

REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC)

Croatia

ACCOUNTING AND AUDITING

June 20, 2002

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Executive Summary

This report is based on an assisted self-assessment of accounting and auditing standards and practices in Croatia conducted under the management of a National Steering Committee consisting of representatives from government and the private sector. The self-assessment exercise, complemented by due diligence by Bank staff, specifically focused on the strengths and weaknesses of the institutional arrangements needed for the observance of International Accounting Standards (IAS) and International Standards of Auditing (ISA).

The Accounting Act was amended in 1992 in order to adopt a more investor oriented approach. The Act took the important step of requiring all companies to prepare IAS financial statements. The Audit Law requires that the audit should be carried out by a certified auditor licensed under authority granted by the Ministry of Finance (MOF) and in accordance with ISA. Therefore, there is no standards gap in Croatia.

While the apparent quality of many of the IAS financial statements reviewed was good, there were significant variations in the level of compliance with IAS. Some of the financial statements presented for review did not purport to comply with IAS. There is no enforcement or monitoring of compliance with IAS. Companies are also required to submit different financial information at different times to separate authorities and some financial information about companies that is available to the public may not be reliable.

While many audit firms make strenuous efforts to carry out audits in accordance with ISA, there are significant variations in the quality of audits. The quality of some audits is materially affected by management attitudes to, and perceptions about, the role of audits. The Audit Law does not deal with the regulation and supervision of the profession and there are some concerns about the issuance of audit licenses. There is no enforcement or monitoring of compliance with ISA.

This report was prepared by a staff team from the World Bank on the basis of the findings from a diagnostic review carried out in Croatia. The staff team was led by John Hegarty (ECSCS). The review was conducted through a participatory process involving various stakeholders and led by the country authorities.

1. INTRODUCTION

1. An assessment of accounting and auditing practices in Croatia was conducted within a Bank-Fund joint initiative on the *Reports on the Observance of Standards and Codes (ROSC)*. The assessment focused on the strengths and weaknesses of the accounting and auditing environment which influences the quality of corporate financial reporting. The International Accounting Standards (IAS) and the International Standards of Auditing (ISA) were used as benchmarks in assessing Croatia's accounting and auditing standards. The assessment involved a review of mandatory requirements and actual practices using a diagnostic template developed by the Bank.

2. A National Steering Committee (NSC) was established by the Ministry of Finance to manage the assessment process and develop the Country Action Plan. The NSC is headed by the Deputy Minister of Finance. The NSC includes representatives from the Ministry of Finance, the Croatian National Bank, the Croatian Securities Commission (CROSEC), the Zagreb Stock Exchange, the Croatian Chamber of Commerce, the Croatian Association of Auditors, the Croatian Association of Accountants and Financial Experts, the Association of Croatian Accountants, academics and local member firms of major international networks and other firms. The assessments made by the NSC were reviewed by Bank Staff through a due diligence process. The report presented in the subsequent sections is prepared by Bank Staff on the basis of information produced by an assessment exercise managed and owned by the country authorities.

3. Croatia became an independent country in 1991. It commenced an extensive privatization program and made significant improvements in the laws on accounting, auditing and securities regulation in order, among other things, to attract domestic and foreign investors. The Zagreb Stock Exchange (ZSE) was established in 1991 and the Croatian Securities Commission (CROSEC) was established in 1996. Nevertheless, the securities markets remain underdeveloped and has limited significance in the financial system. As at 31 December 2000, there were approximately 1,500 joint stock companies of which only four are listed on the ZSE (two of the four are also listed on the London Stock Exchange). The securities of a further 546 joint stock companies and seven privatization funds are not listed but are traded on the ZSE and the Varazdin stock market. The Zagreb Stock Exchange and the Varazdin stock market have decided to merge into one stock exchange. There were almost 38,000 limited liability companies, almost all of which are small or medium sized entities (SMEs).

II. INSTITUTIONAL FRAMEWORK

A. Statutory Framework

4. The Accounting Act was implemented in 1992 in order to adopt a more investor oriented approach. As a result, the Act took the important step of requiring all companies to prepare IAS financial statements. The Act reflects a deliberate attempt on the part of the Croatian authorities to focus financial reporting on capital market needs rather than such matters as the determination of taxable profits. As well as requiring compliance with IAS, the Act incorporates the balance sheet and income statement

formats in the EU Fourth Council Directive on the annual accounts of certain types of companies, the Bank Accounts Directive and the Insurance Accounts Directive. The Act does not include the Fourth Directive valuation rules nor the Seventh Directive requirements on consolidated accounts but compliance with IAS results in the presentation of equivalent information. The Act no longer requires the use of a standard chart of accounts.

