

FINANCIAL SECTOR ASSESSMENT PROGRAM

# BOSNIA AND HERZEGOVINA

ACCOUNTING AND AUDITING

## TECHNICAL NOTE

JUNE 2015

This Technical Note was prepared in the context of a joint World Bank-IMF Financial Sector Assessment Program mission in Bosnia and Herzegovina during October-November 2014 led by Michael Edwards, World Bank, and Sonia Munoz, IMF, and overseen by the Finance and Markets Global Practice, World Bank and the Monetary and Capital Markets Department, IMF. The note contains technical analysis and detailed information underpinning the FSAP assessment's findings and recommendations. Further information on the FSAP program can be found at [www.worldbank.org/fsap](http://www.worldbank.org/fsap).



THE WORLD BANK GROUP  
FINANCIAL AND MARKETS GLOBAL PRACTICE

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## GLOSSARY

|               |  |
|---------------|--|
| A&A           | Accounting and Auditing  |
| BiH           | Bosnia and Herzegovina   |
| EU            | European Union   |
| FBiH          | Federation of Bosnia and Herzegovina   |
| IAASB         | International Auditing and Assurance Standards Board                           |
| IAS           | International Accounting Standards (now IFRS)                                  |
| IASB          | International Accounting Standards Board                                       |
| IFAC          | International Federation of Accountants  |
| IFRS          | International Financial Reporting Standards                                    |
| IFRS for SMEs | International Financial Reporting Standard for Small and Medium-Sized Entities |
| IMF           | International Monetary Fund  |
| ISA           | International Standards on Auditing  |
| MoF           | Ministry of Finance  |
| ROSC          | Report on the Observance of Standards and Codes                                |
| RS            | Republika Srpska   |
| RS-AAA        | Republika Srpska Association of Accountants and Auditors                       |
| SMEs          | Small and Medium-Sized Enterprises   |
| SRRF-FBIH     | Association of Accountants, Auditors, and Financial Workers of FBIH            |
| SAA           | Stabilization and Association Agreement with the European Union                |

## EXECUTIVE SUMMARY

**1. The Second Accounting and Auditing Report on the Observance of Standards and Codes (ROSC) for Bosnia and Herzegovina (BiH) was published in July 2011.** The supporting Technical Note (TN) should be read in conjunction with the ROSC as it reviews the implementation of its recommendations<sup>1</sup> and provides the reader with information on current developments in BiH.

**2. BiH has substantially aligned its accounting and auditing laws with the EU *acquis communautaire* and will need to implement the new Directives on Accounting and Auditing in 2016.** BiH has agreed to implement the European Union (EU) corpus of laws (also known as the *acquis communautaire*) after signing a Stabilization and Association Agreement with the European Union (SAA) in 2008. The 2014 EU progress report for BiH, published in October, found that corporate accounting and auditing laws were substantially aligned with the *acquis communautaire* and harmonized between the two entities. FBiH and RS will need to further align their laws with the new provisions of the EU *acquis*. New Directives on Accounting (2013) and Auditing (2014) will become effective in 2016.

**3. Since the 2010 ROSC was agreed, secondary laws were issued by the MoFs in FBiH and in RS to implement IFRS for SMEs and to address some of the recommendations of the ROSC.** In FBiH, the MoF issued secondary legislation in 2013 for the implementation of IFRS for SMEs, allowing the standard to be used for the preparation of non-public interest SMEs' financial statements from 2013. In RS secondary legislation was issued in 2011 giving the option of using IFRS for SMEs when preparing financial statements of non-public interest entities from 2011 and limiting statutory audit to Public Interest Entities (PIEs - listed companies, banks, insurances companies, pensions funds, etc). Other dispositions in RS included further harmonization to meet the same deadlines as in FBiH for the preparation and submission of consolidated financial statements, and publication of transparency reports for audit firms that audit PIEs.

**4. The implementation of IFRS for SMEs has proven successful in the RS.** More than 50 percent of companies file their financial statements prepared using this standard. This represents a great reduction in the burden on companies when preparing financial statements, as it requires far fewer disclosures than full IFRS. IFRS for SMEs is, however, still a robust framework for reporting and a challenging standard to meet, particularly for smaller companies with unsophisticated accounting functions. Implementation of the standard in FBiH is currently very low, as the corresponding secondary legislation was issued only in 2013. The requirement for IFRS for SMEs should be expanded to all SMEs in both Entities.

