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## PROBLEMS IN AUDIT AND REPORTING IN BULGARIA'S FORESTRY

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**Abstract:** An object of analysis in the paper is the quality of the information in the audit reports of forestry in Bulgaria, as a basis for attracting investments, increasing the confidence in the enterprises and achieving sustainability of the industry in macro level. The subject of analysis are the annual financial statements of public and private forestry for the period 2007 - 2017. A priority objective is to analyze the auditor's opinions on the annual financial statements of the Bulgarian forestry. An additional objective is to analyze the overall reporting of the financial-economic status and development of enterprises for the period 2007 - 2017. Main research tasks are: 1) to study the financial development and strategy of public and private forestry, as well as to compare it with the adopted and applied accounting policies; 2) to examine the audited opinions of the financial statements of the target group enterprises for 2017, as well as to analyze the quality of the audit performed and in this respect the reliability of the financial statements. The applied research methods are based on logical, deductive and comparative methods, as well as methods of analysis and synthesis. Main conclusions of the study are: violations of the control environment, lack of disclosed information in the financial statements of enterprises and the application of accounting policies irrelevant to the financial and economic status of organizations.

**Keywords:** forestry, audit, fraud, disclosures, crimes

### 1. INTRODUCTION

Although audit as a tool of achieving sustainability in forestry is a subject of analysis and discussion in the literature (Brotto and Pettenella, 2018, p. 264; Auditing Forests: Guidance for Supreme Audit Institutions, 2010; Danescu et al., 2014), it is still a neglected factor for efficient and effective planning and management of resources, as well as for the prevention of fraud and illegal actions by Bulgarian enterprises. Currently, a primary document that defines the national strategic policy for achieving long-term and sustainable forest management is the National strategy about development of the forestry sector in the Republic of Bulgaria for the period 2013 – 2020 (NSRGSRB 2013 - 2020). The measures proposed in the strategy do not cover issues related to the financial audit of forest enterprises. However, the SWOT analysis publish in the NSRGSRB points out the following weaknesses of the sector: high intensity of violations in forest areas, low efficiency of the application of the penal provisions provided in the forest legislation, as well as the inappropriate absorption of European funds. Based on the model of the three lines of defence (Bankova, 2019, p. 18), audit is a form of a public interests protection and can be perceived as a means of minimizing the stated weaknesses. It is therefore a priority to monitor the transparency of the currently used, supervision and audit measures. The requirements for independent financial audit in Bulgarian forest enterprises are regulated in: the Forest Act, the Accounting Act (AA), the Independent Financial Audit Act, the International Auditing Standards and the applicable accounting standards. State-owned forestries are also subject to an annual financial audit by an elected by the Management Board certified public accountant who must be a registered auditor at the Institute of Certified Public Accountants in Bulgaria. He is obliged to present to the Management Board his opinion based

on the annual financial statements of the company (Forest Act, Art. 170, para 1). Privately owned enterprises are subject to independent financial audit, upon reaching legally defined criteria related to the book value of assets, net sales revenues and average number of staff.

Based on the agents' theory we could describe the relationship: accountant - manager - auditor, as a system in which each agent is imperfect and affects the others. This idea is confirmed by the research of Donald Cressey (Cressey, 1950), who suggests that the triangle of fraud outlines the factors that affect the criminal behavior of employees, namely - pressure, opportunity and rationalization. Current practice shows that the auditors cannot prevent the criminal behavior of the management and employees in the Bulgarian state-owned forestry. In addition, 118 cases related to violations of regulations in 2018 are stated (Annual Report of the Forest Agency, p.64). It directly affects the budget of the Forest Agency. The existence of vicious practices, weaknesses in the internal audit control and illegal actions helps to strengthen the weaknesses of the forest sector outlined by the NSRGRB 2013 - 2020. It is therefore important to take proactive and preventive measures. Specific certification of auditors by the Forest Stewardship Council (FSC) can be mentioned as part of the adopted measures. Often this certificate is a requirement of state-owned forestries that have announced a public tender for the selection of an auditor. It requires auditors to have additional qualifications and knowledge, but at the same time it limits the persons who can perform an audit. In this respect, main object of analysis in the paper is the quality of the information in the audit reports as fundamental for the reliability of the forestry financial statements and the disclosures to them. This is seen by the authors as one of the factors that attract investment and increase social trust in forestries, while leading to the sustainability of the industry at the macro level. Subject of analysis are published annual financial statements of forestries (state-owned and private-owned), incl. their annexes, activity reports, audit reports, accounting policies. Main purpose of the study is to analyze the audit opinions on the annual financial statements of Bulgarian forestries from 2017. The selection of the target group is based on both the reported crimes and violations in the industry, as well as the fact that forestries are directly related to the implementation of forestry plans and programs, afforestation and protection activities, timber harvesting, marking of plantations and trees. The control over such activities is responsibility of each agent, incl. auditors. An additional goal of the paper is to make an analysis of the statements, annual reports and disclosures about the economic development of the enterprises for the period 2007-2017. In order to fulfill the outlined goals, the following research tasks are set: 1) to study the financial development and applied strategy of forestries, comparing the data with the accounting policy adopted by them; 2) to study the expressed audit opinions of the financial statements of the enterprises for 2017. The adopted research methods are logical, deductive and comparative methods, as well as the methods of analysis and synthesis.

