

70365

REPORT ON THE OBSERVANCE
OF STANDARDS AND CODES (ROSC)
ACCOUNTING AND AUDITING

» BOSNIA AND HERZEGOVINA

DECEMBER 2010



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CURRENCY: CONVERTIBLE MARK (KM)

U\$1=KM1.5 as of December 31, 2010

Main abbreviations and acronyms

A&A	Accounting and Auditing
BH	Bosnia and Herzegovina
BLSE	Banja Luka Stock Exchange
DG MARKET	European Commission Directorate General for the Internal Market and Services
EC	European Commission
EU	European Union
FBH	Federation of Bosnia and Herzegovina
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GNI	Gross National Income
IAASB	International Auditing and Assurance Standards Board
IAS	International Accounting Standards (now IFRS)
IASB	International Accounting Standards Board
IESBA	International Ethics Standards Board for Accountants
IEASB	International Education 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	MoF
OECD	Organization for Economic Cooperation and Development
ROSC	Report on the Observance of Standards and Codes
RS	Republika Srpska
RS-AAA	Republika Srpska Association of Accountants and Auditors
SASE	Sarajevo Stock Exchange
SME	Small and Medium-Sized Enterprises
SRRF-FBH	Association of Accountants, Auditors, and Financial Workers of FBH

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ACKNOWLEDGEMENTS

This report was prepared by a team from the World Bank based on the findings of a diagnostic review carried out in Bosnia and Herzegovina between November 2009 and May 2010. The World Bank team was led by Pascal Frèrejacque, Sr. Operations Officer, and included Liam Coughlan, Sr. Financial Management Specialist, and David Cairns, Consultant, with the support of the Sarajevo Office. The team wishes to thank Siew Chai Ting, Lead Finance Officer, World Bank, and Gary Scopes, Director, International Relations, American Institute of Certified Public Accountants, for their comments on the draft report.

The team acknowledges the extensive cooperation and assistance from the staff of the Entity- and State-level governments and other local organizations who contributed to the ROSC review.

The ROSC assessment was cleared for publication by the Ministry of Finance and Treasury of Bosnia and Herzegovina, the Government of Republika Srpska, and the Ministry of Finance of the Federation of Bosnia and Herzegovina in April/May 2011.

Executive Summary

The first Accounting and Auditing Report on the Observance of Standards and Codes (ROSC) for Bosnia and Herzegovina was published in October 2004. This second report provides an updated assessment of the financial reporting requirements and practices in the country's enterprise and financial sectors. This report uses International Financial Reporting Standards (IFRS), International Standards on Auditing (ISA) and the relevant portions of European Union (EU) law (also known as the *acquis communautaire*) as benchmarks.

Country Context

Following four years of devastating war in Bosnia and Herzegovina, the Dayton Peace Agreement (December 1995) established a decentralized governance structure which includes the Council of Ministers at the State level, and two largely autonomous "Entities", the Federation of Bosnia and Herzegovina (FBH) and Republika Srpska (RS). The District of Brcko was added to the structure in 1999. The Entities enjoy a high level of autonomy, each with its own Governments and institutions, including Ministries of Finance (MoF).

Bosnia and Herzegovina is a middle-income country with a population of 3.8 million and a gross national income per capita of US\$4,700 in 2009 (Atlas method). In the recent years, Bosnia and Herzegovina has seen robust economic growth primarily driven by private sector investments. Bosnia and Herzegovina's small, open economy, left the country vulnerable to the global financial and economic crisis, which soon reversed some of the recent economic gains, putting at risk both macroeconomic stability and some important economic reforms. The economy fell into recession and GDP dropped 3 percent in 2009. To mitigate the effects of the crisis, the Government entered into a USD1.6 billion Stand-By Arrangement with the International Monetary Fund.

Bosnia and Herzegovina achieved an important milestone in June 2008 with the signing of a Stabilization and Association Agreement with the EU. This agreement represents the first formal phase in the EU accession process, under which Bosnia and Herzegovina has undertaken to align its legal and institutional framework with the EU *acquis communautaire*. The 2009 and 2010 progress reports of the European Commission acknowledge that the Entities have adopted IFRS and ISA, but highlights that further work is needed to ensure a fully aligned framework with the EU *acquis communautaire*. They also call for more coordination and harmonization between the two Entities.

The institutional framework has improved since 2004; the universal requirement for "full" IFRS remains an issue

The institutional framework for corporate financial reporting in Bosnia and Herzegovina has improved since 2004. The application of "full" IFRS not just for public-interest entities (PIEs) but for all business entities remains, however, an issue, as it places an undue burden on small and medium-sized entities (SMEs). The requirement for every company to apply IFRS when preparing financial statements is not in line with the spirit or the letter of the Fourth and Seventh Directives, which establish accounting frameworks adapted to different sizes of companies. The adoption of accounting standards adapted to the size of business entities is necessary to enhance the quality of financial statements.

Accounting and Auditing laws have been further aligned with the acquis

Progress has been made since 2004 in aligning the State and Entities laws with the EU *acquis communautaire* as it relates to financial reporting. This includes (i) the harmonization of accounting and auditing laws; (ii) an increased availability of IFRS translations; (iii) the implementation of auditors' registers by each Entity; (iv) the single curriculum for professional education issued by the BH Accounting and Auditing Commission for Accounting and Auditing; and

(v) enhanced requirements for continuing professional development. Several portions of the *acquis* remain to be transposed.

Entities Accounting and Auditing legislation further harmonized

Besides the provisions of the Framework Law, common requirements introduced in both Entities A&A Laws have helped achieve, further harmonization. In particular, thresholds for defining small, medium-sized and large enterprises are now harmonized. The Accounting and Auditing Laws' requirements for the external quality assurance of the work performed by audit firms and public oversight, however, differ in each Entity.¹

Up-to-date Translations are available but sustainability remains an issue

The lack of translation of IFRS into local language in FBH has impaired the ability of enterprises to prepare quality financial statements. They used instead outdated revisions. A translation of the IFRS "bare" standards (without the framework and implementation guidance) is available in FBH since May 2010. In the RS, IFRS bounded volumes translated in Serbian are available since 2005. The continuing availability of translation depends on neighbor countries' willingness to collaborate with and support Bosnia and Herzegovina.

External quality assurance systems have been established; implementation will pose several challenges. Additional reforms are needed to transpose with the Statutory Audit Directive fully

In 2009, the Entities' introduced requirements for external quality assurance and public oversight. In the RS, the MoF is responsible for operating the external quality assurance and public oversight systems since January 1, 2010 and a Council for Accounting and Auditing advises the MoF in carrying out these responsibilities. In the FBH, the Audit Chamber, introduced by the 2009 A&A Law and recently established, is responsible for the external quality assurance. The Public Oversight Board is not yet established. The effective functioning of the external quality assurance and public oversight systems will be challenging and require time and considerable technical assistance. The application of the Statutory Audit Directive is fairly new as it was issued in 2006 to be implemented by June 2008; many new EU Member States have not yet effectively implemented all of its provisions, including all the functions to be taken care of by the public oversight system, for which there is not a single model in the EU. Further reform is needed to align Bosnia and Herzegovina's auditing framework with the provisions of the Directive, including the requirements for audit firms that audit public interest entities to provide transparency reports.

Professional bodies gain increased IFAC recognition; training arrangements require improvements

In November 2010, the Association of Accountants and Auditors of RS was admitted to the International Federation of Accountants (IFAC) as full member, and the FBH Association of Accountants, Auditors and Financial Workers was admitted as associate member. Under the aegis of the Bosnia and Herzegovina Accounting and Auditing Commission, the accounting professional bodies will need provide their members with up-to-date training on IFRS and *Clarified ISA* to comply with their membership obligations vis-à-vis IFAC.

Enforcement mechanisms are lacking for general purpose financial statements among regulated financial sectors

Current monitoring and enforcement arrangements do not ensure that the quality of financial statements published by PIEs meet the standard of IFRS. Financial sector regulatory agencies do not monitor compliance with accounting requirements by regulated entities (e.g. banks, listed companies and insurance companies) systematically. The Banking and Insurance Supervisory Agencies have thus far focused their monitoring mainly on prudential requirements rather than on the quality of IFRS-based financial statements. The Securities Commissions ad-hoc reviews in case of capital increase or reduction but do not review the annual financial statements of listed companies. Financial sector

¹ The external quality assurance system is defined in the Eighth Company Law Directive and is to be independent of reviewed statutory auditors and audit firms. It can be implemented, for example, through regular inspections.

regulatory agencies tend to rely exclusively on statutory audits to evaluate the quality of financial statements of regulated entities. The recent adoption external quality assurance and public oversight mechanisms within both entities are expected to enhance the quality of the financial information published by PIEs.

The review of financial statements carried as part of the preparation of this report also points to instances of noncompliance with IFRS in published PIE financial statements. The review of related audit reports also points to inadequate compliance with ISA.

Policy Recommendations

In order to achieve the desired level of quality in published financial statements, the authorities should focus on (a) increasing the capacity of practicing accountants and auditors to prepare and audit financial statements and (b) ensuring that the requirements of the Accounting and Auditing Laws are effectively complied with. This in turn implies that the relevant authorities at Entity level should continue to increase their capacity to implement A&A reforms in line with the EU *acquis communautaire* and to enforce the requirements of the laws.

Short Term—less than eighteen months

1. Governments should adopt a financial reporting framework based on the IFRS for SMEs and aligned with the EU Directives. A simplified framework would significantly reduce the burden on SMEs and ultimately would improve the quality of SMEs financial statements. This in turn would help those SMEs in their efforts to access financing from potential lenders.
2. Governments should ensure that the accounting and auditing professional bodies, to which the Accounting and Auditing Commission has delegated the responsibility for translation and publication of the IFRSs, Clarified ISAs and the IESBA Code of Ethics, continue to make those translations available to accountants, auditors, students and preparers.
3. The BH A&A Commission should conduct a review of the accounting curricula, reading lists, examination strategies and other requirements of the uniform professional accounting and auditing education program. This is mandated for the qualification structure to ensure that the initial professional development needs of accountants and auditors remain relevant to the needs of Bosnia and Herzegovina's economy.
4. The Securities Commissions of FBH and RS should be allocated adequate financial resources and personnel to step up the monitoring of financial information and to commence enforcement. Regarding listed companies, the European Securities and Markets Authority has set principles for monitoring the quality of issuers' financial statements and ensuring compliance with IFRS, which could serve as a reference.
5. The recently established External Quality Assurance Systems should develop inspection strategies focusing on statutory audits of PIEs and appropriate operating manuals and staff training programs.