**5. BiH will need further efforts to implement the lowering of requirements for small companies envisaged in the EU accounting framework.** The new Accounting Directive opens an option for a micro regime. This process could be informed by the

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<sup>1</sup>[http://imagebank.worldbank.org/servlet/WDSContentServer/IW3P/IB/2012/06/22/000333038\\_20120622024152/Rendered/PDF/703650ROSC0P110osniaherzegovina0eng.pdf](http://imagebank.worldbank.org/servlet/WDSContentServer/IW3P/IB/2012/06/22/000333038_20120622024152/Rendered/PDF/703650ROSC0P110osniaherzegovina0eng.pdf)

guidance published by the IFRS Foundation<sup>2</sup> on implementing IFRS for SMEs in micro-entities.

**6. The RS Association of Accountants and Auditors and the FBiH Association of Accountants, Auditors and Financial Workers are respectively full member and associate member of IFAC.** Both professional bodies have made substantial efforts to comply with the statements of membership obligations of IFAC. More recently the RS association initiated preliminary work on audit quality assurance with the assistance of the French profession. The FBiH Association of Accountants, Auditors and Financial Workers has strengthened its initial and continuing education processes, and published a translation of IFRS for SMEs in local language using the Latin alphabet. The RS Association of Accountants and Auditors has published a version of IFRS for SMEs using the Cyrillic alphabet. The two versions are otherwise substantially alike.

**7. Both professional bodies, however, fail to provide a continuous mechanism for the translation of International Financial Reporting Standards and International Standard on Auditing.** Even if this is not currently causing substantial departure from the English version of the standards, a continuous mechanism for translation is to be put in place in cooperation with Entities governments. The respective Ministries of Finance should monitor that the translation processes are continuous.

**8. Current monitoring and enforcement arrangements do not ensure that the quality of financial statements meet the standard of IFRS.** The audit public oversight systems are not yet fully established and operational, and audit quality assurance systems have only performed preliminary work. It will take at least three to five years of constant effort to implement these systems effectively. In addition, provisions of the new EU audit regulation relating to the monitoring of audits of PIEs will necessitate that the institutions responsible for audit public oversight directly monitor audit firms responsible for PIEs statutory audits and are completely independent from the audit profession. These requirements will imply additional constraints on the capacity of the Entities to implement these systems. Financial sector regulatory agencies have increased their monitoring of financial statements compliance with IFRS and need to continue these efforts by hiring specialized staff or training existing staff in IFRS and at a minimum ISA 700, the standard that governs the audit report.

**Preliminary results in implementing statutory audit quality assurance systems in both Entities point to a decrease in audit quality and numerous instances of non-compliance with ISA and IFRS.** Some of the roots for low audit quality are the constant downward pressure on audit fees, rapid rotation, and late appointment of statutory auditors, with some audit contracts concluded after the closing date of the financial statements.

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<sup>2</sup> <http://www.ifrs.org/IFRS-for-SMEs/Pages/Guidancemicrosizedentities.aspx>

| <b>Recommendations and Authority Responsible for Implementation<sup>3</sup></b>   | <b>Responsibility</b>  | <b>Time<sup>4</sup></b> |
|---|--|-------------------------|
| Continue implementation of simplified accounting frameworks using the IFRS for SMEs standard to reduce the burden on SMEs and improve the quality of SMEs financial statements.   | FBiH: MoF,<br>RS: MoF,   | I                       |
| Develop capacity and skills by hiring skilled staff, developing inspection strategies focusing on statutory audits, operating manuals, and staff training programs.   | Public<br>Oversight and<br>External<br>Quality<br>Assurance<br>Systems | I                       |
| Change regulation on external auditors appointment; auditors should be appointed for a multi-year period of at least three years, unless cause is documented for their dismissal. MoFs should adopt and enforce provisions to sanction companies that does not appoint their auditors before the closing date for financial statements, | FBiH: MoF,<br>RS:MoF,  | I                       |
| Enhance capacity of securities market supervisor to monitor financial information and commence enforcement on the use of IFRS.  | Securities<br>Commissions<br>in RS and<br>FBiH                         | I/NT                    |
| Ensure disclosure and, where relevant, public correction of detected material misstatements in published financial information.   | Financial<br>Supervisors   | NT                      |
| Ensure that the accounting and auditing professional bodies make available translations of IFRS and ISA and the Code of Ethics, in continuous manner, to accountants, auditors, students and preparers.   | Entity<br>Governments  | NT                      |

<sup>3</sup> The current note reiterates recommendations of the 2010 ROSC for Bosnia already agreed with the State and Entity level Authorities for further implementation. The ROSC recommendations and their implementation status are in Annex.

<sup>4</sup> I-Immediate” is within one year; “NT-near-term” is 1–3 years; “MT-medium-term” is 3–5 years.

