides that

“The bank's supervisory board organizes an internal audit department, as an independent organization unit of the bank. The organization structure, rights, responsibilities, and relations with other organizational units in the bank, and the responsibilities and requirements for appointing a manager of the internal audit department are regulated by the supervisory board. The internal audit department officers are employees of the bank and perform only the functions of the department, provided that at least one of them is licensed auditor.”<sup>65</sup>

The National Bank's *Circular on Corporate Governance in Banks* provides additional guidelines for setting up an internal audit department as a separate unit. According to the circular, the bank's supervisory board organizes the internal audit department and specifies its scope of functions as well as resources needed. The supervisory board is authorized for appointing department's officers. Department's officers perform functions related exclusively to the internal audit, and the majority of them should be licensed auditors.

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<sup>64</sup> Law on Banks, Article 95.

<sup>65</sup> Ibid.

**Best International Practices:** A revision commission may consist of one or multiple members. Commission's members should be independent from company's management. Therefore, members of the supervisory board, management board, and board of directors, as well as chief executive officers, cannot be revision commission's members.

Revision commission members need to be elected on basis of their experience and competence in the field of finances. The company's charter or other by-laws may stipulate additional criteria for election of revision commission members.

## 1.2. Internal Audit Department Competences

The way in which objectives, organization, and functions of the internal audit department are set in the Macedonian Law on Banks may serve as an example of organization of a similar function in other companies in the corporate sector.

Pursuant to the provisions of the Law on Banks, an internal audit department conducts an ongoing and complete audit of the legitimacy, accuracy and promptness of bank's operations through:

1. Assessment of internal control systems adequacy and efficiency;
2. Assessment of implementation of risk management policies;
3. Assessment of the design of the information system;
4. Assessment of the accuracy and reliability of the commercial books and financial statements;
5. Inspection of the accuracy, reliability, and timeliness of reporting, in accordance with the regulations;
6. Monitoring of the compliance with regulations, code of conduct, policies and procedures;
7. Assessment of the systems for prevention of money laundering; and
8. Assessment of services obtained by the bank from companies performing supporting banking services.<sup>66</sup>

According to the *Circular on Corporate Governance in Banks*, internal audit department's operation is founded on the following basic principles: continuity in performing assigned competencies, employees' professional capacity and skills, and independence in performing relevant functions.

Internal audit departments of banks have the authority to:

<sup>66</sup> Ibid.

- Asses internal control systems' adequacy and efficiency;
- Review the implementation of risk management procedures;
- Review the design of the management information system (MIS);
- Review the accuracy and reliability of accounting records and financial statements;
- Inspect the performance of specific transactions, or the implementation of internal control procedures in certain operation areas;
- Monitor the compliance with the regulatory framework, and the bank's code of conduct, as well as monitor the implementation of bank's policies and procedures;
- Inspect the accuracy, reliability and timeliness of the regulatory reports filed with relevant institutions;
- Conduct specific inspections of the bank; and
- Consult and advise on matters related to setting suitable internal control systems, and adequate financial reporting systems, resolving important organization issues, introducing new banking products, and analyzing the risks thereof.

In banks' hierarchy, internal audit departments are positioned above operational organization units, which perform functions typical for day-to-day bank operations, and directly beneath the management board and the audit committee. The communication and reporting lines are directed toward the management board and the audit committee.

**Best International Practices:** The revision commission has the authority to:

- Conduct an annual inspection of company's finances and operations before the annual general meeting of shareholders;
- Undertake extraordinary inspections of company's finances and operations;
- Review the accuracy of company's annual reports and audited financial statements;
- Request an extraordinary general meeting of shareholders;
- Request supervisory board meetings for discussing issues under its authority;
- Request and receive minutes of executive board (management board/board of directors) meetings;
- Request and receive documents regarding company's finances and operations from the executive bodies; and
- Request and receive information concerning related parties and related party transactions.

Shareholders may specify in the charter additional authorities of the revision commission, such as the authority to:

- Investigate cases of using insider information;
- Check the timeliness of payments to contractors and mandatory budget payments;
- Check the timeliness of the accruals and payments of dividends, as well as the timely meeting of company's other financial obligations;
- Check the appropriateness of using company's reserve and other funds;
- Review the financial condition of the company, particularly its solvency, liquidity of its assets, and creditworthiness; and
- Oversee the timeliness of the valuations of company's net assets.

### 1.3. Election of Internal Audit Department Members

According to the Law on Banks, the supervisory board of the bank founds the internal audit department and appoints and dismisses its officials.<sup>67</sup>

<sup>67</sup> Ibid.

### Best International Practices:

- **Election and dismissal of revision commission's members.** The procedure for nominating candidates to the revision commission is identical to the procedure for nominating candidates to the board of directors, management board, or supervisory board. The charter can provide for additional criteria for candidates for revision commission members. The agenda of the annual general meeting of shareholders must include the election of the revision commission members. This means that revision commission members are elected for a one year term and serve until the next annual general meeting of shareholders. Revision commission members are elected by a simple majority vote of participating shareholders. Management board, supervisory board, and board of directors members are not entitled to vote on the election of the revision commission members. The election of individual members of the revision commission can be revoked at any time by a simple majority vote of participating shareholders.
- **Contracts with members.** Companies may conclude employment contracts or civil law contracts with revision commission members. However, given that employment contracts are typically concluded with company employees who report directly to management, it is better if companies conclude civil law contracts with revision commission members, underlining their independence from management.

The charter or by-laws should specify who signs the contract on behalf of the company. Normally, the chairperson of the general meeting of shareholders or the chairperson of the supervisory board should be in charge of this. If the chief executive officer or another executive signs the contract, this would likely affect the independence of the revision commission, either in appearance or in fact. Of course, the authority to sign the contract does not imply the authority to negotiate or alter contract terms. Key elements and terms of the contract, for example, remuneration, are subject to the general meeting of shareholders' approval.

- **Remuneration of members.** The general meeting of shareholders decides about revision commission members compensation and reimbursement of expenses. The supervisory board, through a remuneration committee (if one has been established), should recommend the amount of remuneration for general meeting of shareholders' approval. Moreover, it may be provided that shareholders owning a certain amount of voting shares (e.g. 5%) are entitled to propose such item on the agenda.

## 1.4. Operating Procedures

In accordance with the Law on Banks, the internal audit department performs its activities pursuant to the internal audit principles and standards, the code

of conduct of the bank, and the policies and procedures of the department itself.<sup>68</sup>

The internal audit department prepares an annual operation plan that is approved by the supervisory board. The plan must include the subject of the audit, along with the description of the contents of designated audits, and a yearly schedule of individual inspections, and the foreseen period of their duration.

Other companies in the corporate sector may adopt similar solutions. Below is presented an example of operating procedures in case the company has a revision commission.

**Best International Practices:** Revision commission's operating procedures can be specified in the charter or, preferably, in company's by-laws regulating the revision commission issues, and are approved by the general meeting of shareholders. Revision commission members usually elect their chairperson at their first meeting. The charter or by-laws may provide the chairperson of the revision commission with the responsibility to:

- Call, organize, and chair revision commission meetings;
- Prepare and sign the meetings minutes as well as certain decisions;
- Represent the revision commission at meetings with third parties; and
- Cast the deciding vote in case of tie-vote.

The quorum should not be less than half of the revision commission members, and decisions should be approved by a simple majority vote.

In addition to annual inspections of finances and operations, the revision commission may carry out extraordinary inspections at its own discretion, or be required to do so, upon:

- A decision of the general meeting of shareholders;
- A request of the supervisory board; or
- A request of a shareholder (or a group of shareholders) owning at least 10% of voting shares.

Extraordinary inspections should start no later than 30 days after receiving of a shareholder's request, or after signing the minutes of the general meeting of shareholders or the supervisory board meeting, at which the resolution for carrying out an extraordinary inspection have been passed. The duration of these inspections should not exceed 90 days.

The revision commission must prepare a written report on the findings of each inspection. The revision commission should present the results of the extraordinary inspection to the audit committee (if established) and to the initiator of the extraordinary inspection, no later than 3 days after its completion.

<sup>68</sup> Ibid.