Medium Term—eighteen months to three years

6. The Entities should harmonize their formats for corporate financial reporting and align them with the requirements of the Fourth and Seventh Company Law Directives.
7. As all other filing deadlines are already harmonized, the Entities should harmonize their deadlines for the filing of consolidated financial statements and ensure the availability of audited financial statements for public interest entities within four months after the end of the year as required by the Transparency Directive.

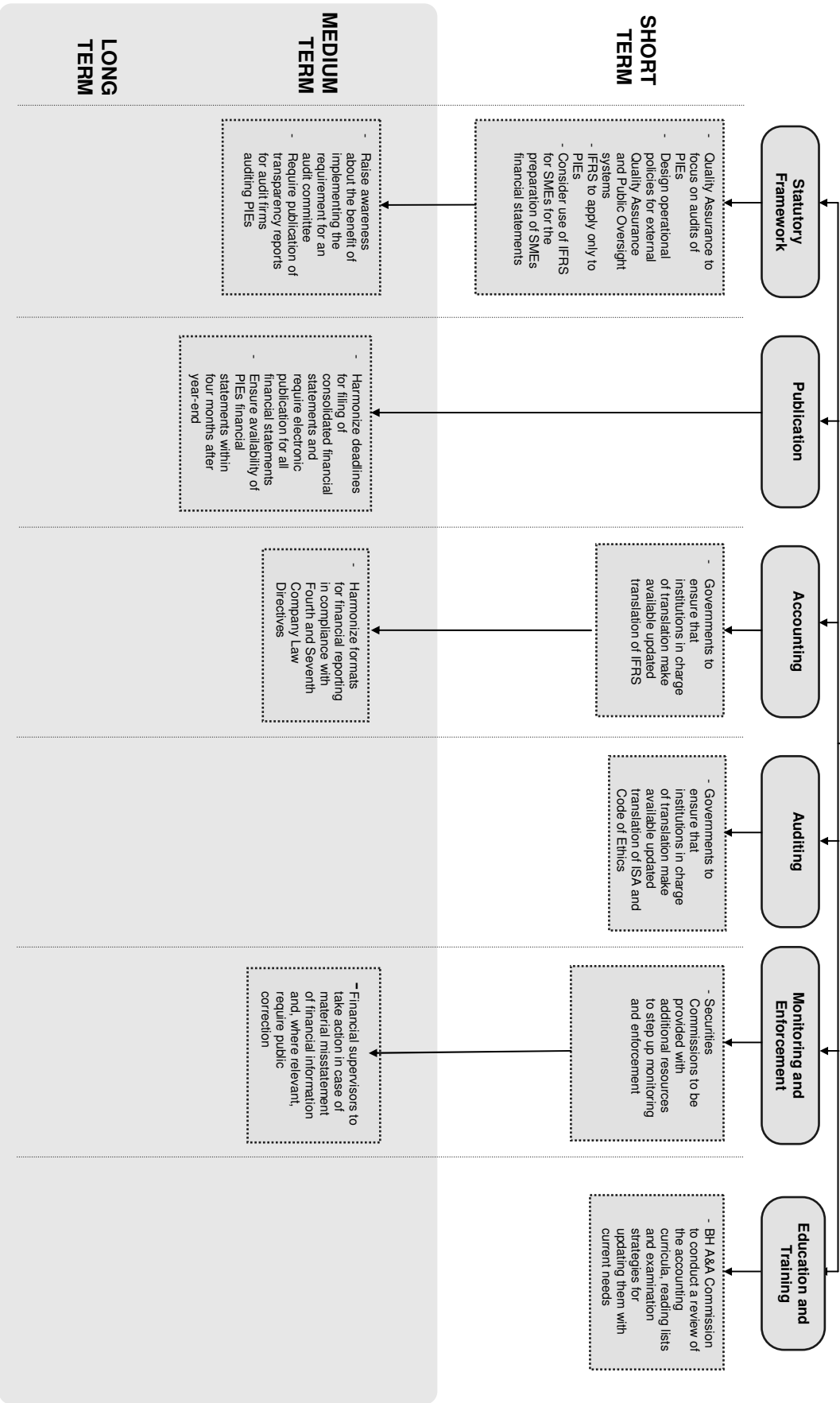
8. Where material misstatements are detected in published financial information, the Banking Supervisory Agencies, Securities Commissions and Insurance Supervisory Agencies should take action to achieve appropriate disclosure and, where relevant, public correction of the misstatements.
9. To contribute to an effective public oversight system, audit firms performing audits of public-interest entities should publish transparency reports on an annual basis.
10. The Entities' governments should raise awareness about the benefit of implementing the requirement for an audit committee ("audit board") as this is a requirement of the Statutory Audit Directive.

Next Steps

Implementing of the recommendations set out in this report will require that the Governments (i) design Country Action Plans in light of the findings and recommendations of this ROSC, (ii) allocate responsibilities for implementation and (iii) have regards to other countries implementation experience to evaluate resources needs.

A coordination mechanism between the two Entities will need to ensure consistency of the implementation of the recommendations set out in this report. In addition, they should inform relevant State-level authorities in order to ensure their support to these reforms especially with regards to access external assistance for capacity development programs.

ACCOUNTING AND AUDITING ROSC 2010 POLICY



I. INTRODUCTION

1. This assessment of accounting and auditing practices in Bosnia and Herzegovina is part of a joint initiative by the World Bank and International Monetary Fund (IMF) to prepare Reports on the Observance of Standards and Codes (ROSC).² The assessment focuses on the strengths and weaknesses of the accounting and auditing environment that influence the quality of corporate financial reporting, and includes a review of both statutory requirements and actual practice. It uses International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA) as benchmarks and draws on international experience and best practices. This assessment updates the findings of the previous Accounting and Auditing ROSC conducted and published in Bosnia and Herzegovina in 2004.³

2. The assessment also considers the European Union (EU) corpus of laws (also known as the *acquis communautaire*) as Bosnia and Herzegovina's defined European perspective has moved a stage forward with the signing of the Stabilization and Association Agreement with the European Union in 2008.⁴ This report evaluates Bosnia and Herzegovina's regulatory framework and institutional capacity against the First, Second, Fourth, Seventh and amended Eighth Company Law Directives, the European Commission (EC) Recommendations on Statutory Auditors' Independence and Quality Assurance, as well as the Transparency Directive, the IAS Regulation and the Bank and Insurance Accounts Directives.⁵

3. **Bosnia and Herzegovina has a complex governance structure that was designed under the 1995 Dayton Peace Agreement.** It comprises a State level Council of Ministers, the Entities' Governments of the Federation of Bosnia and Herzegovina (FBH) and Republika Srpska (RS), as well as the autonomous relatively small District of Brcko, located in Northeastern Bosnia and Herzegovina. Both Entities enjoy a high level of autonomy within Bosnia and Herzegovina, each having its own Governments and institutions, including Ministries of Finance.

4. **With a population of 3.8 million, Bosnia and Herzegovina is one of the smallest countries in Central and Eastern Europe.** That population is largely made up of three constituent peoples: Bosniaks, Serbs and Croats. Prior to the war, the three groups were more evenly distributed throughout the territory of Bosnia and Herzegovina, but now FBH's population is predominantly Bosniaks and Croats, while the RS has mostly Serbs. Since the war, Bosnia and Herzegovina has seen great progress in post-conflict reconstruction and development as well as in terms of reintegration and reconciliation. However, the country's complex governance structure is still subject to much political debate and controversy, and political views are still polarized along ethnic lines.

5. **There are three official languages in Bosnia and Herzegovina: Bosnian, Croatian and Serbian.** The three languages have, however, sufficient commonalities to permit all groups to understand each other. Nevertheless, having three languages poses a challenge because, according to the laws, accounting and auditing standards should be published in each language. The cooperation between the RS and Serbia, giving RS access to the other country's translated IFRS and ISAs and, more recently, similar cooperation between FBH and Croatia, represents a flexible approach that will help give Bosnia and Herzegovina access to international accounting and auditing standards.

² This report was prepared by a team from the World Bank based on the findings of a diagnostic review carried out in Bosnia and Herzegovina between November 2009 and May 2010. The exercise was led by Pascal Frèrejacque, Sr. Operations Officer, and included Liam Coughlan, Sr. Financial Management Specialist, and David Cairns, Sr. IFRS Consultant. The review was requested by the country authorities and conducted through a participatory process led by the country authorities and involving in-country stakeholders.

³ The 2010 A&A ROSC has not reviewed the financial reporting framework of the District of Brcko.

⁴ The SAA is currently being ratified by the EU Member States.

⁵ The amended Eighth Company Law Directive is also known as the Statutory Audit Directive.

6. The Government structures of the two Entities are starkly asymmetric. FBH is subdivided into 10 cantons, each with its own executive, legislative and judicial branches of Government. Each canton is subdivided into municipalities. The RS is more centralized and is subdivided into more conventionally understood municipalities.⁶

7. Bosnia and Herzegovina achieved an important milestone in June 2008 when it signed a Stabilization and Association Agreement with the European Union. The 2009 EC progress report discloses that limited progress has been made in developing company law and that further work is necessary to fully meet international and accounting and auditing standards and to ensure a harmonized framework across the country and the 2010 report states the same. The reports emphasize the requirement for further coordination and harmonization; they also recognize the progress made by the two Entities in adopting common accounting and auditing standards.

8. In recent years, Bosnia and Herzegovina has seen robust economic growth. After the war, this was initially driven by reconstruction efforts, but later private sector investment contributed to most of the growth. Between 2004 and 2008, the economy of Bosnia and Herzegovina grew at an average annual rate of 6 percent in real terms, and GDP growth peaked in 2007 at around 7 percent. Although economic activity started to weaken with the onset of the financial crisis, GDP growth was still relatively strong in 2008 at 5.4 percent. Both private investment and consumption saw strong growth, and export growth averaged 25 percent per annum over the period. Inflation was moderate during this period, amounting to just 3.8 percent in 2008 (year-on-year), despite a sharp rise in fuel and food prices in the first half of the year. The level of external public debt has been relatively low, but has been growing with the onset of the global crisis.