## I. INTRODUCTION<sup>5</sup>

**10. This technical note should be read in conjunction with the Report on the Observance of Standards and Codes – Accounting and Auditing (ROSC), dated December 2010, and cleared for publication by the Ministry of Finance and Treasury of Bosnia and Herzegovina (BiH), the Government of Republika Srpska (RS), and the Ministry of Finance of the Federation of Bosnia and Herzegovina (FBiH) during April and May 2011.**

**11. The objective of this technical note is not to replace or update the ROSC, but to review the implementation of its recommendations and to provide the reader of the ROSC with information on current developments in BiH.** This note has not made a review of current practices by analyzing financial statements and related audit reports; such a review was carried out in the ROSC. It has based its analysis on documentation provided by counterparts and interviews.

**12. This note considers the European Union (EU) corpus of laws (also known as the *acquis communautaire*) as BiH signed a Stabilization and Association Agreement with the European Union in 2008.** The ROSC and the note evaluates the BiH regulatory framework and institutional capacity against the First, Second, Fourth, Seventh, and Eight companies law directives which are in force in the EU at the present time. The notes takes into account the prospect of implementation of the new accounting directive and the new statutory audit directive and the audit regulation that were adopted by the EU Parliament respectively in 2013 and 2014, as these directives will need to be implemented in Bosnia and Herzegovina.

## II. THE INSTITUTIONAL FRAMEWORK FOR ACCOUNTING AND AUDITING

### A. The Statutory Framework

**13. The accounting and auditing framework consist of a State level Framework law, and implementation laws at Entity-level - the former ensuring consistency between the two Entities accounting and auditing practices.** The accounting and auditing laws at Entity level need to be consistent with the Framework law. The Framework law was issued in 2004; it mandates, inter-alia, the use of International Financial Reporting Standards to prepare financial statements and International Auditing Standards for the audit of financial statements, and defines other requirements dealing with education and licensing of accounting and auditing professionals.

**14. The Framework law has some limitations but needs to be maintained.** The Framework law does not address directly the breadth and the depth of the provisions included in the *acquis communautaire* as it relates to accounting and auditing. The *acquis* contains more details on the financial reporting and statutory audit obligations of small, medium, large companies, and Public Interest Entities defined as listed companies on a

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<sup>5</sup> This Technical Note has been prepared by Pascal Frerejacque, WB.

regulated market. Nevertheless the Framework law is an important mechanism that informs consistency between the laws at Entity level.

**15. Very few changes were made to the accounting and auditing legal framework since the publication of the 2010 ROSC.** The laws were not changed and only secondary laws were issued by the MoFs in FBiH and in RS:

- **In FBiH**, the MoF issued secondary legislation in 2013 for the implementation of IFRS for SMEs, allowing the use of this standard for the preparation of SMEs financial statements. The first year of application is 2013;
- **In RS** secondary legislation was issued in 2011 to open an option for the implementation of IFRS for SMEs when preparing financial statements of SMEs from January 1, 2012. Other dispositions included further harmonization of deadlines for preparation and submission of consolidated financial statements to meet the same deadlines as in FbiH. Finally, RS mandates the publication of transparency reports for audit firms that audit PIEs. These reports include descriptions of the structure of the firm and its quality assurance processes, as well as identifying ownership and clients.

**16. Each Entity Company Law defines similar forms of legal entities for the corporate sector:** (i) partnerships, (ii) joint-stock companies, and (iii) limited-liability companies. Further, in its new company law, the RS has defined two sorts of joint-stock companies: open joint-stock companies and closed joint-stock companies having fewer than 100 stockholders. Open joint-stock companies must be registered on the Banja Luka Stock Exchange. FBiH's company law reflects the same distinction between open and closed joint-stock companies.

**17. The 2009 Entities' A&A Laws have further harmonized the accounting and auditing obligations of enterprises in both Entities,** enhancing the single economic space. Both sets of laws use the same definitions of small, medium-sized and large enterprises and set out their obligations in a similar way to the Fourth EU Company Law Directive:

- **Small** legal entities are entities that meet at least two out of three of the following thresholds: less than 50 employees, an average of total assets less than KM1 million and annual revenues less than KM2 million.
- **Medium-sized** entities are entities that meet at least two out of three of the following thresholds: between 50 and 250 employees, total asset value between KM1 and KM4 million and a total annual income between KM2 and KM8 million.
- **Large entities** are entities that exceed at least two out of three of the following thresholds: total employees of 250 employees, total assets of KM4 million and total revenue of KM8 million.



**18. According to both Entities' A&A Laws, all enterprises need to file their financial statements and, when applicable, the related audit report with the Entity registry of financial statements.** In addition to financial statements, enterprises need to file an annual report describing their activities, objectives, forecasts and risks. Bosnia and Herzegovina has three financial statements registries, two in FBiH, in Sarajevo and Mostar, and one in RS, in Banja Luka.