5. The accounting requirements in the Accounting Act apply to all large companies—joint stock and limited liability companies (see table 1). The Accounting Act requires that all companies present IAS financial statements although medium and small companies are relieved of some of the audit and publication requirements. While there is widespread support for the publication of IAS financial statements by listed and publicly traded companies, some believe that the requirement places a significant burden on SMEs. The requirement represents a significantly greater burden than that currently imposed on SMEs in any EU Member State or likely to be imposed by Member States when EU listed companies are required to publish IAS consolidated financial statements with effect from 2005. There is an understandable reluctance in Croatia to abandoning the important step of adopting IAS for all companies but there is significant support for allowing SMEs to use an internationally developed SME version of International Accounting Standards/International Financial Reporting Standards.

6. The Law on Accounting requires all joint stock companies and all large and medium sized limited liability companies to publish their financial statements in a newspaper and file those financial statements with the local court registrar. This requirement is consistent with the EU First Company Law Directive although it appears unlikely that public access to the information filed with the court registrar is, in fact, a reality.

7. According to the Law on Financial Agency, all joint stock and limited liability companies are required to submit quarterly and annual returns of financial information to the Financial Agency (FINA). The financial information submitted to FINA is used for the preparation of government statistics and should be submitted on standard forms. The information should be prepared in accordance with the Accounting Law and should, therefore, comply with IAS. The information need not be audited and auditors often do not review the information before it is submitted to FINA.

Table 1: Financial Reporting Matrix

Requirements Entities	Accounting Law	Chart of Accounts	EU Directives	IAS	Audit
Listed companies	Required	Optional	Optional ¹	Required	Required
Other joint stock companies	Required	Optional	Optional ¹	Required	Required
Privatization investment funds (PIFs)	Required	Optional	Optional ¹	Required	Required
Banks	Required	Optional	Optional ¹	Required	Required
Large limited companies	Required	Optional	Optional ¹	Required	Required
Medium sized limited companies	Required	Optional	Optional ¹	Required	Required
Small limited companies	Required	Optional	Optional ¹	Required	Review every three years

¹ Some parts of the Directives have been incorporated in the Accounting Law and are, therefore, required.

8. **The FINA supplies the financial information on approximately 600 large and medium sized joint stock companies to the Croatian Securities Commission (CROSEC) for inclusion on its public website.** While the returns submitted to the FINA are confidential and are generally not available for public inspection, under a bilateral arrangement FINA provides financial information of approximately 600 joint stock companies to CROSEC. These companies are those which are listed on the ZSE or publicly traded. There are concerns among CROSEC officials and the audit firms about the reliability of the financial information submitted to FINA (and, hence, supplied to CROSEC) and about the responsibility for that information.

9. **The Accounting Law requires that the audit of the annual financial statements of all joint stock companies and all large and medium sized limited liability companies and the Audit Law requires that the audits should be carried out in accordance with ISA.** Only the financial statements of joint stock companies and large and medium sized joint stock companies are required to be audited. The financial statements of other companies need not be audited.

10. **The Audit Law requires that the audit should be carried out by a certified auditor.** A certified auditor must have passed the certified auditor examination set by a professional association of auditors. The Law does not specify the criteria that must be

met by a professional association before it may set the certified auditor examination or issue audit licenses. The MOF currently recognizes the Croatian Association of Auditors (HUR) as the only such professional association. In the past, the MOF also recognized another professional organization, Benedict, which issued approximately 100 audit licenses but which, it is understood, no longer exists. HUR may withdraw the license of a certified auditor for disciplinary and other reasons but it appears that licenses issued by Benedict cannot be withdrawn.

11. **The Audit Law requires the MOF to license audit firms.** An individual who holds an audit license may practice as an auditor only as part of an audit firm that is licensed by the MOF. Audit firm licenses are granted by the Accounting Division of the Sector for Budget Execution in the Department of Treasury. The MOF may withdraw the license of an audit firm only if the audit license has been withdrawn from the individual auditors that are members of that firm. However, HUR is not obliged to tell the MOF about complaints about auditors/audit firms nor to advise the MOF about the withdrawal of audit licenses from individual auditors. There appear to be no sanctions available against holders of audit licenses issued by Benedict and their audit firms.