## 1.5. Reporting

The Law on Banks requires that the internal audit department prepare semi-annual and annual reports on its operations and submit them to the supervisory board, management board, and audit committee.<sup>69</sup> The semi-annual and annual reports contain:

- 1) Description of conducted audits of bank's operations;
- 2) Assessment of internal control systems' adequacy and efficiency;
- 3) Findings and proposed measures by the internal audit department; and
- 4) Assessment of possible implementation of the measures proposed by the internal audit department.

The annual report additionally contains:

- 1) Assessment of the achievement of the objectives set by the annual plan of activities;
- 2) Assessment of the duration of the planned audit, and possible deviations thereof; and
- 3) Information on other conducted activities.

The supervisory board submits the internal audit department's annual report to the bank's general meeting of shareholders and the National Bank.

The internal audit department must immediately notify the supervisory board and the management board, if the audit has detected:

- 1) Violations of risk management standards which are likely to deteriorate bank's liquidity or solvency; and
- 2) Violations of bank's regulations, by-laws, and internal procedures, done by the management board.<sup>70</sup>

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<sup>69</sup> Law on Banks, Article 97.

<sup>70</sup> Law on Banks, Article 98.

**Best International Practices:**

**Inspection Report Essentials.** The revision commission must prepare a report on the results of each annual inspection, which presents:

- Its conclusions on the accuracy of company's operations report, financial statements, and other documents; and
- Information on any discovered violations of accounting and financial reporting procedures, disclosure rules, and relevant laws and regulations.

All revision commission members should sign the report, whereby:

- Members who have not signed the report explain the reason for that; and
- For members who have refused to sign the report and were unwilling to explain the reason a clear indication has to be made.

Revision commission members who attend the general meeting of shareholders should provide shareholders with the opportunity to ask questions and discuss inspection results.

**Inspection Report Presentation.** The revision commission's findings should be attached to the company's annual report. At least 10 days prior to the distribution of materials for the general meeting of shareholders, the revision commission should provide the supervisory board with the inspection report, enabling as such the board to review it and discuss it. The annual inspection report must also be distributed as a separate document to the shareholders, prior to the annual general meeting of shareholders.

## 2. Independent External Auditor

An independent audit conducted by an external auditor is important element of the company's control framework. **It constitutes a process by which external individuals or teams inspect whether company's procedures provide for quality operational standards and results.** The audit's purpose is to enable an external auditor to express an opinion on whether or not the financial statements of the company are prepared, in all material respects, in accordance with an identified financial reporting framework, and whether they are reliable. It gives shareholders, managers, employees, and market participants an independent opinion about the company's financial position, and should attest to the accuracy of company's statements. An independent audit conducted by a reputable audit firm enhances company's credibility, and accordingly, its prospects for attracting investment.

Three key points regarding independent audit are:



- 1) Management is held responsible for preparing and presenting company's financial statements;
- 2) The external auditor is responsible for forming and expressing an opinion on financial statements prepared by the management; and
- 3) The financial statements audit does not exempt the management of any of its responsibilities.

In the Macedonian Audit Law, audit is defined as **independent examination of financial statements and financial information, the aim of which is expression of an opinion on their truthfulness, unambiguity, and conformity with the adopted international accounting standards and international financial reporting standards published in the "Official Gazette of the Republic of Macedonia"**.<sup>71</sup>

## 2.1. Obligation for Carrying Out Audits

According to the Company Law, the following commercial entities are subject to audit:

- 1) Large and medium sized commercial entities registered as joint stock companies;
- 2) Companies, the shares of which are listed on the stock exchange; and
- 3) Large and medium sized commercial entities organized as limited liability companies.<sup>72</sup>

In Macedonia commercial entities are classified as large, medium sized, small, and micro sized, depending on number of employees, annual revenues, and the average value of total assets, as declared in annual accounts for the two recent years (accounting years).<sup>73</sup>

A medium sized commercial entity is considered one that in each of the two recent accounting years, or in the first year of operations, has met the first criterion and at least one of the remaining two criteria of the following:

- 1) The average number of employees, based on the number of full-time working hours, is between 50 and 250; and

<sup>71</sup> Audit Law, Article 4.

<sup>72</sup> Company Law, Article 478.

<sup>73</sup> Company Law, Article 470.

- 2) The annual revenues are between EUR 2 and 10 million in MKD counter-value; and/or
- 3) The average value (at the beginning and at the end of the accounting year) of total assets is between EUR 2 and 11 million in MKD counter-value.

Commercial entities, which exceed the values of criteria set for medium sized commercial entities are treated as large. If, during two recent accounting years, data that affect commercial entity's classification differ, the commercial entity retains the classification from the preceding year.

**Best Practices:** All large and medium sized commercial entities, commercial entities specified by law, as well as commercial entities in the banking and insurance sector, commercial entities listed on the stock exchange, and commercial entities the financial statements of which are part of consolidated financial statements of the aforementioned commercial entities, must prepare and file financial statements in accordance with the adopted international accounting standards, published in "Official Gazette of the Republic of Macedonia". The international accounting standards are being updated on annual basis in order to be aligned with the currently valid standards, such as they are amended, changed, or adopted by the International Accounting Standards Board.

Other commercial entities may also prepare and file financial statements in compliance with the international accounting standards, if provided by law or other regulations pursuant to law, or at their own discretion.<sup>74</sup>

Banks, insurance companies and other financial institutions and commercial entities that generate consolidated annual accounts and consolidated financial statements are classified as large commercial entities.<sup>75</sup>

The banks' duty of financial statements audit is stipulated in the Law on Banks, which specifies, in particular, the following audit items:

- 1) Balance sheet;
- 2) Income statement;
- 3) Cash flow statement;
- 4) Changes in the amount of assets and assessment of capital adequacy;
- 5) Extent and changes in the amount of value adjustments and allocated special reserve, as well as effectuated write-offs;
- 6) Amount of potential liabilities assumed;
- 7) Consolidation effects;

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<sup>74</sup> Company Law, Article 469.

<sup>75</sup> Company Law, Article 470.

- 8) Internal control systems operation, and carrying out of the internal audit function;
- 9) Bookkeeping;
- 10) Information system's security;
- 11) Accuracy and completeness of statements filed with the National Bank for supervision purposes;
- 12) Adequacy of bank's accounting policies and procedures, as well as valuation of on- and off-balance-sheet assets and liabilities;
- 13) Compliance of bank's operations with the regulations; and
- 14) Risk management systems.<sup>76</sup>

The content of the audit of banks' operations and annual financial statements is stipulated in detail by the National Bank Council, according to international standards.

On the other hand, the Audit Law differentiates between legal and contractual audit, whereby:

**Legal audit** is mandatory examination of financial statements and other information, conducted pursuant to law, in accordance with the international auditing standards of the International Federation of Accountants, translated and published in the "Official Gazette of the Republic of Macedonia". Subject to legal audit are:

- a) Financial statements of commercial entities specified by law, with a purpose of expression of an opinion on their truthfulness and unambiguity and their conformity with the adopted international accounting standards and international financial reporting standards, required in Macedonia by law; and/or
- b) Financial information prepared in accordance with relevant criteria, with a purpose of expression of an opinion on them.

**Contractual audit** is voluntary examination of financial statements that is conducted on basis of a contract, in accordance with the international auditing standards of the International Federation of Accountants, translated and published in the "Official Gazette of the Republic of Macedonia", with a purpose of expression of an opinion on their truthfulness and unambiguity, and their conformity with the adopted international accounting standards and international financial reporting standards, required in Macedonia by law,

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<sup>76</sup> Law on Banks, Article 106.

whereby individuals and entities that are not parties of the audit contract can rely on the financial statements and on the audit report prepared in accordance with these standards.<sup>77</sup>

## 2.2. External Auditor's Rights and Duties

According to the Company Law, the certified auditor may request from the executive members of the board of directors, or the members of the management board, or the manager of the company, explanations and evidence needed for proper examination of financial statements.<sup>78</sup>

Additionally, the Audit Law provides the external auditor with the following **rights**:

- A certified auditor is **independent and autonomous** in performing the audit function within the framework of authorities provided for by law, and in accordance with the international auditing standards of the International Federation of Accountants, proclaimed by the minister of finance, and the *Code of Conduct for Professional Accountants* of the International Federation of Accountants.
- A certified auditor has the **authority to access company's books, accounts, and orders** and to request from members of governing bodies, officers, and managers information and explanations that are in their command or knowledge, which is available to them and is considered by the certified auditor as necessary for accomplishment of her/his duties.
- Auditors are **entitled to attend all shareholders meetings** and to receive all notices for shareholders meetings and other communication to which all shareholders (of JSCs) or members (of partnerships) are entitled, to take the floor at any of the shareholders meetings which they attend, and to address any item of the agenda which concerns them as auditors.<sup>79</sup>

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<sup>77</sup> Audit Law, Article 4.