9. Relatively strong foreign investments and a low level of national savings triggered significant current account deficits (CAD) throughout the period financed by a combination of foreign direct investment (FDI), grants and foreign borrowing. FDI inflows averaged 7 percent of GDP, covering an average of about 44 percent of the CAD between 2004 and 2008, and rising capital account transfers covered another 24 percent of the deficit during this period. The remaining debt-creating inflows were largely channeled through international banks incorporated in Bosnia and Herzegovina.⁷ During this time, the authorities built up foreign exchange reserves, which peaked in 2008 at KM6.8 billion, or 5.5 months worth of imports. In 2007 and 2008, food and fuel price increases pushed up the current account deficit further (these two commodities represented nearly 42 percent of imports in 2008).⁸

10. As is to be expected with a small open economy, the global economic crisis spread quickly throughout Bosnia and Herzegovina, reversing some of the strong growth enjoyed before 2009 and putting at risk macroeconomic stability and some important economic reforms. The economy fell into recession, and GDP dropped by 3 percent in 2009. Specifically, during the first half of 2009, exports dropped 44 percent and imports 45 percent (year on year). In the same period, indirect tax revenues decreased by almost 15 percent. Foreign reserves started to drop and, although the fall was not alarming, the Government entered into a USD1.6 billion Stand-By Arrangement with the IMF to deal with the effects of the crisis, which shore foreign reserves up.

⁶ The high degree of decentralization in FBH is the result of an agreement reached during the 1992-1995 war between the representatives of Bosniak and Croat ethnic groups to avoid dominance of the Bosniak majority over the Croat minority.

⁷ This translated into rapid growth of credit to private sector and households, but also to the Government sector in 2008, when its balances deteriorated.

⁸ Due to relatively inelastic demand for these products, imports in 2008 increased 15.8 percent in nominal terms, while they dropped around 2 percent in real terms. Note: nominal trade statistics are published by the BH Statistics Agency, while the rate of real growth is a World Bank estimate.

11. Commercial bank credit to both households and the corporate sector supported growth throughout the 2004-2008 period. The privatization of commercial banks in Bosnia and Herzegovina after 2004 led to a transfer of their ownership to foreign banks, giving them ready access to cheap financing from their parents abroad. During the five-year period prior to the onset of the global economic crisis, commercial bank credit to the private sector increased from 37 percent of GDP to 58 percent. Credit to households increased from 23 to 27 percent of GDP between 2005 and 2008. The quality of banking assets remained strong, and non-performing loans amounted to less than 2 percent before the economy succumbed to the global crisis.

12. The country's banking system is composed of 30 banks, 20 in FBH and 10 in RS. As noted above the banking sector has been privatized since 2004 and is mainly in the hands of foreign banks. The country had inherited a limited financial sector dominated by state-owned banks saddled with large nonperforming portfolios, as well as numerous small, under-capitalized private banks. The state-owned banks were privatized by the end of 2002 in the RS, but there are still two state-owned banks in the FBH. As at the end of fiscal 2008, the bank assets amounted KM21 billion, of which FBH accounts for KM 15billion, and RS banks KM6 billion.

13. In 2009, the IMF found that Bosnia and Herzegovina's financial sector had coped well with the crisis. The commitment of foreign parent banks to maintain their exposure *vis-à-vis* Bosnia and Herzegovina, and to keep their subsidiaries well capitalized through the Vienna Initiative, has had a stabilizing effect.⁹ The Central Bank of Bosnia and Herzegovina and the Entities' bank supervisory agencies have enhanced the monitoring of financial stability. The IMF has also stressed the importance of cooperation between the bank supervisory agencies and the Central Bank.

14. Banking supervision is organized at Entity level by two bank supervisory agencies. The Central Bank of Bosnia and Herzegovina coordinates the activities of the two agencies, but does not participate in the supervision of bank financial statements and regulatory reporting. The bank supervisory agencies enforce the preparation of IFRS-based financial statements, modified by regulatory provisions. Those regulatory provisions affect mostly reserves and loan loss provisioning. Regulatory provisions applying to financial statements are aligned between the two entities and now require compliance under both regulatory provisions and IFRS. RS has implemented these requirements during the first half of 2010 for financial statements relating to the 2009 financial year. These requirements will be applied in FBH for financial statements relating to the 2011 financial year.

15. Bosnia and Herzegovina has two stock exchanges, the Banja Luka Stock Exchange (BLSE) and the Sarajevo Stock Exchange (SASE). Both stock exchanges were founded in the early 2000s and include two main segments, an official segment with a few listed entities and the free market, where securities of companies that were listed mainly under the voucher privatization procedures are traded. Trading volumes were high until 2007, but have since fallen to very low levels.¹⁰ An Entity Securities Exchange Commission supervises each stock exchange.

16. The insurance sector is growing rapidly and there are now 16 insurance companies and four insurance subsidiaries in FBH and 11 insurance companies and 8 subsidiaries in the RS. It is dominated by both foreign and domestic privately owned companies. The insurance sector is characterized by strong competition over motor-vehicle insurance, with some of the companies offering sub-market prices. In 2008, gross insurance premiums amounted to KM335 million in FBH and KM177 million in RS.

⁹ The Vienna Initiative is an IMF-coordinated agreement between the parent banks of the largest local banks that pledged to maintain their overall exposure to Bosnia and Herzegovina and even to provide additional capital if need be. The policy was then duplicated in Hungary, Latvia, Romania and Serbia.

¹⁰ The voucher privatization procedures refer the process by which state-owned entities were privatized by giving citizens vouchers as a share of those companies.

17. In 2004, the State Government created a coordinating agency for the insurance sector, the Insurance Agency of Bosnia Herzegovina to ensure harmonization of the insurance laws between the entities, to liaise between the two Entities' Insurance Supervisory Agencies, and to represent the country's insurance sector in international forums. At this point, the two Entity Insurance Supervisory Agencies are not yet fully staffed and functioning as they do not effectively enforce the use of IFRS for the preparation of financial statements.

18. Progress in improving the business enabling environment leaves much to be desired as Bosnia and Herzegovina ranks 110 out of 178 countries in the 2011 *Doing Business* report. The report shows that Bosnia and Herzegovina's relative ranking in terms of ease of doing business has been mostly falling since 2006. More specifically, in the areas of obtaining credit and protecting investors, the ranking of Bosnia and Herzegovina is low (respectively 65 and 93 in 2010, down from 51 and 84 in 2006), penalized by a disclosure index far below regional levels.

19. A high-quality implementation of the *acquis communautaire* as it pertains to the corporate financial reporting system would help Bosnia and Herzegovina to significantly improve its business enabling environment. The longer-term benefits associated with improved corporate accounting and auditing practices include:

- Strengthening the single economic space of Bosnia and Herzegovina by having a better harmonized corporate financial reporting framework.
- Strengthening the cooperation of Bosnia and Herzegovina with the EU with a view to ultimate integration into the EU and the global economy through greater comparability and alignment of its standards with those applicable throughout the EU.
- Easier and cheaper access to financing for the small and medium-sized enterprise (SME) sector as a result of banks and venture capitalists having access to standardized, useful and reliable financial information to assess lending risk.
- Increased Foreign Direct Investment, which can be facilitated through greater confidence in, and improved comparability of, financial information.
- Increased levels of trading on securities markets. This can be facilitated by enhancing investors' confidence in the availability of financial information that is accurate and complete.
- Increased ability of prudential supervisors to enforce both prudential and financial reporting rules.
- Strengthening prudential supervisors' ability to supervise the entities they regulate.
- Improving the assessment and collection of taxes on corporate profits.

20. In this context, this A&A ROSC aims to support the strategic objective of furthering the development of Bosnia and Herzegovina's corporate sector, improving access to finance for domestic enterprises, and reducing the cost of doing business in the country.

II. THE INSTITUTIONAL FRAMEWORK FOR ACCOUNTING AND AUDITING¹¹

A. The Statutory Framework for Corporate Financial Reporting

21. Since 2004, Bosnia and Herzegovina has adopted a mechanism for harmonizing accounting and auditing laws and regulations, through the adoption of a Framework Law on Accounting and Auditing and parallel adoption of Accounting and Auditing Laws by the Governments of both Entities. Prior to the adoption of the Framework Law and Entities' Accounting and Auditing Laws (A&A Laws), each Entity had different requirements for the certification of accountants, licensing of auditors and corporate accounting and auditing. The Framework Law created the BH Commission for Accounting and Auditing (the BH A&A Commission) to implement and monitor the application of standards and education requirements. The BH Commission served to provide as a coordination mechanism that would implement the requirements of the Framework Law for which it is responsible.

22. The Framework Law harmonizes several aspects of accounting and statutory auditing that contribute to the creation of a single economic space in Bosnia and Herzegovina, but it does not address the relevant *acquis communautaire*. It defines accounting standards, auditing standards and requirements for: education, testing, training, certification and licensing for accounting and auditing professionals. It does not deal with quality assurance, audit oversight, investigation and discipline. According to the Framework Law:

- The accounting standards to be used in Bosnia and Herzegovina are the IFRS and IAS issued by the International Accounting Standards Board (IASB), including implementation guidance and interpretations.
- The auditing standards to be used are the ISA issued by the International Auditing and Assurance Standards Board (IAASB). Professionals should adhere to International Ethics Standards Board for Accountants (IESBA) code of ethics when providing accountancy services.
- Requirements for educational qualifications, practical experience and training, continuing education and testing theoretical knowledge are determined by a the BH A&A Commission, taking into account the Statutory Audit Directive and International Education Standards issued by the International Education Standard Board (IEASB), and are harmonized across the whole territory of Bosnia and Herzegovina.
- The processes for providing certificates (i.e., professional diplomas provided by the professional bodies) and licenses (i.e., periodically renewable permission to carry out regulated activities) are harmonized.

Under the Framework Law, updates of IFRS and ISA are incorporated by reference to the mandatory accounting and auditing standards in use in Bosnia and Herzegovina. When the international standard setter publishes a new or a modified standard, that standard does not need to be published domestically to enter into force.

¹¹ This report outlines the legal principles applicable with regard to accounting, auditing and financial reporting and does not attempt to give anything more than an introduction to the issues. This report is not meant to be an exhaustive rendition of the law nor is it legal advice to those reading it.

23. 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. FBH's company law reflects the same distinction between open and closed joint-stock companies.

24. 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.