12. **The Audit Law does not deal with the regulation and supervision of the profession.** The work of HUR and, in the past, Benedict in granting and withdrawing audit licenses and regulating the holders of licenses is not monitored, regulated or supervised in any way. HUR is not accountable in any way to the MOF and it is possible that HUR's authority to issue audit licenses cannot be withdrawn. The activities of HUR are regulated only by its own members, that is the holders of audit licenses. HUR does not involve any representatives of the public interest in any of its processes including its process for disciplining members and withdrawing audit licenses.

13. **The HUR has voluntarily prepared a new Audit Law which seeks to remedy some of the current deficiencies.** The new draft Law has been discussed with the MOF but the MOF and members of the audit profession believes that further work and consultations are necessary before the draft new Law is submitted to the Parliament. The draft new Law envisages the creation of a Croatian Chamber of Auditors that would have greater powers over the granting and the withdrawal of audit licenses but would still not be accountable to, or subject to oversight by, the MOF or any other body. The MOF has consulted both international and local audit firms on the draft Law and is looking to them to identify appropriate improvements. Apart from any other considerations, the draft new Law falls short of, and differs from, the requirements of the EU Eighth Council Directive on the approval of persons responsible for carrying out the statutory audit of accounting documents, in a number of significant respects, including the qualifications of auditors and the regulation of the auditing profession. However, it should be noted that finalization of the new draft law is the responsibility of the MOF, and enactment of the draft law depends on the Croatian Parliament. The MOF viewed that the new law should stipulate the audit quality control and quality assurance review according to the EU requirements/recommendations. It has been decided that the auditing law should be drafted and adopted by relevant authorities in the manner and time frame provided in the Stabilization and Association Agreement between the EU and the Republic of Croatia signed on October 29, 2001.

14. **The current Audit Law limits the liability of auditors to DM 50,000 although it may be possible to use other remedies to seek more than DM 50,000.** While the Law on Auditing currently includes a very low limit on the liability of auditors and it is uncertain as to whether a claimant could seek other remedies (for example, a citizen's case) to recover the difference between the actual loss and DM 50,000. The MOF intends to review the limit. Under the draft new Audit Law, an auditor's liability is unlimited and an auditor and audit firm are required to hold appropriate insurance. In addition to civil liabilities, certified auditors and audit firms are subject to penalties of up to DM 2,500 under the Audit Law for failing to:

- perform an audit in accordance with the provisions of the Act or ISA
- obtain a license;
- take out professional indemnity insurance; or
- present the audit report to the company.

An auditor or audit firm that carries out the audit of a company in which the auditor holds an equity interest is also subject to a penalty of up to DM 2,500.

B. The Profession

15. **There are currently approximately 1,000 holders of audit licenses issued by HUR and approximately 100 holders of audit licenses issued by Benedict.** It is understood that about 90% of the holders of audit licenses currently carry out audits. The number of certified auditors is believed to be adequate for Croatia's needs.

16. **There are approximately 300 audit firms licensed by the MOF.** The 300 audit firms include local member firms of major international networks and five to ten other firms employing up to 15 people.

17. **The Audit Law requires that the professional association of auditors should prescribe the code of ethics for certified auditors.** The Croatian Board of Accounting Standing Order (Official Gazette No. 39 of 1994) mandates the observance of IFAC issued Code of Ethics for Professional Accountants. The HUR requires all auditors to follow the IFAC Code of Ethics but does not monitor compliance with that Code. Certain aspects of that Code are included in the Audit Law, for example the law requires that an auditor should be independent and prohibits a certified auditor from acting for a company for which that auditor has kept the books, prepared the financial statements or has a family link.

C. Professional Education and Training

18. **In order to acquire an audit license, an applicant must hold a University degree in economics and pass the certified auditor examination set by HUR.** All current holders of audit licenses issued by HUR, including those who practiced as auditors prior to the 1992 Act, meet both these requirements. The Institute of Chartered Accountants in England and Wales assisted HUR in the development of its examinations and the related education. There are, however, some concerns among audit firms that the

level of the examinations and the depth of the education have subsequently been reduced. It has also been suggested that holders of degrees in subjects other than economics should be able to acquire an audit license and the new draft Audit Law opens up such a possibility.