<sup>78</sup> Company Law, Article 479.

<sup>79</sup> Audit Law, Articles 24, 28, and 31.

Certified auditors can request company's executives for explanations and evidence needed for the audit, and for proper examination of the financial statements.

**Best International Practices:** The external auditor has the authority to:

- Determine the method of conducting the audit;
- Examine the documentation, as well as identify and confirm company's assets;
- Receive oral and written explanations on any issue that arises during the audit;
- Refuse to carry out the audit or provide an opinion about the reliability of financial statements if the company does not provide all required documents, or when circumstances arise that have an effect on the auditor's opinion;
- Have access to the charter, including amendments and revised versions of the charter;
- Request an extraordinary general meeting of shareholders;
- Request a supervisory board and management board, or board of directors meeting;
- Receive minutes of the management board, or board of directors meetings; and
- Receive information on related parties and related party transactions.

Apart from the rights, the External Auditor has the following **obligations**:

- To conduct revisions with professional integrity and independence;
- To conduct revisions in accordance with the international auditing standards of the International Federation of Accountants, which have been proclaimed by the minister of finance and published in the "Official Gazette of the Republic of Macedonia", and are being updated on annual basis in order to be aligned with the currently valid standards, such as they are amended, changed, or adopted by the International Federation of Accountants.
- To respect the confidentiality of the information received as a result of professional and business relations, and not to disclose any of this information to third parties without a proper and special consent, except in cases of legal or professional authority, or duty for such disclosure. Exceptionally, when the audit company or the certified auditor – sole proprietor has been replaced by another one, the replaced audit company or certified auditor must provide access to all relevant information on the audited entity to the newly appointed audit company or certified auditor – sole proprietor.

The confidentiality clause regarding this information, however, is still valid for the replaced audit company or certified auditor. Owners and

executive directors of an audited company, on the other hand, must provide information requested by certified auditors, and the Chartered Auditors Institute.<sup>80</sup>

On request of the board of directors non-executive members, or the supervisory board members, the certified auditor must attend the board of directors, or supervisory board meetings.

Regarding the banking sector, the Law on Banks specifies additional duties relevant for audit companies that conduct audits of banks. Thus, pursuant to the Law, an audit company must immediately notify the governor of the National Bank in writing, should it find out during the audit that:

- 1) The bank's solvency or liquidity is compromised;
- 2) The bank is insolvent or illiquid; and
- 3) The bank was and/or still is operating in conflict with regulations.<sup>81</sup>

The audit company must also immediately notify the governor in writing if on basis of conducted audit of a legal entity, which is in close relationship with the bank, finds out that:

- 1) The entity faces liquidity or solvency problems; and
- 2) The entity was and/or still is operating in conflict with regulations.<sup>82</sup>

With respect to the transparency aspect of audit companies' operation, one further provision of the Audit Law is to be mentioned:

An audit company or certified auditor must publish in at least one public medium or on its/her/his website, within a deadline of 3 months following the end of the financial year, an annual transparency report which includes:

- 1) Description of the legal structure and ownership;
- 2) Description of the professional network to which it/she/he belongs, and legal and structural arrangements in that network;
- 3) Description of the governance structure of the audit company or certified auditor;

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<sup>80</sup> Audit Law, Articles 24, and 25.

<sup>81</sup> Law on Banks, Article 107.

<sup>82</sup> Ibid.

- 4) Description of audit company's or certified auditor's internal quality control system, and a statement of its administering or governing body on its functional effectiveness;
- 5) List of entities audited during the preceding year;
- 6) Statement on the policy applied by the audit company, or the certified auditor, regarding the matter of ongoing education of certified auditors; and
- 7) Financial information about the total revenues acquired from audit activities and other services, broken into four categories: audit services, additional services for quality certification, tax advising services, and other non-audit services.

The report should be signed by the authorized officer of the audit company, i.e. by the certified auditor – sole proprietor as the case may be.<sup>83</sup>

**Best International Practices:** The external auditor:

- Must provide the company with relevant information on the legal requirements for conducting the audit, as well as on any regulations on which her/his comments and conclusions are based;
- Must provide the audited company with the audit report, within the time specified by the contract between the external auditor and the company;
- Ensure the safekeeping of documents received or developed during the audit, and not permit disclosure of the contents of these documents to any unauthorized person without the consent of the company, except when such disclosure is required by law; and
- Will often submit, and companies committed to implementing good corporate governance should demand, what is referred to as a “management letter” in addition to the audit report. This management letter typically covers all material weaknesses in the company's internal control, accounting, and operating procedures. The purpose of the letter is to provide constructive suggestions to management concerning improvements for such procedures. The findings contained in the management letter are considered to be “non-reportable” to third parties, yet require corrective action by management. Companies wishing to attract external finance should be aware that investors will typically request a copy of the management letter.

<sup>83</sup> Audit Law, Article 26.

## 2.3. Company's Rights and Duties With Respect to Audit

A company is allowed to select an external independent auditor at its own discretion and to conclude with her/him an audit services contract. The company is entitled to receive the audit report within the deadline set forth in the contract. Moreover, the company has the right of confidentiality of all information provided to the external auditor during the audit.

Regarding companies that have an obligation of auditing their financial statements pursuant to the Company Law, i.e. the Law on Banks, they have already been listed earlier in this section. According to the Company Law, the executive members of the board of directors, or the members of the management board, or the manager of the company, must make available to the auditors all documentation for inspection, including what is considered to be confidential business information.<sup>84</sup>

Company's duty to allow the external auditor an unrestricted access to all needed documentation during the audit, and to provide additional explanations that are required by the auditor during the audit, has also been mentioned earlier.

According to the Company Law, the **obligations for filing audit reports** are as follows:

- a) The executive members of the board of directors, or the members of the management board, or the manager, immediately after receiving the audit report, submit to the board of directors, the supervisory board, or to the supervisor, company's financial statements and annual report, along with the annual accounts. At the same time the board of directors, the supervisory board, or the supervisor, are also provided with a draft of the resolution for distribution of profits earned, which is to be submitted to the general meeting of shareholders, or the members' meeting for decision making.
- b) The non-executive members of the board of directors, or the members of the supervisory board, or the supervisor, are obliged to review the annual accounts and financial statements, as well as the draft resolution for distribution of profits. Upon request by the non-executive members of the board of directors, or the members of the supervisory board, the certified auditor is obliged to attend the meetings of the board of directors, or the supervisory board.

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<sup>84</sup> Company Law, Article 479.



- c) The non-executive members of the board of directors, or the members of the supervisory board, or the supervisor, submit to the general meeting of shareholders, or to the members' meeting, a written report of the results of their review. In the report, the non-executive members of the board of directors, the members of the supervisory board, or the supervisor, present the method of supervision and the scope of supervision over the company's management during the preceding business year. The report also includes their opinion about the results of the audit conducted by the certified auditor, about the annual accounts, and the financial statements, as well as about the auditor's remarks to the annual accounts and financial statements, and recommends whether they should be adopted or not.<sup>85</sup>

The Company Law stipulates the following **procedures and deadlines**:

- a) The annual accounts adopted by the governing body are submitted to the Central Registry of the Republic of Macedonia, no later than end of February.<sup>86</sup>
- b) The approved financial statements, together with the annual report of company's operations, are submitted by the governing body, in transcript, with the annual accounts register of the Central Registry within 30 days following the date of their approval, but no later than June 30<sup>th</sup>, and displayed in the business or other premises for inspection. Each shareholder or member is entitled to inspect these documents. The Central Registry is obliged to process the audited annual accounts or the audited financial statements, where deviations from data of the already filed annual accounts or financial statements have been identified.<sup>87</sup>
- c) Banks, insurance companies, and other financial institutions, within 15 days after the date of the general meeting of shareholders, publish the forms stipulated by the Company Law, free of notes on the applied accounting policies and other explanatory notes, in a way as set forth by law, but mandatorily in the "Official Gazette of the Republic of Macedonia".
- d) All other large companies as well as listed companies are also obliged to publish documents as such.