## **2. ANALYSIS OF THE FINANCIAL STATEMENTS AND DISCLOSURES OF THE FORESTRY ENTERPRISES IN BULGARIA**

In Bulgaria, according to the public information presented on the website of the Ministry of Agriculture, Food and Forestry, there are 8 operating private-owned enterprises<sup>1</sup> and 7 state-owned enterprises<sup>2</sup>, related to forestry. Without claims for a whole comprehensive analysis, the subject of further study are the annual financial statements and attached annexes (including activity report, reports, disclosed significant accounting policies) of forestry enterprises for the period 2007-2017. A limitation of the study is that for the selected period of time the financial statements of all state-owned forestries are analyzed starting from 2011. It is so due to the fact that in 2011 the selected state-owned forestries are established based on an Order of the Minister of Agriculture and Food. Exceptions are the financial statements of State Enterprise "Kabiyuk" and „Fish resources“. An additional limitation is that for almost 33% of the enterprises included in the target group, no statements have been published for some of the years in the scope of the survey. In particular, no financial statements for 2008 are found for „Zeminvest“, none for „SAPI“ for 2016 and 2017, and none for „Fish resources“, North Central State Enterprise and State Enterprise "Kabiyuk" for 2017. The non-publication of financial statements for the last years under analysis could be explained by administrative delays in publishing the reports by the Registry Agency. However, other preconditions should be sought for the non-publication of statements as old as those in 2008. Although the paper does not focus on the reasons for not publishing financial statements, such practices are common in Bulgaria. The analysis of the accounted financial result (profit or losses) of the enterprises under review show no significant fluctuations. In this respect, 5 of the enterprises in the target group report a loss in more than 60% of the years under review. Nearly 26% of the state-own forestries report a loss only during the year of bankruptcy of Corporate Commercial Bank, which can be explained by the accrued impairment of the cash of the enterprises in the bank and the accrued financial expenses (for interest and exchange rate differences). In terms of published disclosures, there is another limitation. For the analyzed period in nearly 73% of the enterprises financial statements no published annexes are found in different years from those under study. However, compared to the accounted financial results during the years where there are lack of disclosure annexes, no dependencies are found. Based on a more in-depth analysis of the content of published annexes, the following conclusions can be drawn: 1) Nearly 53% of forestries apply national accounting standards (NAS) throughout the period under review as a basis for preparing their statements. All state-own forestries, with the exception of State Enterprise "Kabiyuk", apply the national accounting standards until 2012 inclusive, after which they switch to the international ones (IAS). All companies applying IAS publish richer textual information. This confirms previous research showing that Bulgarian enterprises implementing the NAS disclose more limited data (Georgieva, 2020). 2) The companies (nearly 40 %) that account losses for most of the years under analysis indicate: deteriorating financial condition and autonomy, and liquidity indicators based mainly on asset ownership problems, bad debts, low quality of the human capital. They point out the need for a recovery policy, which includes strategies for enterprise development related to design and construction of forest roads,

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<sup>1</sup> „Agrovodinvest“ SOJSC; „Agrolesproekt“ private LLC; „Vrana“ SOJSC; „Zeminvest“ SOJSC; „Irrigation systems“ SOJSC; „Fish resources“ private LLC; „SAPI“ private LLC; „Varietal seeds - Elite“ SOJSC.

<sup>2</sup> Northwestern State Enterprise; North Central State Enterprise; Northeastern State Enterprise; Southwestern State Enterprise; South Central State Enterprise; Southeastern State Enterprise; State Enterprise "Kabiyuk".

renewal of fixed assets and improvement of material and technical base, increase revenue collection, staff training, active participation in European projects, cooperation with research and educational institutions. However, the stated policies and strategies by the forestries remain relatively unchanged through the years. 3) All companies under analysis apply a stabilization type of accounting policy, the elements of which presuppose the presence of economic stability, lack of frequent changes in the regulatory framework, lack of threats from the external and internal environment. Such conditions are opposite to those stated by the enterprises at their reports. A change in accounting policy as a result of material misstatement has been disclosed by one forestry. However, it is not related to use of defensive accounting policy. The previous conclusions may be perceived negatively by the financial statements' stakeholders and contribute to the reduce of the confidence in the company by investors and society. If the financial statements are audited by a certified public accountant, this is an indicator of their reliability. In this respect, the subject of subsequent analysis are the expressed audit opinions on the financial statements of the forestry under review.