**19. Entities' A&A Laws list entities that are subject to an annual audit regardless of the size of their operations.** Entities' A&A Laws require that banks, microcredit institutions, savings and loans cooperatives, insurance companies, leasing companies, investment funds, investment funds, managers, voluntary pension funds' managers or brokers, stock exchanges, brokers and dealers of financial instruments and other financial companies be classified as large companies, subjecting them to extensive accounting and auditing obligations.

**20. Both stock exchanges, the SASE and the BLSE,** publish the financial statements of all listed entities in all segments of the market on their websites. The information comes both from the registry of financial statements and from direct filings by listed companies with the stock exchanges (including statutory audit reports).

**21. The following table summarizes the reporting and filing obligations for companies:**

**Table 1: Reporting and filing obligations for companies**

| Entities as in the A&A Laws  | Legal-entity financial statements  | Consolidated financial statements   | Audit requirements  | Filing  |
|--|--|---|---|---|
| <b>Small entities</b>  | IFRS or IFRS for SMEs except for the absence of a requirement for the statements of changes in equity and cash-flow. | Not unless the group is above the threshold for a small entity (see Para. 24) | No audit required for legal-entity financial statements<br><br>ISA Audit required for all consolidated financial statements | Legal-entity financial statement by end of February<br>Consolidated financial statements:<br>RS: End of March.<br>FBIH: End of April. |
| <b>Medium-sized entities</b>   | IFRS (both entities) or IFRS for SMEs <sup>6</sup>   | IFRS  | ISA (FBIH)<br><br>No audit required (RS) <sup>7</sup>   | Filing as above.  |
| <b>Large entities</b>  | IFRS (both entities) or IFRS for SMEs  | IFRS  | ISA (FBIH)<br><br>No audit required (RS) <sup>7</sup>   | Filing as above.  |
| <b>Listed companies, Banks, Insurance companies, Private pension funds, and other public-interest entities</b> | IFRS   | IFRS  | ISA   | Filing as above.  |

**B. The accounting and auditing profession, professional education and training**

**22. The organization of the accounting and auditing profession reflects the constitutional setup of BiH.** The accounting and auditing profession is represented at the State level by the BiH A&A Commission; its members are the Association of Accountants, Auditors and Financial Workers of FBIH (SRRF-FBiH) that represents the profession in FBIH, and the Republika Srpska Association of Accountants and Auditors (RS-AAA) that represents the same in RS. The BiH A&A Commission provides a coordination mechanism between the two entities' professional bodies to which it has delegated most of its powers. The president of the commission changes every year, and is alternatively from the RS or FBIH.

**23. Both professional accountancy organizations are members of the International Federation of Accountants (IFAC) and need to follow its Statements of Membership Obligations (SMOs).** Professional bodies must use their best endeavors to implement the SMOs. SRRF-FBiH was admitted in 2010 as an associate member, and RS-AAA as a full

<sup>6</sup> IFRS for SMEs has been adopted through the 2009 accounting and auditing law by FBIH and , RS allows the application of IFRS for non-public interest entities' financial statements established since starting 2012.

<sup>7</sup> In RS only Public Interest Entities are required to undergo an annual audit since 2011

member. Both bodies are cooperating to join the Federation des Expert-Comptables Europeens (FEE) in 2015, which only offers one membership per country.

**24. SRRF-FBiH, has made strides in enhancing its operations, notably on continuous professional education.** It has created a system to identify the technical needs of its members through questionnaires, and operates a quality assurance system to monitor the quality of training. It also has expanded the number of trainings topics. In addition, half of the initial professional education courses are provided by practicing professionals. The box below provides a snapshot view on the activities of SRRF-FBiH against IFAC SMO's.

**Box 1: Compliance with IFAC SMOs of SRRF-FBiH**

**SMO 1 – Quality Assurance:** SRRF-FBiH does not operate the audit quality assurance system in FBiH, which is under the mandate of the Audit Chamber, the body named after the 2009 law to ensure control over audits and auditors. In 2012, the Union published the internal control standard ICQC 1 in local language.

**SMO 2 International Education Standards (IESs):** SRRF-FBiH monitors that auditors follow education requirements in line with the IESs and the Framework Law of Accounting and Audit of BiH.

**SMO 3 – International Standards on Auditing (ISA):** ISA are mandated by the 2005 framework laws and the 2009 law on accounting and auditing.

**SMO 4 –Code of Ethics:** SRRF-FBiH has adopted and published the Code of Ethics; it supports its implementation through seminars.

**SMO 5 – International Public Sector Accounting Standards (IPSAS):** SRRF-FBiH is currently in the process of translating IPSASs, which are to be used by the public sector under FBiH law.