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<sup>85</sup> Company Law, Article 480.

<sup>86</sup> Company Law, Article 477.

<sup>87</sup> Company Law, Article 482.

- e) When a company publishes its annual accounts and financial statements in a daily newspaper, even when there is no such obligation, it must publish them in a form that is identical to the one adopted by the general meeting of shareholders or the member's meeting, without any changes or additions, thereby including the certified auditor's report.

Regarding **consolidated financial statements**, the Company Law stipulates that:

- A company prepares and publishes consolidated financial statements each year, jointly with other companies in which it has a controlling influence. Consolidated financial statements are prepared according to the international accounting standards.<sup>88</sup>
- Consolidated financial statements must hold the same date with the financial statements of the company with controlling influence.<sup>89</sup>
- Consolidated financial statements consist of consolidated balance sheet, consolidated income statement, consolidated cash flow statement, consolidated report of equity capital changes, and notes attached to the consolidated statements explaining the applied accounting policies, as well as other explanatory notes.<sup>90</sup>
- Consolidated financial statements cannot be approved without being audited. Companies have their consolidated financial statements audited by a certified auditor. The company licensed to conduct audits determines whether the annual report of company's operations corresponds to the consolidated financial statements for the corresponding business year.<sup>91</sup>
- The approved consolidated financial statements, together with the annual report of company's operations, are submitted by the governing body, in transcript, to the annual accounts register of the Central Registry within 30 days following the date of their approval, and displayed in the business or other premises for inspection. Each shareholder or member is entitled to inspect these documents.<sup>92</sup>

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<sup>88</sup> Company Law, Article 504.

<sup>89</sup> Ibid.

<sup>90</sup> Company Law, Article 505.

<sup>91</sup> Company Law, Article 506.

<sup>92</sup> Ibid.

- The ways and terms of publishing approved consolidated financial statements, along with the annual report of company's operations and the audit report, approved by the general meeting of shareholders or the member's meeting, are identical to those set for companies' financial statements.

On the other hand, the Law on Banks stipulates that:

- A bank must within 8 days after adoption of the annual report of operations, file with the National Bank a copy of it, together with the audit report.
- A bank which is controlled by a foreign bank must file with the National Bank annual and audit reports of that foreign bank as well, within 30 days after their completion.
- A bank must make available to the public the audit report and the annual financial statements, inclusive of the notes, and publish its balance sheet, income statement, report of equity capital changes, cash flow statement, as well as the audit report, in at least one daily newspaper, within 15 days after the adoption of the report by the bank's general meeting of shareholders.<sup>93</sup>

Pursuant to the Securities Law, companies registered with the Securities Commission must file with the Commission their financial statements, prepared according to the international financial reporting standards, together with the opinion of a certified auditor, prepared according to the international auditing standards, within 4 months after the end of each calendar year.

According to the listing rules of the Macedonian Stock Exchange, companies listed on the official market must disclose through the Stock Exchange their audited financial statements within 30 days after their adoption by the general meeting of shareholders, whereby:

- **Companies admitted to super listing** disclose complete consolidated audited financial statements (auditor's opinion, audited balance sheet, audited income statement, audited cash flow statement, audited report of equity capital changes, and audited notes to the financial statements) in Macedonian and English.

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<sup>93</sup> Law on Banks, Article 110

- **Companies admitted to stock exchange listing** disclose part of the consolidated audited financial statements (auditor's opinion, audited balance sheet, audited income statement, audited cash flow statement, and audited report of equity capital changes) in Macedonian.

**Best International Practices:** A company has the right to receive from the external auditor relevant information on the legal requirements relating to the audit, as well as any regulations on which external auditor's comments and conclusions are based.

The audited company is obligated to conclude a contract with the external auditor for carrying out the audit; to assist the external auditor for successful completion of the audit; not to hinder the audit in any way; as well as to pay for the external auditor's services, even when the conclusions of the audit report differ from the opinions of the company's officers.

## 2.4. Appointing an External Auditor

Selection of a certified auditor is done by the general meeting of shareholders prior to the end of the business year covered by the audit.

As far as banks are concerned, they have an obligation to appoint an audit company, notifying the National Bank thereon within 15 days following the appointment date.<sup>94</sup>

The governor does not accept the selection of the audit company if:

- 1) It has less than 3 years audit experience;
- 2) It is a person related to the bank;
- 3) It has provided consulting services to the bank during the preceding three-year period;
- 4) It has been subject to measures imposed by the Chartered Auditors Institute during the preceding three-year period; and
- 5) It has an inadequate expertise or fails to follow professional standards.<sup>95</sup>

Should the governor not accept the audit company, she/he must notify the bank thereon within 15 days after receiving the notification on selection of the audit company, and require from the bank to appoint another audit

<sup>94</sup> Law on Banks, Article 105.

<sup>95</sup> Ibid.

company. The bank must appoint another audit company within 45 days after receiving the notification of non-acceptance of the audit company.<sup>96</sup>

One audit company can conduct maximum five successive audits of the annual financial statements of a bank.<sup>97</sup>

The *Corporate Governance Code for Companies Listed on the Macedonian Stock Exchange* recommends the governing body, or the supervisory body, to take responsibility for the integrity of the process of selection of an independent auditor, as well as the integrity of the independent auditor's reporting process.

**Best International Practices:** The supervisory board should propose candidates for an external auditor to the general meeting of shareholders. However, it is widely considered an even better practice for the supervisory board to announce open tenders for the provision of audit services, and the audit committee of the supervisory board to conduct the procedures.

### a) Who Can Be an External Auditor?

Audits can be conducted by audit companies or certified auditors registered as sole proprietors under the terms and in the manners provided for by the Audit Law and the Company Law. (In both cases the term “certified auditor” is being used further in the text.)

In Macedonia, legal or contractual audits can be conducted only by certified auditors who are members of the Chartered Auditors Institute. The Chartered Auditors Institute is a form of professional association of certified auditors, on chamber principles, the members of which are certified auditors, audit companies and certified auditors – sole proprietors. The Institute has the capacity of a legal person, and its operation is supervised by the minister of finance. Individuals and companies that do not have a status of a certified auditor and are not members of the Institute cannot perform audits in Macedonia, or to present themselves as auditors, neither can use any symbol or description which may make an impression that they are auditors.

The Institute holds a register of certified auditors, as well as of audit companies and certified auditors – sole proprietors. The register data are considered public information and can be found both on the Institute's website and in the Institute's bulletin.

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<sup>96</sup> Ibid.

<sup>97</sup> Ibid.

**b) Who is Prohibited from Conducting Audits?**

Below are listed the restrictions to performing audits, as provided for by the Audit Law.

Prohibited from conducting audits is:

- 1) An audit company that is shareholder, investor or founder of the audited entity;
- 2) An audit company of a legal person that is shareholder, investor or founder of that audit company;
- 3) An audit company, the founder of which is a founder of the audited entity as well;
- 4) Certified auditor that is shareholder, investor or founder of the audited entity;
- 5) Certified auditor who was a legal representative, or management board or supervisory board member of the audited entity, or was participating in bookkeeping and preparing financial and tax statements of the audited entity in the period covered by the audit;
- 6) Certified auditor who is in matrimony, in direct or indirect kinship up to the second family line, or is related through adoption, custody, or tutorship with an authorized representative, or a management or supervisory board member of the audited entity;
- 7) Certified auditor who is partner to or employed by an audited entity's officer; and
- 8) Certified auditor or audit company that have direct or indirect business relations or financial interests with the audited entity, or any of its officers, governing bodies' members, or shareholders.