19. **While the IFAC Code of Ethics requires an auditor to participate in continuing education, HUR does not monitor compliance with that requirement.** HUR recognizes the need for further continuing education for auditors and for the possibility of withdrawing the licenses of those auditors who do not maintain their level of education.

D. Setting Accounting and Auditing Standards

20. **There is no ‘standards gap’ as far as accounting standards are concerned.** The Accounting Law requires that the financial statements of all companies should be prepared in accordance with IAS that have been translated and published in the Official Gazette. The Accounting Law authorizes the Croatian Accounting Standards Board to translate IAS. The translation and publication process is up to date with the result that companies are currently required to comply with all IAS and interpretations issued by the International Accounting Standards Board (IASB). The Law also authorizes the Accounting Standards Board to deal with any IAS guidance or implementation issues.

21. **There is no ‘standards gap’ as far as auditing standards are concerned.** The Audit Law requires that the audit of financial statements should be carried out in accordance with ISA. The MOF recognizes HUR as the responsible professional body to translate and publish ISA. The translation and publication process is up to date with the result that audits should be carried out in accordance with all ISA and other pronouncements issued by the International Auditing Practices Committee (IAPC) of the International Federation of Accountants (IFAC).

E. Compliance with Accounting and Auditing Standards

22. **There is no enforcement or monitoring of compliance with IAS other than through the audit process.** Neither the MOF nor any other organization has the authority to enforce compliance with IAS by any companies. In particular, CROSEC does not have the authority to enforce compliance with IAS by listed or other joint stock companies although it does have limited powers to enforce compliance by Privatization Investment Funds.

23. **There is no enforcement or monitoring of compliance with ISA.** Neither HUR, CROSEC, the MOF nor any other organization has the authority to enforce compliance with ISA. The HUR and the MOF have addressed some aspects of these issues in the draft new Audit Law, which proposes that the MOF should monitor and investigate the activities of audit firms.

III. ACCOUNTING STANDARDS AS DESIGNED AND AS PRACTISED

24. **The financial statements of 20 companies were presented for review but the financial statements of three companies did not purport to comply with IAS.** While

the Accounting Law requires compliance with IAS, the financial statements of three companies submitted for review appeared to be limited to the statistical returns. While the information in such returns may be prepared using accounting policies that conform with IAS, the presentation and disclosures in such statements fall significantly short of full IAS requirements and, therefore, the requirements of the Accounting Law.

25. While the quality of many of the IAS financial statements reviewed was good, there were significant variations in the level of compliance with IAS. The IAS financial statements of 17 listed, publicly traded or large companies were reviewed. These financial statements (particularly those of the two companies listed on both the Zagreb and London Stock Exchanges) were high quality. There were, however, several instances of accounting policies or presentations that did not comply with IAS and missing disclosures and other information. Examples of deficiencies in the IAS financial statements examined include:

- absence of statements of changes in equity (conflict with IAS 1);
- missing segment disclosures (conflict with IAS 14);
- misclassification of items of income and expenses as extraordinary items (conflict with IAS 8);
- confusing disclosures about property valuations, in particular about whether privatization values and IAS 29 adjustments in 1992 are re-valuations;
- limited disclosures about the fair value of financial assets - many companies implied that carrying amounts always approximated fair value (potential conflicts with IAS 32); and
- inconsistencies over the recognition of deferred tax assets arising from tax loss carry forwards (possible conflicts with IAS 12).

26. The application of IAS is sometimes influenced by taxation consideration and other needs of company management. The IAS financial statements of one company indicated that provisions and write downs of inventories were determined by the company's general manager rather than in accordance with the relevant IAS. Discussions with representatives of that company, other companies and auditors indicated that companies sometimes manage their profits in order to minimize taxation liabilities (or differences from tax or FINA returns). Such an approach may result in the financial statements failing to comply fully with IAS.

27. Auditors, including big-5 firms, sometimes issue unqualified opinions on IAS compliance notwithstanding material non-compliance with IAS. All the audit reports on the financial statements reviewed by Bank Staff were unqualified with respect to compliance with IAS notwithstanding the deficiencies identified above. For example, the audit opinion given by one member firm of a major international network on the IAS financial statements of a ship repair company was unqualified notwithstanding the use of the completed contract method rather than the percentage of completion method required by IAS 11.