All companies report their classification as small, medium or large, when they file their financial statements. The RS and FBH A&A laws were adopted in April 2009 and in December 2009, respectively, and are effective as of January 1, 2010. The thresholds are significantly lower than the ones of the EU Fourth Directive, which reflect the level of economic development of Bosnia and Herzegovina compared to EU Member States. It should be noted that EU Member States can set lower thresholds than the Fourth Directive and still comply with the directives' requirements. In the case of a group of small entities, it is not required to prepare consolidated financial statements when the sum of employees, total asset value and revenues for all business entities within the group, does not meet the criteria set for defining small entities.

25. 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 FBH, in Sarajevo and Mostar, and one in RS, in Banja Luka. Enterprises need to file individual financial statements before the end of February and consolidated financial statements before the end of April in FBH and the end of March in RS.

26. Medium-sized, large and listed companies, regardless of their size, must prepare semi-annual financial statements. Semi-annual financial statements comprise: a balance sheet, an income statement, a cash-flow statement, a statement of changes in equity and notes to the financial statements prepared in accordance with IAS 1 *Presentation of Financial statements* or IAS 34 *Interim Financial Reporting*. Semi-annual financial statements should be filed before the end of July. In EU Member States, SMEs are not required to prepare semi-annual financial statements.

27. The date of filing annual financial statements with the registry in both entities makes it difficult to audit the statements before filing. If, however, the auditors were to require a modification of a set of financial statements, they would have to be filed again. Financial supervisors and the stock exchanges do require the filing of audited financial statements. Financial statements are available at the financial statements registries on request. They are not, however, available electronically.

28. 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 all of their accounting and auditing obligations.

29. 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). Abridged financial statements are published in newspapers.

30. The following table summarizes the reporting and filing obligations for corporate sector entities:

Entities as in the A&A Laws	Legal-entity financial statements	Consolidated financial statements	Audit requirements	Filing
Small entities	IFRS or IFRS for SMEs except for the absence of a requirement for the statements of changes in equity and cash-flow.	No if the group is not above the threshold for a small entity (see Para. 24)	No audit required for legal-entity financial statements ISA Audit required for all consolidated financial statements	Legal-entity financial statement by end of February Consolidated financial statements: RS: End of March. FBH: End of April.
Medium-sized entities	IFRS (both entities) or IFRS for SMEs ¹²	IFRS	ISA	Filing as above.
Large entities	IFRS (both entities) or IFRS for SMEs	IFRS	ISA	Filing as above.
Listed companies Banks Insurance companies Private pension funds Other public-interest entities	IFRS	IFRS	ISA	Filing as above.

31. The Ministries of Finance are responsible for supervising bookkeeping and accounting systems and ensuring that legal entities comply with the provisions of the Entities' A&A Laws. Supervision can take different forms: on-site supervision, control of the accounting and bookkeeping systems and the monitoring and control of bookkeeping documentation.

¹² IFRS for SMEs has been adopted through the 2009 accounting and auditing law by FBH, RS allows the application of IFRS for non-public interest entities' financial statements established at end-2011

32. Each Entity A&A Law implementation prescribes in detail the organization of the bookkeeping and accounting systems and the roles of the people involved. These requirements are generally not prescribed in a law but in by-laws or regulations. In any case, all enterprises are required to describe (i) the organization of their bookkeeping and accounting systems to ensure that all transactions are captured and to prevent and detect fraud and error; (ii) internal accounting controls procedures; (iii) accounting policies and valuation methods; (iv) the persons legally responsible for the transactions, booking entries and control of those entries; (v) the flow of bookkeeping documents as well as the deadlines for processing them; (vi) procedures for preparing, compiling and drawing up financial statements; (vii) procedures for collecting data, and preparing reports for performance, tax or statistical purposes. The Entities' Laws also define the nature of bookkeeping documents, their validation and the timescale within which those documents must be booked. Deadlines and timescales in the two Entity Laws are not fully aligned with each other.

33. The general manager of a company is responsible for accounting and bookkeeping activities. The Framework Law had cancelled the requirement for licensing accountants employed to provide internal accounting, bookkeeping and tax services for companies. The responsibility of the general management over accounting and bookkeeping is similar to the responsibility he carries over any internal process of the company.

34. Statutory audit obligations of enterprises are defined by the Entities' A&A Laws. Except small enterprises, all enterprises, including enterprises that have their securities listed on a stock exchange, banks and insurance companies, are required to be audited. Small enterprises may have their financial statements audited, but it is not mandatory.

35. Auditors of joint-stock companies are appointed by the shareholders at their annual general meeting. In other forms of companies, the manager designated as the legal representative of the entity appoints the auditors. Both Entities' A&A Laws introduce a mandatory audit firm rotation policy of five years. However, mandatory firm rotation can be postponed for two years if a new engagement partner – the partner in charge of conducting the audit – is appointed.

36. The State Framework Law established the BH A&A Commission. The Commission was founded by the professional bodies of the two Entities, and has seven members, three from each Entity and one from the District of Brcko. Commission members are appointed for a two-year term by the professional bodies and can be re-appointed only once. The Commission itself appoints its President for a one-year term. While it is recognized that the BH A&A Commission has provided a sound mechanism for harmonizing the accounting and auditing professional curricula, there is some argument that, because its membership comprises only the accounting and auditing profession, this could be construed as a conflict of interest when it comes to monitoring the implementation of accounting and auditing standards. The profession has failed, *de facto*, to monitor the application of the standards.

37. The BH A&A Commission is responsible for: (i) translating IFRS, ISA and the IESBA codes of ethics, and monitoring their application; (ii) establishing Bosnia and Herzegovina's accounting and auditing curricula in compliance with the International Standards of Education issued by IAESB, monitoring their application and reviewing them periodically; (iii) establishing common examination processes; (iv) monitoring professional bodies' certification of candidates fulfilling all education, training, examination and work experience requirements; (v) monitoring the procedures for certification and licensing of professional accountants and auditors. The Accounting and Auditing Commission discloses information on its activities to the State Council of Ministers on an annual basis.

38. The Framework Law has harmonized the titles and the accession requirements to the accountancy profession. Those titles are now restricted by law. The State Framework Law has reduced the five former titles to three (two for accountants, one for auditors), reflecting progressive sets of education and work experience: (i) Certified Accounting Technician, (ii) Certified Accountant and (iii) Authorized Auditor. Professional bodies issue certificates and licenses for accountants and the certification for authorized auditors, The Entities' Ministries of Finance are the competent authorities to provide licenses to authorized auditors. Under the Framework Law, all persons holding valid titles, certificates and licenses obtained in accordance with the law will have those titles recognized in any part of Bosnia and Herzegovina without having to meet any additional requirements.

39. The Framework Law sets the maximum requirements for education, licensing and training. Entities cannot impose additional requirements to that law in terms of education, testing and professional training. The law also stipulates that an audit report is valid in all of Bosnia and Herzegovina regardless of which Entity the auditors reside in. In 2005-2006, during the transition to the new order, what were then Assistant Auditors had to complete 40 hours of CPD and a test of professional competence to become Authorized Auditors.

40. The Framework Law contains no licensing requirements for accountants who are employees of private or public companies. As noted above, the Framework Law had cancelled the requirement for licensing of accountants providing internal accounting, bookkeeping and tax services for companies. However, accountants who prepare financial statements are still required to carry a license. In the context of a country where corporate governance needs much improvement, this requirement is understandable.

41. Only audit firms holding a license from the Entity MoF have the right to issue statutory audits reports in Bosnia and Herzegovina. Audit firms are licensed by the Entities' Ministries of Finance. An audit firm can perform audit services only if it employs at least one licensed authorized auditor full time on an open-ended contract. Although it is the practice for an audit team to include a licensed auditor, the whole team need not have the license and certification. The Entities' Ministries of Finance provide licenses to certified Authorized Auditors every three years, provided that auditors have complied with the CPD requirements of the Framework Law (a minimum of 120 hours over three years). An audit firm has also to be owned by a majority of authorized auditors or another audit firm. Audit licenses for audit firms already licensed by in the other Entity or the District are issued in line with the Framework Law.

42. In FBH, only audit firms having a minimum of two licensed auditors can carry out statutory audits of public-interest entities. Public-interest entities include joint-stock companies and limited liability companies having more than KM8 million in revenue—which is one of the thresholds that defines large companies—or being (according to the law) above the SME thresholds, companies traded on a stock exchange, banks, investment funds, insurance companies and brokerage companies, other companies providing financial services or companies whose consolidated financial statements are also audited.

43. Entities' A&A Laws provide for the licensing procedures of authorized auditors and require a public register of auditors and audit firms. It should be noted, however, that only audit firms are authorized to perform audits. An audit firm should employ at least one auditor full-time under an open-ended contract.

44. The public registers of audit firms are maintained by the Entities' Ministries of Finance. The public registers are accessible through the websites of the two Ministries of Finance. Information contained in the public register complies with the requirements of the Statutory Audit Directive, that is, it includes the name, address and registration number of each audit firm, describes its legal form, the names and business addresses of owner and shareholders, as well as of members of the administrative or management body, and the names of Authorized

Auditors employed by the firm. The Entities' Ministries of Finance have established the necessary processes to update the information in a timely manner. In addition to the public register, the Ministries of Finance maintain registers of licensed individual authorized auditors. The Ministries of Finance renew licenses on the basis of the completion of the Continuous Professional Development (CPD) program.

45. Both Entities A&A Laws require that audit firms have professional liability insurance. An auditing company must insure itself against the risks for damages caused by an incorrect audit opinion. The minimum insured amount per event should be KM50,000 and, for clients such as banks, leasing companies, investment and pensions funds and insurance companies, that amount must be at least KM500,000. The ROSC team is not aware of any instances where a payment of such an amount was made to an audit client by an insurance company on behalf of an audit firm.

46. As mentioned above, the Framework Law does not deal with quality assurance, public oversight and investigation and discipline. All these areas are covered in the recently adopted Entities' A&A Laws, although the provisions in those areas for the two Entities differ significantly. The scope of the Framework Law is indicative of the consensus that was built at the time between the two Entities' Governments and professional bodies.