During the period of the audit, a certified auditor is prohibited from providing the following services to the audited entity:

- 1) Bookkeeping or other services related to accounting records, annual accounts or annual consolidated accounts of the audited entity;
- 2) Financial information systems design and implementation;
- 3) Internal audit outsourcing services;
- 4) Participation in proprietary deals, directly or indirectly, of the audited entity or any other entity related to it; and

- 5) Other activities, as specified by the Chartered Auditors Institute regulations.<sup>98</sup>

**Best International Practices:** In the U.S., the 2002 Sarbanes-Oxley Act prohibits public accounting firms from providing non-audit service to their audit clients including: (1) bookkeeping or other services related to the accounting records or financial statements of the audit client; (2) financial information systems design and implementation; (3) appraisal or valuation services, (4) actuarial services; (5) internal audit outsourcing services; (6) management functions or human resources; (7) broker or dealer, investment adviser, or investment banking services; (8) legal services and expert services unrelated to the audit; and (9) any other service that the board of directors determines as impermissible.

An exception to this rule is made for non-audit services that are not listed above, if they are previously approved by the supervisory board's audit committee. The audit committee should, however, disclose these services in its periodic reports. Another exceptions are made as follows: when the charge for the non-audit services constitutes less than 5% of the total amount paid to the auditor; if these services were not recognized as being non-audit services at the time of engagement; and if the audit committee promptly approves these services prior to completion of the audit.

### c) The Contract with the External Auditor

In order to have the audit conducted, the company must conclude a contract with the external auditor after the approval of her/his selection by the general meeting of shareholders. The regulations do not specify who is to sign the contract on behalf of the company, but in practice this is typically done by the chief executive officer. The contract with the external auditor stipulates the rights and duties of both the external auditor and the company, and may include additional clauses, as agreed by both parties. The contract always includes a clause about the fee which is to be paid by the company for the external auditor's services. The procedure of payment of the external auditor's fee and the amount of the fee must not depend on audit results.

**Best International Practices:** The amount of the fee for external auditor's services should be disclosed to the shareholders.

<sup>98</sup> Audit Law, Article 24.

## 2.5. Reporting

The External Auditor's duties relating to the submission of an audit report, according to the Audit Law, are as follows:

- The certified auditor submits to the shareholders or members a report of the audited accounts. The report is reviewed at the annual general meeting of shareholders of the audited entity and is available for inspection and questions by any shareholder or member.
- A certified auditor, who is responsible for conducting an audit of consolidated annual accounts, submits to the shareholders or members a report of the audited consolidated accounts.<sup>99</sup>

The Law on Banks provides for the following obligations related to audit reports of banks:

- The audit company must submit the audit report concurrently to the bank's management and supervisory board, the National Bank, and the Ministry of Finance, no later than April 30 of the current year for the preceding calendar year.
- The National Bank may require from the audit company additional explanations and data with respect to the audit report.
- The audit company must make all supporting documents of the bank audit available to the National Bank upon its request.<sup>100</sup>

**Best International Practices:** The external auditor should divulge (potential) errors, misconduct, and violations of legislation or of company's internal rules during the audit, and report them immediately to the supervisory board or to its audit committee. The external auditor should make the company aware, as soon as possible and at an appropriate level of responsibility, of material weaknesses in the design or operation of the accounting and internal control systems, which have come to the auditor's attention. The supervisory board or audit committee should take appropriate steps to remedy these problems.

If the company intends to access international capital markets, the external auditor should prepare the report in accordance with the international auditing standards of the International Federation of Accountants (IFAC).

<sup>99</sup> Audit Law, Article 29.

<sup>100</sup> Law on Banks, Article 108.



## 2.6. External Auditor's Liability

The external auditor is liable for the accuracy of the company's condition diagnosis, which has resulted from the audit, and for the opinion expressed in the audit report.

The following of the IFAC's international auditing standards and *Code of Conduct for Professional Accountants* by the audit companies, is monitored by the Chartered Auditors Institute. In the event of violation, the Institute solicits disciplinary procedures and imposes measures. Those measures include:

- A warning notice;
- Temporary exclusion from Institute's membership; and
- Permanent exclusion from Institute's membership.<sup>101</sup>

## 3. Audit Committee

Companies practicing good corporate governance establish special bodies – audit committees, which focus mainly in three areas: financial reporting, risk management, and internal and external control. In Macedonia, only banks are legally obliged to establish audit committees. The purpose of this body is to assist the bank's supervisory board in fulfilling its function of ensuring complete review of the quality, and integrity of the bank's accounting systems and procedures, internal control, and finances.

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<sup>101</sup> Audit Law, Article 14.

**Best International Practices:** International best practices suggest that the audit committee develops and maintains an internal document, for example an audit committee by-law, which addresses its purpose, duties, and responsibilities. The New York Stock Exchange (NYSE) suggests that this by-law should include provisions as follows:

- The purpose of the audit committee is to assist the supervisory board in overseeing the integrity of company's financial statements; the company's compliance with legal and regulatory requirements; the independent auditor's qualifications and independence; and the performance of the company's internal audit function; as well as to prepare the report that according to Securities Commission rules needs to be included in the company's annual proxy statement.
- The duties and responsibilities of the audit committee are, *inter alia*, to:
  - At least once annually, obtain and review the independent auditor's report;
  - Discuss the audited annual financial statements and the quarterly financial statements with the management and the independent auditor;
  - Discuss press releases that disclose company's earnings, as well as financial information on company's earnings provided to analysts and rating agencies;
  - As appropriate, provide advice and assistance from external legal, accounting, and other advisors;
  - Discuss policies with respect to risk assessment and risk management;
  - Hold separate meetings with management, internal auditors, and independent auditors, at least once quarterly;
  - Review, together with the external auditor, the problems or difficulties that might have arisen during the audit, and the management's response to them;
  - Set clear employment policies for individuals, who previously were, or still are working with the independent auditor; and
  - Report regularly to the board of directors.
- Conduct an annual performance evaluation of the audit committee.

### 3.1. Audit Committee's Functions

Audit committee's functions are directly linked to its principal purpose. As today in Macedonia the appointment of an audit committee is a legal duty of the banks only, the attention of this passage will be focused in the provisions of the Law on Banks that stipulate audit committee's range of activities. According to them, the committee performs the following operations:

- It reviews bank's financial statements and makes sure that disclosed financial information on bank's operations is accurate and transparent, and in compliance with the accounting regulations and international accounting standards;
- It reviews and assesses the operation of the internal control systems;

- It monitors the operation and assess the efficiency of the internal audit department;
- It monitors the audit process of the bank and assess the work of the audit company (the independent auditor);
- It enacts bank's accounting policies;
- It monitors the compliance of bank's operations with regulations related to accounting standards and financial statements;
- It holds meetings with the board of directors, the internal audit department, and the audit company, on the matters of identified non-compliances with regulations and weaknesses in bank's operation;
- It reviews the reports of the risk management committee; and
- It proposes a selected audit company (independent auditor).<sup>102</sup>

The National Bank's *Circular on Corporate Governance in Banks* is more descriptive of audit committee's functions. According to the circular, these functions include:

- *Establishment of adequate accounting procedures and control of the compliance of these procedures with the law and other regulations.* Given its composition, this body should play the decisive role in the implementation of the international accounting standards. Carrying out of this function assumes relevant communication lines with the accounting department and the internal audit department. If there have been problems and weaknesses identified by the auditors regarding accounting records and compliance with the adopted policies and legal regulations in this domain, this body ensures that the management takes timely and appropriate corrective measures.
- *Insight in the internal audit department's operations*, by approving the annual audit plan. The final verification of this plan is provided by the supervisory board of the bank. The board, on the other hand, is authorized to obtain from the internal audit department a general report, which assesses (1) the adequacy of the internal control systems and the possible deficiencies in its functioning, as well as (2) the realization degree of the audit plan (at least once quarterly).
- Review of the offers submitted by licensed audit companies for performing an external audit, and submitting an opinion thereon to the supervisory board;

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<sup>102</sup> Law on Banks, Article 91.

- Supply of an official written statement by the auditors about possible conflicts of interest with respect to the relations of the auditors with the bank, the top clients, and the shareholders, and making and estimation of the potential effect of these relations on auditor's objectiveness and independence;
- Evaluation of the external auditors' work;
- Review of the audited financial statements, and discussions thereof with the bank's top management, and with the external auditors.