28. Companies and their auditors face a number of practical difficulties in implementing current IAS. Discussions with representatives of companies and auditors

suggested a number of IAS implementation problems. Most of these problems arise from the lack of adequate IAS expertise among the corporate accountants who find it difficult to prepare financial statements in accordance with the IAS requirements. Moreover, the lack of standardized implementation guidelines constrain proper application of the IASs.

29. Companies sometimes publish abridged versions of their IAS financial statements (usually consisting solely of the income statement and balance sheet) with a complete audit report. One annual report reviewed by Bank staff included only the balance sheet and income statement of the company but no cash flow statement, statement of changes in equity, accounting policies or note disclosures. The annual report included a full audit report with an unqualified IAS opinion. It is also common practice for companies to publish only the balance sheet and income statement in the press but with the full audit report with an unqualified IAS opinion. The attachment of such an audit report to abridged versions of the financial statements may mislead readers of the financial statements. Discussions with the auditors implied that the matter is, to some extent, beyond their control as companies do not always let them see annual reports or press announcements before they are published.

30. Many small and medium sized companies (SMEs) are struggling with the burden imposed by current IAS. The Accounting Law requires all companies to comply with IAS but, in recent years, IAS have grown significantly in length and complexity. Full compliance with current IAS imposes a significantly higher burden on SMEs in Croatia than is imposed on SMEs in other European countries or developed economies.

IV AUDITING STANDARDS AS DESIGNED AND AS PRACTISED

31. While many audit firms make strenuous efforts to carry out audits in accordance with ISA, there are significant variations in the quality of audits and the quality of some audits is materially affected by management attitudes. It is clear that many audits are carried out to a high standard by both local member firms of major international networks and other firms and comply fully with ISA. Nevertheless, the quality of some audits is affected by management attitudes including misconceptions about the nature of the audit. As a result, compliance with ISA varies significantly, something which is confirmed by the reluctance of auditors to rely on the work of other auditors (for example when they take over an audit). Examples of problems identified during discussions with the audit firms include:

- the audit is sometimes seen as part of a government control process designed to ensure that everything within a company, including its tax liabilities, is ‘correct’;
- management often places greater emphasis on the submission of statistical returns and the determination of taxation liabilities and less emphasis on the IAS financial statements – there is also the perception that the IAS financial statements must conform with the statistical returns and tax submissions;
- the absence of audit working papers in some audit firms (potential conflict with IAS 230) - it was suggested that, in some cases, the working paper file contains

- only the financial statements and that, as a result, it was impossible for successor auditors to rely on the work carried out by predecessor auditors;
- uncertainty about the auditor's responsibility for reporting fraud, in particular management fraud (potential conflict with ISA 240) - one firm commented that, in the case of fraud, it would resign as auditor rather than issue an audit report;
 - a lack of understanding of the concept of materiality with the result that there is an expectation (particularly from the taxation authorities) that everything in the financial statements is absolutely correct (potential conflict with ISA 320 which is likely to lead to excessive, rather than inadequate, audit work);
 - the lack of audit evidence for such matters as related parties, fair values, asset impairments etc. (potential conflict with ISA 500); and
 - going concern uncertainties, in particular the difficulty of obtaining evidence in support of the use of the going concern concept (potential conflict with ISA 570).

32. There are uncertainties, and hence different practices, about the appropriate translation of the audit report (ISA 700) and the signing of that report. Although the law requires the use of ISA, there is not an agreed Croatian translation of the wording of the ISA 700 audit report. As a result, different firms use different forms of wording in the same circumstances. In addition, there is a legal uncertainty about whether the audit report should be signed in the audit firm's name or by the individuals responsible for each particular audit.

33. The ability of auditors to carry out the audit of banks and the relationship between auditors and bank supervisors need to be clarified. There is a growing concentration of bank audits in the hands of local member firms of major international networks which concerns other audit firms that believe they have the requisite capability and experience to carry out bank audits. There is also some uncertainty about the respective role of auditors and bank supervisors, with a feeling that too much is expected of the auditors.

34. Many audits of smaller companies are carried out by audit firms that include only one holder of an audit license with the result that there may be inadequate audit planning, quality control and supervision. Over 95% of audit firms employ only one or two holders of audit licenses which, it is claimed, enables those auditors to carry out audits without any supervision. In such circumstances, audit planning is usually limited and quality control procedures non-existent. Questions were also raised about the specialist expertise of many very small firms.