47. The Entities' Banking Agencies require banks to prepare financial statements based on both IFRS and their prudential regulations and then to have them audited. The double requirement to adhere to both IFRS and prudential regulations has produced bank financial statements that are not in compliance with IFRS. Banks also have the obligation to publish abridged financial statements, including the audit opinion. It can be misleading to publish the audit opinion on the full financial statements with abridged financial statements that are, by nature, incomplete financial statements. When abridged financial statements are published, it should be indicated that the version published is abridged and reference should be made to the registry in which the full financial statements have been filed. The audit report on the full financial statements should not be attached to the abridged financial statements, but it should be disclosed whether an unqualified, qualified or adverse audit opinion was expressed, or whether the auditors were unable to express an audit opinion. It should also be disclosed whether the audit report included a reference to any matters to which the auditors drew attention by way of emphasis without qualifying the audit opinion. The Entities' Bank Supervisory Agencies need to approve audit firms before they can be appointed as statutory auditors for banks.

48. The Entities' Insurance Supervisory Agencies require monthly, quarterly and annual regulatory reporting in addition to the filing of financial statements. Financial statements are required to be filed together with the statutory audit report by end of April. Consolidated financial statements are required in September. The RS Insurance Agency approves the appointment of the statutory auditor of insurance companies. The FBH Agency does not.

49. Specifics of the FBH and RS Statutory Framework are dealt in the sections below.

A.1 The Statutory Framework in FBH

50. The 2009 FBH Accounting and Auditing Law implements the State Framework Law together with other provisions. In fact, several of the FBH A&A Law provisions repeat provisions in the State Framework Law to give them the force of law at the Entity level. The FBH A&A Law is divided into eight chapters and 77 articles: (i) Basic Provisions, (ii) Professional Titles and Qualifications, (iii) Accounting and Bookkeeping Systems, (iv) Financial Reporting, (v) Auditing of Financial Statements, (vi) Supervision of the Quality of the Work of Auditors, (vii) Penalties, (viii) Transitional and Final Provisions.

51. The new FBH A&A Law established a Public Oversight Board (POB) and an Audit, which is actually a Chamber of Audit Firms. The law mandates that the POB's responsibilities be implemented in 2010. In line with the provisions of the Statutory Audit Directive, it will have ultimate responsibility for: (i) the licensing of auditors and audit firms, (ii) the adoption of auditing standards, (iii) ethics standards and internal quality control standards, (iv) continuous education, (v) quality assurance and the investigative and disciplinary system. It should be noted that the Framework Law and the FBH Law have already adopted the auditing and ethics standards, hence the role of the POB will be to enforce those standards. To that end, it will have to supervise and build investigation and disciplinary mechanisms.

52. The Audit Chamber is a creation of the 2009 FBH A&A Law and was to be established by June 30, 2010. It was given the role of establishing a methodology for implementing a Quality Assurance Review program for Statutory Audit Firms and Statutory Auditors, monitoring and checking the work of audit firms and proposing measures to improve audit quality to the FBH MoF, including a scheme for the investigation and discipline of statutory auditors and audit firms. Its role also extends to the development of audit methodologies for audit firms, including standard forms for working papers, and the promulgation of a Code of Ethics. A total of 65 Audit Firms agreed on the Statute of the Audit Chamber and submitted it to the MoF for approval. Membership fees will fund the Audit Chamber. According to the law, the Audit Chamber needed to be established before June 30, 2010, with operational guidelines developed before the end of June 2011. It will have to give the MoF an update on its activities every six months. However, the law does not specify when the POB should be in place.

53. Audit firms have an important role to play in sharing their knowledge and tools in a community of largely small and medium practices. But it may not be wise to give them statutory responsibility for effectively policing themselves. This would not lead to improvements in either audit quality, or even in the perception of audit quality, and could well reduce public confidence in the audit function. Therefore, the timely implementation of the POB, as established by the FBH A&A Law, will be essential. The MoF should clarify the statute, function, role and responsibilities of the Audit Chamber prior to enabling its operation through an Administrative Instruction. That would help to achieve its goal of mandating the establishment of an effective FBH system of quality assurance for statutory audits within a framework that is consistent with the principles of the Statutory Audit Directive and the EC Recommendation on Quality Assurance for the audit of financial statements of public interest entities.

54. The new FBH A&A Law calls for the establishment of a Public Oversight Board (POB). The POB will be appointed by the Government of the Federation of Bosnia and Herzegovina on proposal of the Minister of Finance; there is no defined mechanism for regulators to propose candidates. POB members will not need to be professional auditors but must be knowledgeable in accounting and auditing. The POB will be ultimately responsible for overseeing the registration of audit firms, the adoption of standards and professional ethics, internal quality control, implementation of continuous professional education requirements, quality assurance and discipline.

55. The effectiveness of the POB will also depend on its ability to influence the quality assurance system that will be implemented by Audit Chamber, and its direct involvement in the review of statutory audits for public-interest companies. The POB will require considerable technical assistance over several years to become effective and to be able to reassure the public about the reliability of the audit function. Until now, there was no quality assurance mechanism reviewing the work of statutory auditors, even for public-interest entities. The SRRF-FBH had established a committee on quality in 2007, but it was never made operational. It will be essential for the POB to communicate its findings to the BH A&A Commission so that this body can use POB findings to design the CPD programs that will enhance the capacity of the profession.

56. The new FBH A&A Law contains provisions governing conflicts of interest. It does not use directly the threats and safeguards approach of the EC Recommendation for the Independence of the Statutory Auditor but establishes a list of conflict of interest situations under which auditors cannot perform an audit. An audit firm or an auditor cannot perform an audit of a company when (i) they own shares of the company, (ii) when they have prepared the financial statements or assist the enterprise in their bookkeeping, (iii) if the company is affiliated with the audit firm and that may raise independence issues, (iv) when an auditor, his/her spouse or kin related up to the second degree, is a member of the supervisory board, the management or an employee of the company and (v) any other situation that could lead to a perceived conflict of interest. The ROSC team considers that approach as complementary with the threats and safeguards approach adopted by the Framework Law from the Code of Ethics issued by the IESBA.

A.2 The Statutory Framework in the RS

57. The 2009 RS Accounting and Auditing Law implements the State Framework Law together with other provisions. The law is divided into nine chapters and 58 articles: (i) Basic Provisions, (ii) Bookkeeping and Accounting Systems, (iii) Financial Reporting, (iv) the Accounting and Auditing Council of the RS, (v) The Audit of Financial Statements, (vi) Supervision, (vii) Titles, Testing, Certification and Licensing, (viii) Provisions for Penalties, and (ix) Transitional and Final Provisions.

58. The 2009 RS A&A Law's monitoring and enforcement mechanism represents the main difference between the two Entities' sets of A&A Laws. Because the RS has chosen not to create new bodies to take on the external quality assurance role for the accountancy profession in its Entity, there is no Chamber of Auditors. The monitoring of the quality of the work of accounting and audit firms will be performed by the accounting and auditing department in the MoF, advised by the RS A&A Council.

59. Two levels of external quality assurance are being established in the RS: one, under the MoF, will review the quality of the work performed by audit firms; the other, in the Association of Accountants, Auditors of RS (RS-AAA), will review the quality of the work of its members. For the time, these are only individuals. While, some of these individuals are involved in audit work, they do not perform statutory audit services per se, as statutory audits can only be contracted with audit firms. It should be noted, however, that the external quality assurance system described by the Statutory Audit Directive applies to audit firms and auditors who sign audit opinions.

60. The RS A&A Law allocated the responsibility for quality assurance and public oversight systems to the MoF. The MoF is, therefore, ultimately responsible for overseeing: (i) the licensing of auditors and audit firms, (ii) implementation of internal quality control standards, (iii) implementation of continuous education, (iv) external quality assurance and the investigative and disciplinary system. As ISA and ethics standards are set by the Framework Law, the MoF does not have responsibility for adopting them, but it is charged with enforcing them. In carrying out the public oversight responsibility, the MoF will be advised by RS A&A Council, which also carries responsibility for setting criteria for determining audit fees. The MoF has established a unit responsible for external quality assurance that will review the quality of the work of audit firms, as well as the work of accounting firms. It has established guidelines for public oversight (methodology) and a review plan for 2010 under which 7 auditing firms were reviewed. The unit is currently staffed with three persons. The quality assurance of licensed auditors will reside with the RS-AAA. It should be also noted that the requirements of the Statutory Audit Directive do not cover the accounting profession.

61. The RS A&A Law established the RS A&A Council and the MoF appointed the members of that council. The RS A&A Council reports to the Minister of Finance. Its role is *inter alia* to cooperate with the BiH A&A Commission, local and foreign institutions involved in accounting and auditing education and domestic or foreign professional bodies; to monitor the application of IFRS and ISAs; to establish criteria for determining audit service fees; to monitor the process of the application of EU Directives in the areas of accounting and auditing and to propose implementation strategies suitable for the RS; and to participate in the preparation of strategy and development of an action plan for improving the quality of financial reporting in the RS. Members of the A&A council are representatives of the MoF, professional bodies and university professors and can be extended to other people who may contribute with their theoretical and practical experience to the work of the Council.

62. As of end 2010, the Accounting and Auditing Council had already met several times. The objective of the second meeting was to discuss the methodology for implementing the public oversight system and the 2010 external quality assurance review plan. The MoF is now responsible for overseeing the work of audit firms, each audit firm to be reviewed once in every five years. This is not aligned with the Statutory Audit Directive that requires the work of audit firms auditing public interest entities to be reviewed every three years and the work of all other audit firms every six years.

63. The RS MoF issued an order allowing the use of IFRS for SMEs in 2011. The RS A&A Council recognizes the importance of IFRS for SMEs and has advised that non-publicly accountable entities would find it much easier and simpler to apply this standard, significantly improving the cost-benefit balance of their adoption.

B. The Accounting and Auditing Profession

64. The accounting and auditing profession is represented at the State level by the BH A&A Commission, which has provided a mechanism for co-operation among the Entities' professional bodies. This Commission has already made a positive contribution to the development of a Bosnia and Herzegovina-wide, unified framework for the education, training and continuing professional development requirements for accountants and auditors. The Union of Accountants and Auditors and Financial Workers of FBH (SRRF-FBH) and the RS-AAA – the only professional bodies that enjoyed statutory recognition until the end of 2009 – are the founding members of the Commission. Since January 2010, another professional body has gained statutory recognition in FBH, the Association of Auditors. In November 2010, the RS-AAA was admitted to the International Federation of Accountants (IFAC) as full member, and the SRRF-FBH was admitted as associate member.