The *Corporate Governance Code for Companies Listed on the Macedonian Stock Exchange* is the first document that has addressed companies' audit functions with more precision. The code recommends appointment of an audit committee, the main purpose of which would be to supervise the activities of the executive directors, or the management board members, with respect to:

- Operation of the internal risk management and control systems, including supervision of the enforcement of relevant legislation and regulations, and oversight of the implementation of codes of conduct;
- Preparing and filing financial statements (choosing accounting policies, implementing new accounting policies and assessing the effects thereof, preparing information on the use of certain items of the annual accounts, forecasting, evaluating the work of the internal and external certified auditors, etc.);
- Compliance with recommendations and findings of the internal and external certified auditors;
- Role and functioning of the internal audit department;
- Company's policies on tax planning;
- Relations with the external certified auditor, including, in particular, her/his independence, remuneration, and non-audit services to the company;
- Financing of company's operations; and
- Implementation of information and communication technologies.

The code advises that the audit committee cooperates with the external certified auditor, particularly if she/he has discovered irregularities in the contents of the financial statements.

**Best International Practices:** The National Association of Corporate Directors' (NACD) Blue Ribbon Commission on Audit Committees has identified the following risk indicators that the audit committee should monitor and closely examine:

- Complex business arrangements appearing to serve little practical purpose;
- Large last-minute transactions that have resulted in significant revenues in quarterly or annual reports;
- Replacement of auditors as a result of accounting or auditing disagreements;
- Overly optimistic press releases in which the chief executive officer attempts to encourage investors to believe in company's future growth;
- Widely dispersed business locations with decentralized management and a poor internal reporting system;
- Inconsistencies between Management's Discussion and Analysis (MD&A), the President's Letter, and the underlying financial statements;
- Insistence by the chief executive officer or chief financial officer to be present at all meetings of the audit committee held with the internal or external auditors;
- A consistently close or exact match between planned results and reported results, and managers who always achieve 100% of their bonus opportunities;
- Hesitancy, evasiveness, and/or lack of specifics provided by management or auditors, regarding questions about the financial statements;
- Frequent differences in views between management and external auditors;
- A pattern of shipping most of the month's or quarter's sales in the last week or on the last day of the relevant reporting period;
- Obstructions to normal carrying out of the internal audit function;
- Unusual balance sheet twists, shifts in trends or in important financial statements' ratios such as, for instance, receivables growing faster than revenues, as well as accounts payable being permanently delayed;
- Unusual accounting policies, particularly for revenue recognition and cost deferrals such as, for example, recognizing revenues before products have been shipped ("bill and hold"), or deferring cost items that are normally expensed as incurred;
- Accounting methods that appear to favor form over substance;
- Accounting principles/practices that swerve from industry norms; and
- Numerous and/or recurring unrecorded or "waived" adjustments raised, in connection with the annual audit.

### 3.2. Audit Committee Structure

According to international business practices, selection criteria for audit committee members are set in companies' charters, and such practice should be accepted by Macedonian companies as well.

The Macedonian Law on Banks, however, includes the following provisions regarding audit committee structure:

- A bank's audit committee consists of at least 5, but not more than 9 members;
- The majority of audit committee members are elected from among members of the supervisory board, while the remaining members are independent;
- At least one audit committee member must be a certified auditor;
- Officers of an audit company, selected to conduct bank's annual audit, must not serve as audit committee members; and
- Audit committee members elect from among themselves a chairperson, who is to be responsible for the organization of the audit committee's operation.<sup>103</sup>

The audit committee members have a position of officers entitled to special rights and responsibilities with the bank. Therefore, the appointment of audit committee members is subject to the rules that apply to that position, such as follows:

- An officer entitled to special rights and responsibilities with a bank must have a university degree in a relevant field, and knowledge of the banking and/or finance regulations, as well as appropriate experience that guarantees safe and sound bank management.
- The following persons cannot be entitled to special rights and responsibilities with a bank:
  - National Bank's Council members;
  - National Bank's officers;
  - Persons sentenced to imprisonment for crime in the area of banking and finance;
  - Persons awarded misdemeanor sanctions, such as ban on performing profession, activity, or duty;
  - Persons with bad reputation that could compromise the safety and soundness of bank's operations;
  - Persons who fail to comply with the provisions of the law and the regulations adopted on basis of the law and/or failed in the past or still fail to implement and/or acted in the past or still act contrary to the measures imposed by the governor, compromising as such, either the past or the present safety and soundness of the bank;

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<sup>103</sup> Ibid.

- Members of another banks' supervisory boards, risk management committees, audit committees, and boards of directors, as well as another banks' officers; and
- Persons who were entitled in the past to special rights and responsibilities with a bank or another legal entity, which was going into administration, or against which a bankruptcy or liquidation procedure was initiated, unless unambiguously ascertained on the basis of available documentation and data, that they were not involved in any action that had led to administration, bankruptcy or liquidation, or unless they served in such capacity only immediately prior to or after the occurrence of the reasons that led to administration, bankruptcy, or liquidation.
- Individuals who are related persons to legal entities, in which the bank holds a stake, cannot serve as members of the bank's audit committee.<sup>104</sup>

In addition to the foregoing general requirements relating to entitlement to special rights and responsibilities with a bank, audit committee members are also required to be knowledgeable in:

- Bank's operations, products, and services;
- The risks, which the bank is exposed to;
- Bank's internal control systems and risk management policies; and
- Accounting and audit.<sup>105</sup>

The *Corporate Governance Code for Companies Listed on the Macedonian Stock Exchange*, on the other hand, advises that:

- The audit committee is not chaired by the chairperson of the board of directors i.e. of the supervisory board, or by a former executive director i.e. former member of the management board of the company, at least two years following the termination of her/his service; and
- At least one member of the audit committee is a financial expert. The annual report discloses the name of this member of the committee.

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<sup>104</sup> Law on Banks, Article 83.

<sup>105</sup> Law on Banks, Article 91.

**Best International Practices:** The qualifications of audit committee members should inspire confidence that they are able and willing to detect accounting irregularities, and act in the best interests of the company and its shareholders. It is, therefore, recommended that only persons of an impeccable reputation be elected to the supervisory board and appointed to the audit committee.

Because the audit committee is an internal structure of the supervisory board, it consists solely of supervisory board members. The audit committee should have at least 3 members, though this may be difficult for small supervisory boards. Other individuals (such as the external auditor, or revision commission members) are likely to participate in audit committee meetings as well. They may not, however, be committee members.

Audit committee's chairperson should be an experienced individual. Chairperson's independence, aptitude, and leadership skills are critical to committee's success.

Furthermore, the audit committee should be entirely composed of independent members of the supervisory board. If this is not plausible, it is recommended that an independent member of the supervisory board chairs the audit committee, and that the committee be composed solely of non-executive members of the board of directors.

### 3.3. Meetings and Reporting

According to business practices of Macedonian banks, and pursuant to the Law on Banks, audit committees meet at least once quarterly, or upon request of the supervisory board.<sup>106</sup>

Regarding reporting, the stipulated procedures are as follows:

- The audit committee enacts operating rules and procedures, which are to be previously approved by the bank's supervisory board.
- The audit committee reports to the bank's supervisory board on its operations at least once quarterly.
- The audit committee makes self-assessment of its operations, both on individual and joint basis, at least once annually.
- The audit committee submits an annual report of its operations to the bank's supervisory board and general meeting of shareholders, which includes the self-assessment report.<sup>107</sup>

<sup>106</sup> Ibid.

<sup>107</sup> Ibid.



The recommendations of *Corporate Governance Code for Companies Listed on the Macedonian Stock Exchange* regarding this matter are as follows:

- The audit committee decides at its own discretion whether the presence of management board's chairperson or chief executive officer, chief financial officer, external certified auditor, and internal certified auditor is needed at its meetings; and
- The audit committee meets the external certified auditor whenever is needed, but at least once annually, without the presence of executive directors or management board members.

**Best International Practices:** If a supervisory board discusses at its meeting matters relating to audit committee activities, the audit committee should meet prior to the supervisory board meeting. The audit committee meeting should take place sufficiently in advance of the supervisory board meeting, in order to allow the committee communicate its conclusions to the board in a timely manner.

The audit committee should meet at least once monthly to prepare recommendations for the supervisory board. However, monthly meetings may be both difficult to arrange and costly. Therefore, the U.K. *Combined Corporate Governance Code* suggests that audit committee meetings be held with respect to key dates in the financial reporting cycle, but no less than three times annually. The audit committee's chairperson will likely arrange additional meetings to establish ongoing and informal contacts with the supervisory board's chairperson and the chief executive officer.