**SMO 6 – Investigation & Discipline:** In 2013, the Union has established a Disciplinary Review Committee and a Council of Appeal; members of those bodies are appointed. These committees are under the supervision of the Audit Public Oversight.

**SMO 7 – International Financial Reporting Standards:** IFRS are mandated by law in FBiH. SRRF-FBiH supports that effort in translating IFRS and IFRS for SMEs. The translation process is not continuous; the translation of IFRS is dated 2010, and includes IASB pronouncements until 2010. The translation of IFRS for SMEs is up to date.

**25. RS-AAA is a more mature professional body that initiated work on quality assurance and operates its own education system, including continuing professional education.** The following box provides a snapshot view on the activities of the RS-AAA against IFAC SMO's.

**Box 2: Compliance with IFAC SMOs of RS-AAA**

**SMO 1 – Quality Assurance:** RS – AAA are developing their quality assurance system, with the assistance of the French professional body, through the Commission for monitoring, implementation and control. The system started operating in 2012. Auditors are required to apply International Standard on Quality Control (ISQC 1).

**SMO – 2 International Education Standards (IESs):** Statutory auditors follow education requirements in line with IESs (2009 edition) and the Framework Law of Accounting and Audit of BiH. Auditors must have at least a bachelor degree, pass selected exams, meet a three year minimum requirement for professional experience, and are required to participate in a 40 hour CPD program each year.

**SMO 3 – International Auditing and Assurance Standards (IAASB) pronouncements:** the use of ISA is mandated by law, the last translation was performed in 2010 by RS-AAA which supports its implementation by training auditors and publishing audit manuals.

**SMO 4 –International Ethics Standards Board for Accountants (IESBA) Code of Ethics:** The use of the code of ethics is required by law. The last version was translated in 2012 in cooperation with the Serbian and Montenegrin Professional Accountancy bodies. Ethics is supported by seminars organized by the RS-AAA.

**SMO 5 – International Public Sector Accounting Standards (IPSAS):** IPSASs are translated by the RS-AAA.

**SMO 6 – Investigation & Discipline:** The RS-AAA system of investigation and discipline was adopted in 2002 and further amended in 2005. It is implemented through an in-house committee, which cooperates with the committee monitoring the application of auditing standards.

**SMO 7 – International Financial Reporting Standards:** IFRS are mandated by law in BiH and RS. RS-AAA participates in the translation of IFRS and IFRS for SMEs. The translation process is not continuous; the translation of IFRS is dated 2010, and include IASB pronouncement until 2009. The translation of IFRS for SMEs is up to date. The RS-AAA provides support to their members in providing, inter-alia, training and publishing the standards and implementation guidance.

### C. Setting Accounting and Auditing Standards

**26. The BIH A&A Framework Law mandates IFRS as the accounting standards to be used by all reporting entities, and ISA as the standards to be used in auditing throughout Bosnia and Herzegovina.** IFRS is still mandatory for PIEs but is now optional for other companies. IFRS for SMEs was introduced in both Entities for preparing the financial statements of non-public interest entities; this alleviates the administrative burden for non-PIEs and will enhance the quality of their financial reporting measured in terms of compliance with the provision of the standard.

**27. The continuous availability of the most recent IFRS and ISA remains an issue.** The Entities have languages that share similarities but are written in a different alphabet. The latest translations were performed in 2010, and updated translations are expected in 2015. The current translation mechanisms do not ensure the continuing and timely availability of translations. Neither Entity's Government plays a role in ensuring the continuous availability of translations. Governments and professional accountancy organizations sharing the same language in the region need to further cooperate on technical and financial fronts. A stable and well-resourced translation process is essential to the correct application of the standards in a country in which foreign language skills are generally too low for using standards written in English.

## D. Enforcing Accounting and Auditing Standards

**28. The enforcement of accounting and auditing standards is different in each Entity.** As discussed below, both FBiH and RS need to improve their regulatory capacity to monitor and enforce compliance with accounting and auditing standards. This will present a challenge, but it will be critical for both to add staff with appropriate education, training, and experience to ensure a productive monitoring and oversight of the accounting and auditing functions.

### *DI. Enforcing Accounting and Auditing Standards in FBiH*

**29. The Audit Public Oversight Council was set up in 2013 and is not yet funded.** The Council consists of 5 members representing various supervisory agencies, academics, and the profession. The Council has met several times but lacks funding to effectively start its operations. The members of the Council are accounting and auditing experts.

**30. The Audit Public Oversight is supported by an Audit Chamber that will need to hire more staff to fulfill its mandate.** The chamber is responsible for audit quality assurance. The Audit Chamber was first established in 2011, but commenced its operations only in 2013. It has started preliminary work to review the characteristics of the audit market and better understand quality in financial statements, by reviewing publicly available audit opinions and financial statements and analyzing the responses of audit firms to questionnaire on audit quality. The Chamber of Auditors has only two staff, and will need to hire more staff to fulfill its mandate.