65. The BH's statutory recognition of the Association of Auditors poses a challenge for the BH A&A Commission. The BH A&A Commission's statute provides for the future inclusion of other professional bodies, provided they achieve at least Associate IFAC membership. The designation of the FBH's Association of Auditors as a professional association under the 2009 FBH A&A Law may require a change to Commission's statute to facilitate the representation of this Association within the Board of the Commission as the Association is not a member of IFAC. If the Association of Auditors does not cooperate with the Commission, that could threaten the unified framework for education. Statutory recognition of a professional body gives it the right to run its own education and CDP programs and to issue legally recognized professional qualifications, including those permitting their holders to be licensed to carry out statutory audits.

66. The BH A&A Commission has partially succeeded in promoting a harmonized approach among the professional bodies in Bosnia and Herzegovina to executing their roles under the respective Entity A&A Laws passed since 2005. Entities' MoF, academia and the professional associations have expressed satisfaction with the extent of co-operation, collaboration and agreement achieved by the Commission among the previously divided profession. Although the Commission has succeeded thus far in its mandate to develop and administer a Bosnia and Herzegovina-wide uniform approach to the qualification requirements, examinations and continuing professional development (CPD) for accounting and audit professionals, it has not as yet addressed its role in monitoring the implementation of professional standards (including IFRS, ISA and the Code of Ethics), nor has it adequately addressed the issue of ensuring the availability of updated translations of international standards, through translation and adoption agreements with the relevant global standard setters. It has preferred to delegate these functions back to its constituent professional bodies.

67. Though the BH Commission has a vital role in providing a single voice for the accounting and auditing profession in Bosnia and Herzegovina, and a mechanism for enabling the profession to implement common requirements and programs for entry to the profession that has facilitated mutual recognition of qualifications within Bosnia and Herzegovina, it is neither a professional accounting body in its own right, nor a standard setter. It is significant that the Commission has dropped the reference to its standard setting role in its annual reports. While the Commission has a potentially significant role in negotiating translation agreements for international standards, the adoption of agreements for translation of international standards remains an Entity-level competence.

68. Since 2005, the BH A&A Commission has emerged as a consultative committee that represents the various professional accounting and auditing bodies within Bosnia and Herzegovina, and plays well its role in maintaining a unified framework for the initial education, training and continuing professional development requirements. In the absence of the Commission's participation in any external quality assurance mechanism for compliance with IFRS, ISA and the Code of Ethics, this task will be now closely monitored by the Entities' Governments. The only chance for the profession to remain involved in monitoring the application of standards is to proactively collaborate with the Entities Governments on external quality assurance issues and their resolution. As noted above, the external quality assurance will be monitored by the POB and the MoF in FBH and directly by the MoF in RS. The RS MoF will also be directly responsible for public oversight.

69. The Framework Law established a system of recognition of foreign qualifications. The BH A&A Commission is empowered to certify a person qualified in another jurisdiction if that person can demonstrate that he or she not only meets the IFAC education requirements in the country of qualification, but also has the education, experience and knowledge of Bosnia and Herzegovina's taxation and legal system in accordance with the country's curricula for professional accountants and auditors. For their part, however, the Entities' professional bodies – to which the Commission has delegated the certification process – recognize foreign qualifications only on the basis of a mutual recognition process. While this process works well with neighbor countries (e.g., Montenegro, Serbia, Croatia), Bosnian citizens who have undertaken the professional programs and examinations of some foreign professional bodies, notably the Association of Chartered Certified Accountants (ACCA), do not have their qualification recognized in Bosnia and Herzegovina. They are not granted exemptions from the professional examinations that are described under Paragraph 82 other than those obtained because of their academic education.

B.1 The profession in FBH

70. The 2009 FBH Law on Accounting and Auditing provides statutory recognition for two professional accounting and auditing bodies: the FBH Association of Accountants, Auditors and Financial Workers (SRRF-FBH), which is a union of three associations which agreed to come together under the umbrella of SRRF-FBH in 2003. There is also the Association of Auditors of the FBH, formed in 2003, for auditors licensed by the former Institute of Accountants and Auditors, which was abolished by the 2005 FBH Entity Law on Accounting. Many, if not the majority of this association's members are understood to be also members of SRRF-FBH.

71. The term “statutory recognition” in the context of both the 2005 and 2009 FBH A&A Entity Laws refers to the authority granted to the prescribed professional bodies to provide initial and continuing professional accounting and auditing education for persons wishing to engage in activities regulated under the law. These professional bodies are the only ones permitted to administer professional education. The BH A&A Commission selects CPD providers. The titles “Certified Accountant” and “Authorized Auditor” are legally protected by FBH, and only persons who have been admitted as members of the recognized professional bodies are permitted to use these titles. In addition, the MoF will consider applications for audit licenses only from members of the professional bodies who have completed their professional education, examinations, and professional experience and CPD requirements, as established by the BH A&A Commission.

72. The SRRF-FBH represents a union of three former professional associations in FBH, none of which enjoyed statutory recognition prior to 2004. 4921 Certified Accountants were members of the SRRF-FBH in 2009, including 497 Authorized auditors; an additional 141 certified accountants' technicians were also members of the SRRF-FBH. The three bodies were the association of accountants and financial workers employed in the FBH public sector (JAFIS) and two associations of accountants and auditors, each largely representing ethnic Croat and Bosnian professionals within FBH. The Statute and Governance of SRRF-FBH designates equal representation of these still-registered associations. Since gaining statutory recognition in the 2005 FBH Entity Law on Accounting and Auditing, SRRF-FBH has participated in the governance of the BH A&A Commission, and has operated the Commission's uniform professional education program, including establishing the requirements for CPD in FBH. The SRRF-FBH is represented on the BH A&A Commission and has indicated to the ROSC team its intent to request an Associate membership of the International Federation of Accountants.

73. The SRRF-FBH has not yet developed the full range of operations of a mature professional body and will need to build strict control systems over the activities that it delegates to other entities. The SRRF-FBH has mainly focused on the administrative part of the processes for professional qualification and licensing for accountants. It has recently initiated cooperation with Croatia for the translation of IFRS, ISA and the Code of Ethics, which were not updated for several years and, as a result, published an updated version of IFRS in May 2010. It contracts out the delivery of professional education and CPD. Although it created committees responsible for the implementation of systems of external quality assurance and investigation and discipline, those committees were never made operational. The SRRF-FBH has been admitted to IFAC in November 2010 as an associate member.

74. The 2009 FBH A&A Law gave the Association of Auditors of FBH statutory recognition. All Authorized Auditors are members of the SRRF-FBH although some are also members of the Association of Auditors. While competition in the provision of educational and CPD offerings for accountants and auditors expands choice and may improve the quality of materials, the ROSC team would like to stress the importance of a unified approach to the

establishment, implementation and enforcement of standards for the profession throughout Bosnia and Herzegovina.

B.2 The profession in RS

75. The RS Association of Accountants and Auditors (RS-AAA) enjoys statutory recognition as a professional accounting and auditing body under the RS Entity Laws on Accounting and Auditing (2005 and 2009). Established in 1996 to provide a professional membership organization for persons qualified under the former Yugoslav system, the RS-AAA was admitted as full member of IFAC in November 2010 and has been an observer member of the *Fédération des Experts Comptables Méditerranéens* (FCM) since 2009.

76. The RS-AAA has a total of 5,191 voting members (179 Authorized Auditors and 2512 Certified Accountants, 2500 Certified Accounting Technicians). In addition, the Association has 881 non-voting members that are students. The MoF is responsible for issuing licenses to individual auditors and audit firms, and anyone who applies for a license to engage in statutory audit work must provide evidence that they have completed the RS-AAA's professional education, examination, experience and CPD requirements and remain members in good standing of the Association. The Ministry issues renewable licenses to authorized auditors for three years as long as they have an RS-AAA document stating that they have complied with continuing professional education requirements.

77. The RS-AAA is represented on the BH A&A Commission. It operates the Commission's uniform professional accounting and auditing education and examination program that leads to the Bosnia and Herzegovina-wide legally protected titles of "Certified Accounting Technician", "Certified Accountant" and "Authorized Auditor".

78. The RS-AAA participates in the process for translating IFRS into Serbian, led by the Association of Accountants of Serbia, by being part of the review group that monitors the translation process. It offers its members regular updates on IFRS.

79. Since the establishment of the BH A&A Commission in 2004, the RS-AAA has participated in its activities. It does this by giving leadership and technical assistance to the Commission under a rotating agreement, and also makes financial contributions together with the SRRF-FBH. Because it had already developed a CPD program, the BH A&A Commission gave the RS-AAA the responsibility of providing the first CPD program in 2006 in RS.

80. On April 28, 2010, the Steering Board of the RS-AAA adopted a regulation on quality control of its members. RS-AAA members are physical persons, not accounting or audit firms. Although it may help in improving audit quality, this external quality assurance system is not aimed at audit firms. Therefore, it cannot implement effectively the provisions of the Statutory Audit Directive. The regulation's objective is to determine whether RS-AAA members perform their accounting and auditing using ISA, IFRS and IAS, as well as adhere to the Code of Ethics. Quality will be monitored by the ad hoc Committee for the Monitoring of the Application of Accounting and Auditing Regulations (the RS External Quality Assurance Committee). This committee will comprise five members who are not engaged in professional audit activities; committee members will either be non-practitioners knowledgeable in accounting and auditing or Authorized Auditors who have not been active for at least three years.

81. The RS-AAA External Quality Assurance Committee will (i) define the standards for external quality assurance, (ii) plan a external quality assurance program, (iii) assist its members in developing a good understanding of the goals of quality assurance and in implementing and maintaining an appropriate quality system. In preparing the quality assurance

system, the Commission will look to the EU Statutory Audit Directive and the recommendations of the EU Commission.

C. Professional Education and Training

82. The State Framework Law establishes professional education requirements for three categories of accounting practitioners: Certified Accounting Technician (CAT), Certified Accountant (CA) and Authorized Auditor (AA). All candidates for these titles are required to complete a course of theoretical instruction as set out in the Bosnia and Herzegovina uniform professional accounting and auditing education program. They must also complete the uniform certification examinations developed by the BH A&A Commission and administered throughout Bosnia and Herzegovina by the Entities' professional accounting and auditing associations that have statutory recognition for this purpose under the respective Entity laws on accounting and auditing. The SRRF-FBH annually tenders out to potential suppliers the delivery of the CDP and the administration of the exams. The qualification structure comprises three progressive levels, with a total of 14 courses and examinations.¹³

83. Certified Accounting Technicians are required to complete the courses and pass examinations in subjects 1 to 4 (see footnote 15). Certified Accountants must complete courses 1 to 4 (or be awarded exemptions from one or more of them if they have prior qualifications, such as a university degree for a course covering this content) and complete the courses and professional examinations for 5 to 9 inclusive. In addition to the requirements for Certified Accountant, candidates for Authorized Auditor are required to complete the examinations for 10 to 14 inclusive.