The Audit committee should also:

- Regularly inform the supervisory board on possible violations of procedures and legislation by company's officers;
- Inform the supervisory board about individuals who are responsible for irregularities and the circumstances under which they have occurred; and
- Analyze and give recommendations to the supervisory board regarding risks associated with company's transactions and operations.

### 3.4. Access to Information and Resources

The audit committee members should have unfettered access to documents and corporate information in order to be able to confidently fulfill their functions. In this respect, the corporate secretary often plays a crucial role, as she/he facilitates the free flow of information.

The audit committee should further be authorized, as well as provided with resources, to hire external audit, financial, legal, and other professional advisors, without asking the supervisory board or executive directors for permission.

## 4. Internal Control

Internal control is a process conducted jointly by the supervisory board, management and company's officers. The purpose of internal control is to provide a reasonable guarantee that the following company objectives have been achieved:

- Financial reporting is reliable and accurate;
- Company's operations and activities are efficient and effective; and
- Company's operations and activities comply with the legislation, and the internal rules and guidelines.

In fact, an effective internal control structure can help the company:

- Make informed business decisions;
- Gain (or regain) the trust of investors;
- Prevent loss of resources;
- Provide security of its assets;
- Prevent fraud;
- Comply with applicable laws and regulations; and
- Gain a competitive advantage through streamlined operations.

With respect to Macedonian business practices a banking sector example is mentioned again. Namely, the National Bank's *Circular No. 1 on the internal control systems, the structure of the internal audit, the role of the external audit and the relationship among the internal audit, the external audit and the banking supervision*, considers in particular the internal control issue, explaining its purposes and aspects, and describing its main components. Needless to say, similar solutions may apply to other companies of the corporate sector as well.<sup>108</sup>

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<sup>108</sup> For detailed consideration of Macedonian banks' internal control systems see also *Circular No. 1 on the internal control systems, the structure of the internal audit, the role of the external audit and the relationship among the internal audit, the external audit and*

## 4.1. Internal Control Principles

A company's internal control system should be based on the following principles:

- The internal control system should function at all times and without interruption. A system as such allows the company to timely identify existing deviations, as well as predict possible future deviations;
- Each person involved with the internal control process should be held accountable. The performance of each person carrying out internal control functions should be subject to additional checks by at least one other person with the internal control system;
- The internal control system should segregate duties. Companies should preclude duplication of control functions, and distribute them among the employees in a way which ensures that functions related to authorization of operations with certain assets, keeping records on such operations, securing and safe-keeping of assets, and inventory of those assets are not concentrated in one person;
- Assignments should be appropriately delegated and approvals properly granted. Companies should establish procedures for approving financial and business operations by authorized persons, within a defined scope of authorities of those persons;
- Companies should provide for an organizational separation of their internal control units, and make sure that these units are reporting directly to company's governing bodies (typically the supervisory board). Internal inspections are in that way subject to verification by an independent authority, which adds to their accuracy and objectivity;
- All units and departments of the company should act in an integrated and cooperative way to allow smooth operation of the internal control system;
- A culture of aspiration toward permanent advancement and improvement needs to be developed. A company's internal control system should be structured to allow flexible adoption of innovations, and easy extension and upgrade; and

- A system for timely reporting should be put in place. Ensuring timeliness of reporting on deviations allows authorized persons act quickly to resolve problems.

## 4.2. Elements of the Internal Control System

The internal control system includes the following inter-related elements:

1. **Control friendly environment:** A control friendly environment sets the tone of an organization by developing control consciousness. Control friendly environment factors include integrity, ethical values, and competence of the company's employees and officers; management's philosophy and operating style; ways of assigning authorities and responsibilities, and of organizing and developing staff by the management; and attention and direction provided by the supervisory board.

**Best International Practices:** Essential element of an effective internal control system is a strong control culture. It is the responsibility of the supervisory board and senior management to emphasize the importance of internal control, both in words and actions. This includes ethical values that management demonstrates in their business dealings, both inside and outside the organization. The words, attitudes, and actions of the supervisory board and senior management affect the integrity, ethics, and other aspects of the company's control culture.

2. **Risk assessment:** Every entity faces a variety of risks from external and internal sources. A precondition to appropriate risk assessment is setting out clear company objectives. Risk assessment is but an identification and analysis of risks accompanying the process of achieving company objectives. Relevant assessment of potential risks is critical for the introduction of a system for managing those risks.
3. **Control activities:** Control activities are the policies and procedures, which help ensure that management directives are being carried out. They also help ensure that necessary actions are taken in addressing risks and achieving company's objectives. Control activities are carried out throughout the organization, at all levels and in all functions. They include a range of activities related to different approvals, authorizations, verifications, reconciliations, reviews of operating performance, as well as to assets safekeeping and segregation of duties.

**Best International Practices:** Control activities should be as strict on the top as on the bottom of company's operations. In that way the control environment credibility gains in strength.

4. **Information and communication:** Essential information must be identified and communicated in a form and within a timeframe that enables employees to carry out their responsibilities. Information systems generate reports that contain operational, financial, and compliance-related information that enable running and control of the business. They deal both with internally generated data and with information about external events, activities, and conditions, necessary for informed business decision-making and external reporting. Effective communication must be understood in its broader sense, for it should freely flow bottom-up, top-down, and across the organization. Entire personnel must receive a clear message from senior management that control responsibilities must be taken seriously. Everyone must understand their own role in the internal control system, as well as how individual activities relate to the work of others. Of particular importance is that the management goes beyond simple communication of individual control measures, by emphasizing their meaning within the context of the control function as a whole. Management must ensure effective bottom-up communication, as well as effective external communication – with customers, suppliers, regulators, and shareholders.
5. **Monitoring of internal control system efficiency:** The efficiency of the internal control systems needs to be monitored over time. The ongoing monitoring activities should be accompanied by separate periodical evaluations. Ongoing monitoring takes place during the processes of operation. It includes regular management and supervisory activities, as well as daily activities of the personnel relating to their duties. The scope and frequency of separate periodical evaluations depend primarily on the risk assessed and the ongoing monitoring procedures effectiveness. Internal control deficiencies should be reported bottom-up, with most serious matters being reported directly to senior management and the supervisory board. Senior management and the supervisory board need to clearly formulate sanctions for control violations and communicate them in advance.

### 4.3. Bodies and Persons Responsible for Internal Control

Internal control is, to a certain extent, everyone's responsibility in an organization and should, therefore, be included in everyone's job description. Actually, all employees produce information used in the internal control system, or take other actions that affect the control function. The entire personnel should be responsible for bottom-up communication of operations problems, of non-compliance with the internal code of conduct or company-level corporate governance code, if such documents exist, and of other policy violations or illegal actions.

**Best International Practices:** The Company's department responsible for corporate training programs should make sure that all employees and executives receive training on the company's control culture and systems.

Although each company has its own specific internal control system and bodies, there are some general rules that a company should follow. Internal control always starts at the top of the company, at supervisory board and executive body level. The supervisory boards and executive bodies have particular responsibility for establishing appropriate internal control environment and maintaining high ethical standards at all levels of company's operations. The internal control procedures are approved by the supervisory board, mainly through its audit committee. The supervisory board's audit committee is also assigned to review and evaluate the efficiency of the internal control system as a whole, and to prepare proposals for its possible improvements. The implementation of internal control procedures is a responsibility of the executive bodies.

**Best International Practices:** The chief executive officer has the ultimate responsibility for and should assume ownership of the system. More than anyone else, he sets the 'tone at the top' that affects the integrity and ethics of the control environment. In a large company, the chief executive officer fulfils this duty by providing leadership and direction to senior managers and reviewing the way they are controlling the business. Senior managers, in turn, assign responsibility for establishing more specific internal control policies and procedures to officers responsible for the units' functions. For example, control of the company's IT system should fall under the responsibility of the chief information officer. Of particular significance for the internal control system are financial officers and their staff. Their control activities cut across all company's units and levels of reporting.

The executive bodies, in particular the chief executive officer or the chief finance officer, further create structures (units or departments), or assign persons in charge of specific day-to-day control activities.