V PERCEPTIONS ON THE QUALITY OF FINANCIAL REPORTING

35. Currently there is little demand from capital market users for financial information from Croatian companies with the result that there is no evidence available about the perception of the quality of financial reporting. Banks base their lending decisions on other information in addition to that in the financial statements. Furthermore, there is currently little demand for bank lending and, therefore, little pressure from banks for the improvement in the preparation and audit of financial statements. There is also little demand for equity capital. The ZSE and the Varazdin

stock market are not major sources of capital and trading volumes in both listed and unlisted companies are low. Again, there is little pressure for improvements in the quality of financial reporting from equity market participants.

VI POLICY RECOMMENDATIONS

36. The National Steering Committee (NSC) has discussed the policy recommendations flowing from the review exercise. Members of the NSC have reviewed all the issues arising from the review of accounting and auditing practices within the ROSC initiative. It was decided that a detailed Country Action Plan (CAP) will be developed and implemented on the basis of these policy recommendations. The CAP, developed by in-country stakeholders, will be implemented under the coordination of the NSC and with assistance from international development partners. The policy recommendations in specific areas are briefly presented below.

37. Oversight of accounting and auditing regulations:

- Establish a ‘Croatian Financial Reporting Council’ in order to ensure that, in the public interest, all relevant interested parties participate in the oversight of the accounting and auditing requirements and that such requirements are adopted only with full transparency and participation by the relevant parties.
- Clarify which unit within the Ministry of Finance is responsible for general accounting and auditing legislation and ensure that this unit has adequate resources to discharge properly its responsibilities.

38. Preparation of financial statements:

- Retain the requirement for full IAS compliance by all public interest companies – this should include (but should not be limited to) listed companies; banks, insurance companies and other financial institutions/intermediaries; other significant publicly and privately owned commercial entities; and entities which are on the way to becoming any of these.
- Modify the Accounting Law to conform fully with the EU Fourth and Seventh Council Directives but only after those Directives have been modernized to reflect the proposed requirement for listed companies to publish IAS consolidated financial statements. Maximum advantage should be taken of the accounting and auditing exemptions in the Fourth Directive for SMEs when there is no public interest requirement for the preparation, publication or audit of financial statements.
- While allowing all entities to prepare full IAS financial statements, consider the relaxation of the requirement for full IAS financial statements from SMEs, but only as part of a harmonized European and/or international approach to SME reporting and only in compliance with the EU *acquis communautaire*.

- Establish more structured, accountable, transparent and properly resourced arrangements to ensure the timely and proper translation of IAS and the development of necessary implementation guidance on the application of IAS in the Croatian context – the arrangements should seek to agree on common solutions to common problems and the issuance of authoritative guidance and should involve fully representatives of the audit firms and companies.

39. **Auditing:**

- Make necessary arrangements for timely preparation and publication of standardized practical implementation guidelines on the audit related pronouncements of the International Federation of Accountants (IFAC), e.g. International Standards on Auditing and Code of Ethics for Professional Accountants.
- Adopt a new Audit Law, following full and transparent consultation with all interested parties, that includes provisions about:
 - the criteria that should be met both initially and on an ongoing basis by the proposed Chamber of Auditors (and any other similar organization) before any regulatory functions can be delegated to it;
 - the appropriate accountability and monitoring mechanisms to ensure that the proposed Chamber of Auditors (and any other similar organization) continues to meet the criteria for the delegation of regulatory authority;
 - the legal form and authority of the proposed Chamber of Auditors (and any similar organization) given the intention to delegate significant regulatory authority to it;
 - measures to ensure adequate public interest oversight of the public interest activities of the proposed Chamber of Auditors (or any similar organization) –the measures should encompass such public interest activities as pre-qualification education, training and examinations; certification; continuing professional education; quality assurance; discipline; translation and dissemination of ISA and the issuance of application guidance in relation to ISA; and the translation, elaboration and promulgation of ethical/independence requirements;
 - general principles on any special requirements with respect to the audits of entities subject to regulatory supervision by agencies such as the Croatian National Bank and the Croatian Securities Commission; and
 - the revalidation of all existing auditor licenses in order to ensure that all auditors and audit firms are subject to the new regime.