84. In addition, the Commission has established requirements for professional experience for each of the above titles. These exceed the minimum number of years established by the IES - 5 Practical Experience requirements, as well as the minimum number of years set by the Statutory Audit Directive for Authorized Auditors.

85. The State Framework Law requires Certified Accountants, Authorized Auditors, and Certified Accounting Technicians to complete a minimum of 120 hours of CPD over a three-year period. This requirement was established by the BH A&A Commission, which has developed a scheme for the recognition of approved CPD providers. The CPD requirement is enforced by the professional associations at the Entity level. In practice, CPD requirements have been monitored annually by the professional bodies, which require members to complete 40 CPD hours each year.

86. Though the BH A&A Commission and the professional bodies mandate CPD for professional accountants and statutory auditors, the current approach does not take into full account of the needs of professionals. The system of CPD seems to be mostly input-based and supply-driven, with compliance achieved through mandatory attendance at CPD courses organized by approved providers (that includes the professional bodies). There is no formal recognition of in-house courses provided to Certified Accountants and Authorized Auditors by, for example, the larger audit firms. The BH A&A Commission and professional bodies should develop a system for assessing the CPD needs of the professional accounting community, encouraging the provision of courses that provide opportunities for accountants and auditors to update their knowledge of the latest IAASB, IASB, IESBA standards and pronouncements, along

¹³ 1-Introduction to Financial Accounting; 2-Cost and Management Accounting; 3- Management and Communications; 4- Information Technologies and Applications; 5- Commercial Law and Taxation; 6- Management Accounting Applications; 7-Financial Reporting; 8- Auditing and Internal Controls; 9-Financial Management Applications; 10-Advanced Management Accounting; 11-Advanced Auditing; 12-Advanced Financial Reporting; 13-Advanced Financial Management; 14-Strategic Management.

with those of other relevant standard setters, and developments within the *acquis communautaire*.

87. The BH A&A Commission prescribes the content of the Bosnia and Herzegovina professional accounting and auditing education program. Though the curriculum is broadly in compliance with International Education Standards (IES-2, Content of Professional Accounting Education Programs, and IES-8, Competence Requirements for Audit Professionals) and the EU Statutory Directive, it has not kept fully abreast of developments in ISAs, IFRS and the ethical requirements that have been updated substantially since the Bosnia and Herzegovina curriculum was adopted in 2005. The BH A&A Commission should update the education syllabus to fully align the required content of the country's professional accounting and auditing education program with the requirements of IES-8 and the Statutory Audit Directive, which was last updated in 2006. Particular areas of possible improvement include the specific identification of the IFRS requirements and learning outcomes in the subjects of Financial Accounting, Financial Reporting and Advanced Financial Reporting, with specific reference to the knowledge levels required. A similar approach is also recommended for Audit and Internal Control and Advanced Auditing, considering *clarified* ISAs.

88. The educational and teaching resources to support the effective implementation of Bosnia and Herzegovina's curriculum and examination system for professional accountants are becoming increasingly outdated. In assessing the quality of professional accounting and auditing education, the ROSC team examined the textbooks prescribed by the Commission for both candidates and tutors for each of the subjects within the curriculum. It was noted that the Commission attempts to address the growing obsolescence of the textbooks covering subjects that require frequent updates by adding further textbooks to the recommended reading list, generally publications by university professors and tutors. The Commission may wish to explore the possibility of negotiating the rights to obtain and translate updated educational materials, especially in financial reporting and auditing subjects, with international providers of educational materials and teaching resources. A significant effort was made between 2002 and 2005 to provide updated textbooks to all universities in RS and FBH. Neither the universities nor the profession have sustained that effort since.

89. The Bosnia and Herzegovina uniform examinations for professional accountants and auditors are set by the BH A&A Commission and administered by the Entities' recognized professional bodies in May and November of each year. This is an improvement on the situation reported in the 2004 ROSC report, and the Commission's use of the IAESB's Examination Administration guidance has provided a useful framework for the effective administration of the professional examinations throughout Bosnia and Herzegovina. The ROSC team has noted that the structure of the examination papers has evolved with the use of multiple choice examination questions together with cases studies and dissertations. A future review of the syllabus and supporting educational materials will also incorporate a review of the structure of the examinations, to ensure that the principles of IES-3, Professional Skills and General Education, IES-4, Professional Values, Ethics and Attitudes, and IES-6, Assessment of Professional Capabilities and Competence, are adequately addressed by the professional accounting and education program. This review should be performed by the BH A&A Commission.

90. The practical experience requirements for Certified Accountants and Authorized Auditors are an essential element of the professional accounting and auditing education program. Commission involvement in this area is restricted to setting quantitative guidance, with the Entities' professional accounting and auditing associations actually implementing that guidance. The Statutory Audit Directive sets explicit requirements designed to ensure that statutory auditors are progressively trained to achieve the minimum competence requirements for performing statutory audit functions. The professional accounting bodies' requirements fall short of meeting all of the requirements of IAESB's IES-5 Practical Experience Requirements and

IES-8 Competence Requirements for Audit Professionals. A system of approved training practices for statutory auditors, with qualitative training targets, should be established for trainees, with the professional bodies providing effective and continual monitoring of their implementation. The current systems in place do not guarantee that auditors obtain relevant practical experience during their training.

C.1 Professional Accounting and Auditing Education in FBH

91. Leading universities in FBH, including the University of Sarajevo and the University of West Mostar, have made some progress in integrating accounting and auditing in their syllabi in a tightly resourced environment. For example, the University of Sarajevo's Faculty of Economics has made further progress in the integration of accounting, financial management and auditing education in its undergraduate and postgraduate programs. The accounting and auditing department, however, includes only one professor, two associate professors and three teaching assistants for a rapidly growing number of students. In addition to a Bachelor program, the University of Sarajevo offers a Master in Accounting and enjoys several cooperation agreements in Europe and in neighboring countries. The Master program is offered through a cooperation agreement with the post-graduate accounting and auditing degree program of the University of Economics of Zagreb. The University of West Mostar also has a cooperation agreement with the University of Zagreb. Other universities in FBH have made less progress and have not been equally supported by development financing.

92. Through training providers accredited by the A&A Commission, professors from other Universities of FBH, such as the University of Mostar, have become increasingly involved in the delivery of professional accounting education and CPD programs. This development strengthens the essential linkages between the professional bodies and university sectors. It also improves the climate for adopting curriculum reforms within the university sector that will equip future graduates with the accounting and auditing knowledge and skills required to improve the quality of financial reporting and auditing in FBH.

93. The SRRF-FBH contracts out its education program to prepare applicants to take the accounting certification exams. The program is not mandatory. The delivery of courses and examinations have been tendered and awarded to a consortium of private providers and the University of Sarajevo. This university, in addition to the courses it can provide, brings its capacity to organize exams.

94. The SRRF-FBH also contracts out its CPD programs through a tender process. The SRRF-FBH tenders annually CPD programs to consortiums of several private providers across FBH. As mentioned above, CPD providers need to be accredited by the BH A&A Commission. Six private companies provide training courses in addition to the Faculty of Economics of Sarajevo. Although the ROSC due diligence missions obtained only limited feedback on CPD, the training courses were said to be useful, albeit mostly limited to accounting. In addition, feedback suggested that CPD requirements are not always strictly enforced, as some interviewees indicated that it was not necessary to attend courses to have the benefit of CPD. Simply registering and paying for the courses would suffice. Also, CPD programs provided by individual audit firms are not recognized, although the firms remain eligible to apply as CPD providers. In doing so, they need to accept other participants to the training courses in addition to their staff.

95. The perceived flexibility of the FBH CPD system is an issue as some CPD participants could view it as a lack of quality. The CPD processes should be strengthened and the BH A&A Commission and the SRRF-FBH should create mechanisms to verify attendance of CPD participants and to closely monitor the quality of CPD delivery. Although such a system of

monitoring is not required under IES-7, it is essential if the FBH POB is to be in compliance with the Statutory Audit Directive.

C.2 Professional Education in the RS

96. Unlike the SRRF-BH, the RS-AAA runs the BH A&A Commission's uniform professional accounting and auditing education and examination system by itself. The RS-AAA is the designated competent authority in the RS Entity Law for the implementation of the system for attaining the recognized qualifications of Certified Accounting Technician, Certified Accountant and Authorized Auditor. It is a well-resourced and organized professional body that has very much focused, so far, on professional education and training.

97. Since 2004, mandatory CPD requirement set by the BH A&A Commission has been implemented in the RS. CPD courses are offered only by the RS-AAA. Most of the CPD sessions are offered during (i) the annual congress of the RS-AAA and (ii) semi-annual CPD seminars. Compliance with CPD requirements is monitored using a points system that takes into account the participation in the congress and the seminars and attendance at individual events.

98. The University of Banja Luka and the University of East Sarajevo have incorporated a number of the Bosnia and Herzegovina professional accounting and auditing education courses into their curricula. University students study the same educational materials as those prescribed by the BH A&A Commission in Financial Accounting, Auditing and Internal Controls, Cost and Management Accounting and Financial Management courses. The University sector is represented on RS-AAA education and examination committees. It has several professors teaching accounting and auditing, some of them serving on the RS-AAA Education Board. There are only two universities in RS, but these work closely together, resulting in better use of academic professionals.

D. Setting Accounting and Auditing Standards

99. The BH 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. The 2009 A&A Law for FBH introduced the IFRS for SMEs as possible accounting standard for that sector, and the RS MoF will follow the same route in 2011. Both Entities will, however, need to clarify which enterprises will be allowed to use these standards to prepare their annual and consolidated financial statements. Those provisions should be aligned to contribute to the single economic space in Bosnia and Herzegovina. The use of IFRS for SMEs for preparing the financial statements of non-public interest entities would alleviate the administrative burden on these and enhance the quality of their financial reporting.