### 3. ANALYSIS OF AUDIT OPINIONS ON THE FINANCIAL STATEMENTS

From the 15 forestry under study, the authors were able to find available annual financial statements for 9 of these enterprises (see Table 1). No financial audit is made for some of them, and for others, no published data is found in the site of Commercial Register. This poses significant risks associated with access to information for the society and for the public interests. The opinion in 6 audit reports is unmodified. In one of the audit reports there is an emphasis of matter paragraph by the lead auditor. Emphasis is placed on the disclosure of assets and liabilities. This problem is common in financial and accounting practices in Bulgaria. It should be noted that in the company "Irrigation systems" there are 13 qualifications, 5 key audit matters, 3 emphasis of matter paragraph. Without generalizing and identifying the critical remarks that they are a guarantor of the quality of the performed audit, there are obvious serious mistakes in the activity of this forestry. Based on the analysed data there are only 2 qualified opinions from the auditors indicating problems in the activity of the forestries. In conclusion by conducting a financial audit and a specialized audit of the forestry, auditors cannot prevent the criminal behavior of human capital in forestry.

*Table 1. Audit opinions on the financial statements of forestries for 2017*

№	Company	Auditor`s opinion
1.	Agrovodinvest	Unmodified opinion, but there is a problem with disclosed information in section IV Other disclosures, item 2 "Contingent assets and liabilities". There is a large number of objects with unclear technical and physical condition.
2.	Vrana	Unmodified opinion
3.	Zeminvest	Qualified opinion. In the auditor`s report it is pointed: 1) accumulated losses; 2) the equity is below the amount of the share capital; 3) there is significant uncertainty as to whether the entity is operating; 4) the real value of the tangible fixed assets has not been determined and

		sufficient and relevant audit evidence has not been obtained; 5) there are significant increases in liabilities to staff.
4.	Southeastern State Enterprise	Unmodified opinion
5.	South Central State Enterprise	Unmodified opinion
6.	Southwestern State Enterprise	Unmodified opinion
7.	Irrigation systems	Qualified opinion. In the auditor's report it is pointed: 1) the owned properties, machines, facilities, lands, buildings are not used and depreciated, as their future use is very limited due to their poor condition; 2) the owner of part of the assets is not identificate; 3) there is a possibility for overestimation of the value of the assets; 4) there are immovable inventories, and there are impairments of materials and products; 5) no confirmations have been received from no confirmations have been received from external sources regarding trade receivables and payables; 6) there is a termination of a contract with a key supplier, the occurrence of a lawsuit, which leads to an unclear financial result; 7) court cases have been filed in which the company is a defendant and leads to limitation of the period for accrual of provisions; 8) the company's equity includes reserves that are formed as a result of revaluation of assets. About the limitations, the assessment and completeness of the reserve have not been established; 9) the activity of the company is carried out with morally and physically obsolete assets, as it has not been established whether the submitted quantities of water masses to the users are reported correctly and aren't completed; 10) difference in the prices for sale of water; 11) it is not clear how exactly the revenues and expenditures related to grants provided by the state are distributed; 12) unclearly charged repair costs; 13) there is significant uncertainty as to the company to going concern basis.
8.	Northwestern State Enterprise	Unmodified opinion
9.	Northeastern State Enterprise	Unmodified opinion

Source: own analyses based on data extracted from <https://public.brra.bg/>

The asymmetric information in the audit reports is not a precedent. It is therefore fundamental that the relevant measures are taken into account by the managers of this type of enterprises. The question is - how can audit reports be improved to provide more valuable and reliable information to the public and investors? In this respect, the International Auditing and Assurance Standards Board propose how audit services quality can be improved (A framework for audit quality key elements that create an environment for audit quality, 2014). The most significant factors are: the way of receiving information, the procedures, the results of the performed procedures, key actions for the preparation of the financial statement and contextual factors. Each of these factors affects the right functioning of this framework in relation to the appropriateness of the audit. However, it is important to pay attention to human and institutional

capital: management, government, consumers and regulators. Even if internal policies are developed by high-level auditors, without legal and institutional changes it is impossible to properly, effectively and efficiently conduct financial audits in any sector, including forestry. A good example of institutional control is the pre-trial proceedings initiated in 2020 at the State Forestry Company - Velinograd. It is the result of the joint efforts of: General Directorate for Combating Organized Crime (GDCOC) at the Ministry of Interior, the Prosecutor's Office and the Forestry Agency. The reason is "illegal extraction and subsequent marking by employees and issuance of transport tickets for the wood, in order to legalize its origin (<https://www.monitor.bg>)". The illegal extraction of the material serves for illegal profit by the organized criminal group.

### 3. CONCLUSIONS

Based on the analyzes it can be stated that often the information in the financial statements of Bulgarian forestry is asymmetric. Weaknesses are identified in the control environment, which should be tested and updated to minimize losses to companies and the state treasury. It is difficult to calculate the current losses from this type of crime, so it is fundamental to take proactive and preventive measures. These can be done through the following measures: 1) Increase of the oversight of the forestry by appropriate legislative and institutional reforms related to financial reporting. 2) To carry out subordination and coordination between the government departments. 3) The internal audit in enterprises should be improved. 4) To carry out additional alternative procedures by the auditors, such as possibility to monitor the process of handing over and calculating the harvested timber, tracking the way tickets which are issued and etc. 5) To make a detailed review of internal and external environmental factors in order to update the accounting policy and link it to the maximum extent with the strategy of the organization. 6) To improve the control of publicly disclosed information by forestries in order to avoid lacks and non published data.

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