- Ensure that the new Audit Law is fully harmonized with the EU Eighth Council Directive and other applicable EU legislation in the areas of minimum requirements for audit experience under the supervision of an approved auditor prior to being eligible for certification/licensing as an auditor; prior education requirements (i.e. the specification of the relevant university degrees); contents of the syllabus and examination for auditor certification/licensing; and the recognition of foreign auditor certificates/qualifications/licenses.
- Ensure that the accountability and monitoring mechanisms on audits and auditors are consistent with the recommendations of the European Commission. Provisions may be included in the new Audit Law on the creation of a “Regulatory Commission of Auditors” under joint sponsorship of the Croatian Securities Commission and the Croatian National Bank; other regulatory bodies, including the regulator of the insurance industry, may join forces. The sponsoring regulators should delegate power to the governing board of the Commission for taking enforcement actions against the errant auditors of the regulated enterprises. The governing board will consist of representatives of the sponsoring regulatory agencies, chamber of commerce and industry, professional bodies, academia, and well-respected eminent persons in the society. Majority members of the governing board should not be the professional accountants and auditors. The main function of the Review Commission would be to conduct independent practice review of auditors and audit firms.¹ In addition, the Council should take disciplinary actions on a transparent basis against those found responsible for noncompliance with auditing standards and code of professional ethics. Appropriate sanctions may include fines, penalties, and suspension/expulsion from the auditing profession.
- Agree a Croatian text for the ISA 700 audit report and clarify the law with respect to whether the audit report should be signed by individual auditor and/or by the audit firm.

40. **Publication, filing and public inspection of financial statements:**

- Rationalize the requirements for the publication and filing of financial statements and financial information by companies so as to ensure that:

¹ The Regulatory Commission should have competent reviewers and follow a transparently established review methodology. The Commission is not expected to have a large number of reviewers as full-time staff. Depending on the need for additional human resources, competent individuals from outside sources, including audit firms other than those subject to review in a particular year, can be seconded. After completion of the practice review, the Review Commission will submit invoice to the reviewed audit firm for the number of hours worked on the review. The employers of borrowed human resources will also send invoice to the Regulatory Commission for the level of efforts provided by their staff for practice review purposes. Thus the Commission will conduct independent practice review on a self-financing basis. Other feasible methods of financing may be considered.

- a common financial reporting platform as specified in the Accounting Law should be used, with supplementary returns being in addition to – not instead of – this common platform;
 - other than in exceptional circumstances, companies should not be required to submit the same information in different returns to multiple agencies (e.g. FINA, the tax administration, CNB, CROSEC, Commercial Courts, newspapers, etc.);
 - deadlines for the submission of annual financial statements to FINA, the tax administration, CROSEC, the commercial courts, etc.) should be harmonized in order to ensure that only audited financial statements are used for regulatory purposes (for those entities subject to audit);
 - when the financial statements are published in full, they should be reproduced in the same form and text as was subject to audit and should be accompanied by the full text of the auditor’s report—the publication of the auditor’s report without the full financial statements should be prohibited;
 - any abridged financial statements that are published should indicate that they are abridged and refer to the place at which the full financial statements may be obtained or inspected; the abridged financial statements should not include the audit report, but should include a statement about whether the financial statements have been audited and, if so, whether the audit opinion was qualified or unqualified;
 - the information on the CROSEC web site is limited to audited annual financial statements and interim financial statement prepared in accordance with IAS 34; and
 - public disclosure of interim (quarterly or half-yearly) financial information should be required only if there is confidence in a minimum level of reliability of such information, in the ability of enterprises to prepare it on a timely basis, and in the cost/benefit relationship involved. Consideration should be given to requiring some form of assurance (less than full audit) on such information, either at the time of publication or retrospectively, when the audit of the annual financial statements is carried out.
- Establish FINA as a central registry for copies of all financial statements and for public access to those financial statements in accordance with the EU First Company Law Directive;

41. Monitoring of compliance with accounting requirements:

- Establish mechanisms within the regulatory agencies (CNB, CROSEC etc.) to ensure entities under their supervision have complied with accounting and

auditing requirements and to respond to complaints from users about deficiencies in the financial statements.

- Establish mechanisms within the regulatory agencies to monitor the quality of audited financial statements of the entities under their supervision and take appropriate actions against those companies, members of company management, audit firms, auditors and others who have failed to comply with accounting and auditing requirements.

42. Accounting and auditing education and training:

Improve accounting and auditing capacity by, among other things, reforming the university curricula and examinations, and updating knowledge of the enterprise accountants and practicing auditors.