#### 4.4. Internal Audit

Internal audit is an integral part of company's internal control system. While internal control is wider in scope, internal audit is focused in adding value to the company and improving its operations. It helps companies achieve their objectives by introducing systematic and disciplined approach to assessment and improvement of the effectiveness of the processes of risk management, control, and corporate governance. More specifically, internal audit ensures reliability and integrity of information, compliance with policies and regulations, safeguarding of assets, economical and efficient use of resources, and achieving of the established operational goals and objectives. Internal audit is related to financial activities as well as to operations, including systems, production, engineering, marketing, and human resources.

The internal auditor should enjoy a reasonable degree of independence. This can be achieved by making him accountable to the supervisory board (through its audit committee) rather than the company's executives (the chief executive officer or the chief finance officer).

**Best International Practices:** In reality, it is difficult for the internal audit function to be entirely independent of management. Indeed, the internal control function is a key management tool. It would lose a great deal of usefulness should it not report to management. Cognizant of the need for maintaining independence while working closely with management, the Institute of Internal Auditors suggests that the internal auditor reports administratively to the executive bodies, and functionally to the supervisory board's audit committee.

Further on is yet another example:

**Best International Practices:** In May 2003, the U.S. Securities and Exchange Commission (SEC) approved a rule for implementation of the requirements of Section 404 of the Sarbanes- Oxley Act of 2002. Section 404 of the Act directs the SEC to adopt rules requiring each annual report of a company to contain (1) a statement of management's responsibility for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and (2) management's assessment, as of the end of the company's most recent fiscal year, of the effectiveness of company's internal control structure and procedures for financial reporting. Section 404 also requires the company's external auditor to attest to and report of management's assessment of the effectiveness of company's internal controls and procedures for financial reporting, in accordance with standards established by the Public Company Accounting Oversight Board.

Under the final rules, management's annual internal control report will have to contain:

- Statement of management's responsibility for establishing and maintaining adequate internal control of company's financial reporting;
- Statement indicating the internal control effectiveness evaluation framework used by management;
- Management's assessment of the internal control effectiveness as of the end of the company's most recent fiscal year; and
- Statement approving that the external auditor has issued an attestation report of management's assessment.



**Table 1: Disclosure Calendar**

<b>Statute</b>	<b>Entities Subject to Disclosure Obligations</b>	<b>Disclosure Data Subject to Publishing/Filing</b>	<b>Disclosure Destination/Medium</b>	<b>Disclosure Deadlines</b>
<b>Company Law</b>	Commercial entity	Annual accounts	Central Registry	No later than end February of the current year
	Commercial entity	Approved financial statements together with the annual report of operations	Central Registry	At latest 30 days following the date of their approval, but no later than June 30
	Commercial entity	Approved consolidated financial statements together with the annual report of operations	Central Registry	At latest 30 days following the date of their approval, but no later than June 30
	Company from the banking and insurance sector	Forms specified by the Company Law (excluding notes on applied accounting policies and additional explanatory notes)	"Official Gazette of the Republic of Macedonia"	Within 15 days following the date of the general meeting of shareholders
<b>Law on Banks</b>	Bank	Annual report of operations, together with the audit report	National Bank of the Republic of Macedonia	Within 8 days after adoption
	Bank controlled by a foreign bank	Annual report of operations, and audit report of the foreign bank	National Bank of the Republic of Macedonia	Within 30 days after their appearance
	Bank	Audit report and annual financial statements together with the notes to the report	Public availability	Within 15 days after adoption of the report by the bank's general meeting of shareholders
	Bank	Balance sheet, income statement, report of equity capital changes, cash flow statement and auditor's report of annual financial statements	At least one daily newspaper	Within 15 days after adoption of the report by the bank's general meeting of shareholders
<b>Securities Law</b>	Companies entered in the Securities Commission register	Financial statements prepared in accordance with the international financial reporting standards, together with certified auditor's opinion prepared in accordance with the international auditing standards	Securities Commission	Within 4 months following the end of the calendar year

Listing Rules of the Macedonian Stock Exchange	Companies admitted to super listing	Full consolidated audited financial statements (auditor's opinion, audited balance sheet, audited income statement, audited cash flow statement, audited report of equity capital changes, and audited notes to the financial statements) in Macedonian and English	The electronic reporting system of the Macedonian Stock Exchange SEI- NET	Within 30 days after their adoption by the general meeting of shareholders
	Companies admitted to stock exchange listing	Part of the consolidated audited financial statements (auditor's opinion, audited balance sheet, audited income statement, audited cash flow statement, and audited report of equity capital changes) in Macedonian	The electronic reporting system of the Macedonian Stock Exchange SEI- NET	Within 30 days after their adoption by the general meeting of shareholders

<b>Table 2: Summary of Company's Control and Audit Functions</b>			
	<b>Internal Audit Department</b>	<b>External Auditor</b>	<b>Audit Committee</b>
<b>Status</b>	Independent organization – unit of a bank (company)	Certified auditor (typically audit company), member of Chartered Auditors Institute, independent of management and shareholders, that does not provide other services to the company.	Special body appointed by the supervisory board
<b>Main functions</b>	<ul style="list-style-type: none"> <li>- Assessment of internal control systems' adequacy and efficiency;</li> <li>- Assessment of risk management policies' implementation;</li> <li>- Assessment of information system's design;</li> <li>- Assessment of commercial books' and financial statements' accuracy and reliability;</li> <li>- Inspection of the accuracy, reliability, and timeliness of reporting, in accordance with the regulations;</li> <li>- Monitoring of the compliance with regulations, code of conduct, policies, and procedures;</li> <li>- Assessment of the systems for prevention of money laundering; and</li> <li>- Assessment of services obtained by the bank from companies performing supporting banking services.</li> </ul>	<p>Assessment of:</p> <ul style="list-style-type: none"> <li>- Balance sheet;</li> <li>- Income statement;</li> <li>- Cash flow statement;</li> <li>- Changes in the amount of assets and, assessment of capital adequacy;</li> <li>- Extent and changes in the amount of value adjustments and allocated special reserve, as well as effectuated write-offs;</li> <li>- Amount of potential liabilities assumed;</li> <li>- Consolidation effects;</li> <li>- Internal control systems operation, and carrying out of the internal audit function;</li> <li>- Bookkeeping;</li> <li>- Information system's security;</li> <li>- Accuracy and completeness of statements filed with the National Bank, for supervision purposes;</li> <li>- Adequacy of accounting policies and procedures, as well as valuation of on- and off-balance-sheet assets and liabilities;</li> <li>- Compliance of</li> </ul>	<ul style="list-style-type: none"> <li>- It reviews the financial statements and makes sure that disclosed financial information is accurate and transparent;</li> <li>- It reviews and assesses the operation of the internal control systems;</li> <li>- It monitors the operations, and assess the efficiency of the internal audit department;</li> <li>- It monitors the process of audit, and evaluates the work of the audit company (the independent auditor);</li> <li>- It enacts the accounting policies;</li> <li>- It monitors the compliance of business operations with regulations relating to accounting standards and financial statements;</li> <li>- It holds meetings with the management board, the internal audit department, and the audit company, on the matters of identified non-</li> </ul>

		business operations with the regulations; and - Risk management systems.	compliances with regulations and weaknesses in business operations; - It proposes selection of an audit company (independent auditor); - It monitors the relations with the external certified auditor, including her/his independence, remuneration, and any non-audit services to the company; - It supervises the compliance with internal and external certified auditors' recommendations and findings; - It oversees the tax planning policies; - It supervises the financing of the company; and - It oversees the Implementation of information and communication technologies.
<b>Reporting</b>	To the supervisory board, management board, and audit committee.	To company's shareholders; bank's management board, bank's supervisory board, NBRM, and Ministry of Finance.	To the supervisory board (and the general meeting of shareholders of a bank).
<b>Relevant regulations</b>	Law on Banks	Accounting Law, Audit Law, Company Law, Law on Banks, contract concluded between the company and the auditor.	Law on Banks, Macedonian Stock Exchange's corporate governance code.
<b>Structure</b>	Bank's staff that works solely on assignments of this unit. Most of them are certified auditors.	The external auditor should be independent of the company in every respect.	Supervisory board members (majority) plus independent members; at least one member is certified auditor, but other than the selected bank's auditor.