**31. The preliminary work performed by the Audit Chamber points to a lack of audit quality.** The conjunction of the pressure on audit fees, lack of knowledge and experience with international standards of accounting and auditing, and the lack of supervision of the audit market has resulted in poor audit practices that are not compliant with ISA.

**32. The extent of financial regulators monitoring of financial statements in FBiH was reviewed.** The review is based on the interviews of representatives of the staff of the agencies by the team and on information provided by other members of the FSAP team.

- **The FBiH Securities Commission has not made the necessary investments in resources and skills to monitor the quality of financial statements of listed entities.** Periodical information is not reviewed and financial statements are scrutinized only on the occasion of a public filing, i.e. when the number of shares is increased or decreased based on the report of an independent auditor.
- **The FBiH Banking Supervisory Agency (FBA) has enhanced its monitoring of financial statements to comply with the requirements of the new Basel Core Principles** that gives more responsibility to banking supervisors to ensure quality in financial reporting of banks. Financial statements are now to be prepared based on IFRS. The agency has accompanied the transition of IFRS of the banking sector in 2012-2013, and trained its staff accordingly. Banks are

mostly audited by audit firms that are member of international networks. The agency holds discussions with auditors on a bilateral basis once a year before the audit

- **The FBIH Insurance Supervisory Agency has improved its monitoring practices vis-à-vis the audited financial statements.** It now reviews financial statements and audit opinions, and has expanded its staff and its training program. In 2013, only one Insurance company was audited by a local auditor; this auditor had issued a modified opinion on the financial statements of that company.

## *D.2 Enforcing Accounting and Auditing Standards in RS*

**33. The RS A&A Law allocates the responsibility for quality assurance and public oversight systems to the MoF, which lacks the necessary resources to fulfill them.** The MoF mostly undertakes compliance oriented controls but is not in a position to review the work performed by audit firms. The control unit has only one staff member, and therefore does not have the capacity to discharge all tasks for the quality assurance and the oversight systems. .

**34. The RS A&A Law established the RS A&A Council which was initially viewed as leverage for the MoF to operate audit quality assurance and the public oversight system.** The A&A council comprises representatives of the MoF, professional bodies and university professors. The council advises the MoF on possible reform but does not play a meaningful role in supervising the quality assurance of audits and auditors. Membership can be extended to others who may contribute to the work of the Council based on their theoretical and practical experience. In reality little work has been done in the area of audit quality assurance and public oversight by the Council to help the MoF discharge its responsibilities to oversee audit firms.

**35. The RS-AAA has initiated the implementation of an audit quality assurance system with the assistance of French Professional Accountancy Organizations.** Initial steps in 2014 comprised analyzing questionnaires and interviewing audit firms. Preliminary results point to a lack of application of ISAs by a number of audit firms. The RS-AAA hosts a Commission for quality assurance constituted by the five members, representing the association, regulatory bodies and other interested parties. Representatives of the MoF,, the RS-AAA and representatives of financial supervisors.

**36. Preliminary work performed by the RS-AAA points to a lack of audit quality.** Pressure on audit fees, lack of knowledge and experience in the profession, and a lack of supervision of the audit market has contributed to poor audit practices that are not compliant with ISA.

**37. The extent of financial regulators' monitoring of financial statements in RS was reviewed.** The review is based on the interviews of representatives of the staff of the agencies by the team and on information provided by other members of the FSAP team.

- **The RS Securities Exchange Commission faces constraints in reviewing periodical financial information provide by listed entities.** It has only two staff to review the financial statements of issuers. Therefore, reviews of the financial statements of companies listed on the RS stock exchange are mostly undertaken when capital has been modified, much like in FBiH. The SEC's human and financial resources should be enhanced as discussed in the ROSC document;
- **The RS Banking Supervisory Agency is responsible for enforcing the use of IFRS.** It is legally responsible for supervision of the application of IFRS in the financial sector and under the new Basel Core Principles for Banking Supervision. Although its staff has some knowledge of IFRS, the capacity of the off-site and on-site supervision teams will need to be strengthened in this area. Financial statements of banks comply *prima facie* with IFRS, but some do not contain enough information to understand the underlying operations of the banks. Banking supervisors need to ensure that financial statements provide all the relevant information necessary to understand underlying operations;
- **The Insurance Supervisory Agency lacks resources and skills to review financial information.** It has not improved its staffing since 2011 and at least one skilled resource left; it devotes no resources to participating in international training on IFRS.

### III. ACCOUNTING STANDARDS AS DEVELOPED AND AS PRACTICED

**38. Both Entities in BiH have initiated a change from a full IFRS regime to a regime less burdensome for SMEs.** Both Entities have added an option to use the IFRS for SMEs standard, a less burdensome but still rigorous standard to be used by SMEs when preparing their financial statements. IFRS for SMEs is translated in both Entities, in Latin alphabet for use in FBiH and Cyrillic in RS. The BiH Framework Law establishes IFRS, as issued by the IASB, to be the only accounting standards applied in BiH.

- **In FBiH** the option to use IFRS for SMEs for the preparation of SMEs financial statements is only recent and the level of adoption seems very low. The register of financial statements could not provide information on the number of companies using the standard. SRRF-FBiH representatives have a view that the level of adoption is low.
- The level of adoption of IFRS for SMEs **in RS** is very high with more than fifty per cent of all companies filing financial statements prepared under IFRS for SMEs. Only non-Public Interest Entities can use this standard to prepare their financial statements; the standard requires fewer disclosures than full IFRS, but still requires modern and quite rigorous accrual accounting.

#### IV. AUDITING STANDARDS AS DESIGNED AND AS PRACTICED

**39. This technical note does not include a review of statutory audit on financial statements but builds on interviews with persons participating in the nascent quality assurance systems in FBiH and RS.**

**40. The quality of statutory audit seems to have declined in an environment where there is a rapid rotation in auditors, an increased pressure on audit fees by companies, and in which quality assurance were only recently established and public oversight system are not yet fully implemented.** The annual appointment of auditors seems to be to blame, as it is the occasion to discuss a decrease in audit fees in both Entities. In some instances, companies change their auditors annually, and appoint them late. These practices are not favoring quality audits.

**41. Initial quality assurance work performed in the FBiH and RS show low compliance with ISA for a number of audit firms.** This confirms the findings of the 2010 ROSC on lack of compliance with ISA. These findings should be seen in the context of very small firms that do not always have the resources to perform auditing and the large portion of audit revenue (more than 50 per cent) taken by member firms of international networks.

#### V. PERCEPTION OF THE IMPORTANCE OF FINANCIAL REPORTING

**42. The length of the relationship of a bank with its customer is more important than the financial information that is provided.** Banks request high-levels of collateral for loans to SMEs, between 1 and 3 times the nominal amount of the loan, with an average above 2.3. The high-level of collateral required reflects the lack of trust in numbers, whether these are from financial statements or realizable amounts of collateral values. Over time, as trust is built between a bank and a company, the level can go as low as 100 per cent of the nominal amount of the loans.

**43. Banks indicated limited trust in the cash-flows figures of companies requesting a loan.** SMEs often have two sets of books, one of which does not take into account parts of the business of a company, and which scope would vary. The black book can represent a substantial part of the operations of some small companies and in others it is very marginal.

**44. As noted above there is a perception that the quality of financial reporting and especially of auditing is declining.** Audit quality assurance and public oversight systems, and enhanced supervision by the financial supervisors are critical to reestablish trust in financial information across BiH



**Annex I: 2010 ROSC Recommendations and Implementation Status**

| RECOMMENDATIONS  | FBIH   | RS  |
|--|--|---|
| <b>Statutory Framework</b>   |  |   |
| <b>IFRS for SMEs to be adopted</b>   | <b>Partially Implemented.</b> Decision published in 2013 for the implementation of IFRS for SMEs but only as an option. There is no record of implementation of this standard in the FBIH and the use of IFRS for SMEs should be expanded.   | <b>Partially Implemented.</b> Guidance on application of IFRS for SMEs (number 93/11) published in 2011. More than 52 per cent of all companies chose IFRS for SMEs for preparing their FS. The use of IFRS for SMEs should be expanded to all SMEs.  |
| <b>IFRS to apply only to PIEs</b>  | <b>Partially Implemented.</b> Secondary law for implementing IFRS for SMEs was published only in 2013. There is no record of implementation of this standard in the FBIH and the use of IFRS for SMEs should be expanded. PIEs mandated to apply full IFRS for the preparation of their financial statements.  | <b>Partially implemented.</b> IFRS for SMEs was introduced as an option for SMEs. More than 52 per cent of all companies chose IFRS for SMEs for preparing their FS. The use of IFRS for SMEs should be expanded. PIEs mandated apply full IFRS for the preparation of their financial statements. The use of IFRS for SMEs should be expanded. |
| <b>Quality assurance to focus on the statutory audit of PIEs</b>                               | <b>Not implemented.</b> The Audit Chamber has yet to design its audit quality assurance methodology. It performed preliminary desk work through the review of publicly available reports and questionnaires sent to audit firms. No specific focus on PIEs' statutory audit.   | <b>Not implemented.</b> The RS-AAA has yet to finalize its quality assurance methodology. It performed preliminary work with the technical assistance of the French Professional Accountancy Organizations, consisting of questionnaires sent to audit firms and short meetings with audit firms.   |
| <b>Design Operational policies for external quality assurance and public oversight systems</b> | <b>Not Implemented.</b> The Public Oversight Council was only established in late 2013, and was not to date awarded any funding. It has yet to design its operational policies, and begin its operations. The Chamber of Audit Control has established its operations and commenced preliminary work. The Audit Chamber still needs to design a methodology for quality assurance. | <b>Not implemented.</b> The MoF does not perform the oversight function over statutory audits and auditors as defined under the EU Statutory Directive. Preliminary work for audit quality assurance is performed by the RS-AAA with the assistance of the French Professional Accountancy Organizations.                                       |

| RECOMMENDATIONS  | FBiH   | RS   |
|--|--|--|
| <b>Raise awareness about the benefit of implementing the requirement of an audit committee</b><br><b>Require publication of transparency reports for audit firms auditing PIEs</b> | <b>Not implemented.</b> Transparency reports are not required.   | <b>Partially implemented.</b> Transparency reports are required since 2011.  |
| <b>Publication</b>   |  |  |
| <b>Harmonize deadlines for the filing of consolidated financial statements; and</b>  | <b>Implemented.</b> Consolidated financial statements are to be filed by the end of May.   | <b>Implemented.</b> Consolidated financial statements are to be filed by the end of April.   |
| <b>Require electronic publication for all financial statements</b>   | <b>Partially implemented.</b> Financial statements available at the registers against a standard fee. No complete electronic filing yet possible at PIF and APIF   | <b>Partially implemented.</b> Financial statements available at the register against a standard fee. The register continues to require paper filing because of the identification provided by the physical stamp; the notes to the financial statements are not published. Electronic signature not yet implemented. |
| <b>Ensure availability of PIEs financial statements</b>  | <b>Implemented.</b> Financial statements available on the stock exchange. No complete electronic filing yet possible at FIP and AFIP.  | <b>Implemented.</b> Financial statements available on the stock exchange. No complete electronic filing yet possible.  |
| <b>Accounting</b>  |  |  |
| <b>Government to ensure that institutions in charge of translation make available updated translation of IFRS</b>  | <b>Partially implemented.</b> IFRS for SMEs is translated, but IFRS are not available on a continuous basis (last translation 2010 handbook). Government is not involved in the financing or making sure that translations are performed continuously. | <b>Partially implemented.</b> IFRS for SMEs is translated. (last translation 2010 handbook). Government is not involved in the financing or making sure that the translations are performed continuously.  |
| <b>Harmonize formats for financial reporting with the Fourth and Seventh Company Law Directive.</b>  | <b>Partially implemented.</b> The formats are mostly aligned with IFRS requirements and not with the requirements of the acquis.   | <b>Partially implemented.</b> The formats are mostly aligned with IFRS requirements and not with the requirements of the acquis.   |

| RECOMMENDATIONS  | FBiH   | RS  |
|--|--|---|
|  |  |   |
| <b>Auditing</b>  |  |   |
| <b>Government to ensure that institutions in charge of translation make available updated translation of ISA and Code of Ethics</b>                          | <b>Not implemented.</b> Some efforts made to publish accounting and auditing standards are made by the SRRF-FBiH but there is no continuous system for translating ISA and the code of Ethics. | <b>Not implemented.</b> AARS have published translations of ISA in 2010. There is, however no continuous system for translating ISA and the code of Ethics.   |
| <b>Monitoring and Enforcement</b>  |  |   |
| <b>Securities Commission to be provided with additional resources to step up monitoring and enforcement</b>  | <b>Not implemented.</b> The Securities Commission has not enough resources to supervise the financial statements of issuers.   | <b>Partially implemented.</b> The Securities Commission has initiated some review of financial statements of issuers but was not allocated the necessary resources to broaden and deepen that effort. |
| <b>Financial Supervisors to take action in case of material misstatement of financial information and when relevant, require public correction</b>           | <b>Not implemented.</b><br>No public record of financial statements modified at the request of a financial supervisor.   | <b>Not implemented.</b><br>No public record of financial statements modified at the request of a financial supervisor.  |
| <b>Education and training</b>  |  |   |
| <b>BiH A&amp;A Commission to conduct a review of the accounting curricula, reading lists and examination strategies for updating them with current needs</b> | <b>Partially implemented.</b> The BiH A&A Commission reviews regularly the list of books that supports the curricula. The curricula are not updated.   |   |