100. The translation of IFRS and ISA remains an issue. As noted previously, the Entities have languages that share similarities but are written in a different alphabet; in total, three official languages coexist in Bosnia. The BH A&A Commission is responsible for the translation and publication of IFRS and ISA. In 2006, the commission delegated that responsibility to the professional bodies at the Entity level, namely the RS-AAA for RS and the SRRF-FBH for FBH.¹⁴ Subsequently, the SRRF-FBH and the RS-AAA, respectively, published translations of IFRS in 2006, based on the standards as at the end of 2004. The SRRF-FBH has published an update of the standards in May 2010. In the RS, since 2005, auditors may use the handbook made available by the Serbian Association of Accountants that holds translation agreements with IFAC and the IFRS Foundation. The IFRS Foundation and IFAC allow only one translation per language for IFRS, ISA and the Code of Ethics.

¹⁴ This decision of the A&A Commission was published in the official gazette under the no. 81/06.

101. While RS accountants have access to IFRS and ISA translated into Serbian and published by the Association of Accountants in Serbia, FBH accountants did not have access to Croatian translations until very recently. RS-AAA members are part of the review committee that ensures the quality of the Serbian translation, this review committee being part of the quality mechanism requested by the IFRS foundation. The MoF of Croatia, which is responsible for the translation of IFRS in Croatia, has offered to share its translations with SRRF-FBH. Similar cooperation is foreseen on ISA translations.

102. The translation mechanisms will, however, need to be strengthened to ensure the continuing and timely availability of translations for all accountants and auditors. To achieve this, cooperation by various Government bodies and associations of countries sharing the same languages is needed both on technical and financial fronts. A stable and well-resourced translation process is essential.

E. Enforcing Accounting and Auditing Standards

103. The monitoring and enforcement mechanisms exist only at the Entity level and are performed by Entity-level financial supervisory authorities. Further, the BH A&A Commission, which is required by the Framework Law to monitor the application of accounting and auditing standards, delegated that role to the professional bodies, hence pushing the monitoring mechanism back to the Entity level. Because the monitoring of the application of IFRS and ISA has never been enforced by professional bodies, the Entities' Governments decided to take leadership in establishing quality assurance and public oversight systems through the Entities A&A Laws (applicable starting January 1, 2010), as well as in converging the accounting and auditing framework with the requirements of the relevant portion of the *acquis communautaire*.

104. The FBH Securities Commission and the RS Securities Commission should implement the principles-based standards issued by the European Securities and Markets Authority, with a view to contributing to a consistent application of IFRS across Bosnia and Herzegovina.

E.1 Enforcing Accounting and Auditing Standards in FBH

105. The FBH Securities Commission does not monitor the quality of financial statements of listed entities. Financial statements are scrutinized only in public filings, i.e., when the number of shares is increased or decreased based on the report of an independent auditor. The FBH SEC has neither the resources, nor the capacity, to monitor financial statements of all listed companies. It does not, however, monitor the financial statements of the three companies listed on the official segment of the stock exchange either. The commission does monitor the activities of brokers, as well as the activities of a number of investment funds with closed or open capital, for which it performs compliance reviews. The FBH SEC has only four professional staff members for supervising all entities.

106. The FBH Banking Supervisory Agency supervision mainly serves regulatory purposes. It relies on the statutory auditors' work for the review and the compliance of bank financial statements and has set minimum requirements for auditors' reports. The financial statements are to be prepared based on IFRS and then modified to comply with the rules of the FBH Banking Supervisory Agency requiring general loans and regulatory impairment policy provisions for loans and other assets. As a result, auditors audit financial statements that are not prepared under IFRS and are, in fact contradictory to the FBH A&A Law. Should the auditors' report identify any items that do not comply with the laws, the Banking Supervisory Agency can take corrective actions. Audited bank financial statements have to be filed with the FBH Banking Supervisory Agency within six months of the end of the fiscal year.

107. The FBH Insurance Supervisory Agency does not verify the calculation of technical provisions of insurance companies; it relies on company actuaries to do that or to review insurance company financial statements to ensure their compliance with IFRS. The Agency's off-site and on-site inspections are mostly to review compliance with specific regulatory requirements. All insurance companies must hire a least one actuary licensed by the FBH Insurance Supervisory Agency. The licensing is based on obtaining an actuarial degree after a two-year course at the University of Sarajevo. Actuaries file reports with the Agency on the calculation of technical and mathematical provisions and other insurance reserves. The FBH Insurance Supervisory Agency cannot, however, impose any financial sanctions on a contravening company or its management. The most comprehensive report is provided to the FBH Insurance Supervisory Agency by the end of April for the previous year, and in the second half of the year for consolidated financial statements.

E.2 Enforcing Accounting and Auditing Standards in RS

108. The RS Securities Exchange Commission has an ad hoc approach to enforcing financial reporting requirements for listed entities. Reviews of the financial statements of companies listed on the RS stock exchange are carried out only when capital has been modified, much like in FBH. Therefore, the RS SEC reviews financial statements only infrequently, which does not allow for effective monitoring procedures. The Commission's resources do not seem to be appropriate, given the number of entities to be reviewed. The SEC's human and financial resources should be enhanced, and the focus of their work for listed entities should be on the official segment of the BLSE, which includes 23 companies, or on the active part of the "free" market.

109. Until 2010, the RS Banking Supervisory Agency supervision mainly serves regulatory purposes. Starting 2010, however, it will need to enforce the use of IFRS, as an instruction of the MoF now requires financial institutions to implement both regulatory/prudential requirements and IFRS financial statements. The RS Banking Supervision Agency wants institutions to show the additional reserves required for the calculation of regulatory capital in equity. Although staff already has some knowledge of IFRS, the capacity of the off-site and on-site supervision teams will need to be strengthened in this area.

110. The Insurance Supervisory Agency was created in 2006 and does not yet have structured processes for reviewing financial statements prepared by insurance companies. While it has recently made some quality additions to its team of financial reporting supervisors, it lacks procedures for selecting insurance companies to be reviewed and a supervision manual for a consistent approach to supervision. The regulatory supervision team includes actuaries, who carry a university degree diploma with a master specialization.

III. ACCOUNTING STANDARDS AS DESIGNED AND AS PRACTICED

A. Introduction

111. Because the BH Framework Law establishes IFRS, as issued by the IASB, to be the only accounting standards applied in Bosnia and Herzegovina, there was no standards gap to be assessed. This requirement dates back to 2004, but the lack of updated translations of IFRS, combined with the BH's lack of capacity to apply IFRS, means there is little financial statement compliance with IFRS. Each company seems to have its own understanding of the date of the standards which should be used, which also contributes to the lack of IFRS compliance. The compliance gap was assessed in both Entities, by reviewing 13 FBH financial statements and 11 RS financial statements. The assessment of compliance with IFRS was complicated by the extensive use of standard wording in accounting policies and other key disclosures. Much of the text seemed to be drawn from model financial statements made available by audit firms.

112. Few financial statements included disclosures of accounting policies and key assumptions and estimates that dealt adequately with the transactions and circumstances of the entities concerned and were tailored to the business of the enterprise involved. The tailoring of accounting policies, along with disclosures of key assumptions and estimates, helps the reader to better understand how an enterprise's activities influence its performance and financial position.

113. Due to the relatively small sample size, the outcome of the compliance assessment cannot be considered representative for Bosnia and Herzegovina companies. Hence, the findings, although useful for indicating potential systemic problems in financial reporting, will pertain only to the shortcomings found in the financial statements of the companies concerned. The assessment does, however, give a flavor of the general lack of financial statement compliance with IFRS for companies considered to be of public interest. A further review of six SMEs financial statements in the financial statements registry shows an even weaker picture of compliance with IFRS, with some statements required under IFRS totally absent and a level of disclosure far below requirements. Further, the forms used for the financial statements were not harmonized between the two Entities.

B. The Compliance Gap in FBH

114. To assess the compliance gap for financial statements prepared under IFRS in FBH, 13 sets of audited financial statements were reviewed. All financial statements selected were prepared as of the end of 2008. The sample included the financial statements of banks (4), insurance undertakings (2), an investment fund (1), a not-for-profit entity (1) and other companies in the enterprise sector (5). Despite statements within the financial statements or audit reports that the reports complied with IFRS, only four of the 12 sets of financial statements were prepared in accordance with IFRS.

C. IFRS Compliance Gap for the Enterprise Sector in FBH

115. Although the five companies in the FBH enterprise sector stated that their financial statements had been prepared in accordance with IFRS as issued by the IASB, the audit reports on two of the companies referred to extensive and significant departures from IFRS. Areas of non-compliance with IFRS identified in the two audit reports included: (i) the measurement of inventories and property, plant and equipment, (ii) the determination of impairment losses on receivables and other financial assets and (iii) the absence of recognition of employee benefit liabilities. Often accounting policies and disclosures of key assumptions and

estimates did not deal adequately with the transactions and circumstances of the entities concerned. There was also some doubt about whether any of the companies complied with IFRS as issued by the IASB for periods ending December 31, 2008.

116. It is also unclear which IFRS, as at what date, were applied in the preparation of the financial statements. Some financial statements imply that they comply with IFRS adopted nationally at some earlier date or that were translated into the local language at some earlier date. To assert compliance with IFRS, the financial statements must comply with IASB-approved IFRS applicable to accounting periods ending on December 31, 2008.

D. IFRS Compliance Gap for the Financial Sector in FBH

117. In FBH, bank financial statements do not comply with IFRS. Under the FBH A&A Law, banks are required to prepare financial statements in compliance with IFRS. The financial statements of the four banks state that they were prepared in accordance with IFRS as modified by the Banking Supervisory Agency rules for to the determination of impairment losses on financial assets. They do not, therefore, comply with IFRS. The audit reports on three of the banks make similar references, while the audit report on the fourth bank refers only to compliance with **local** accounting requirements.

118. Often accounting policies and disclosures of key assumptions and estimates often did not deal adequately with the transactions and circumstances of the banks concerned. In particular, the accounting policies for the impairment of financial assets conflict with other disclosures by implying compliance with IAS 39 rather than with the Banking Supervisory Agency's requirements. Some banks disclose the effect of the departure from IFRS as issued by the IASB, such as the calculation of provision for the impairment of financial assets.

119. There are also contradictions between statements of compliance in the financial statements and statements of management responsibility for the financial statements. Confusion arises from the statement of management responsibility for the financial statements included in the annual reports. While some statements refer to the obligation to prepare financial statements in accordance with IFRS as modified by the Banking Supervisory Agency regulations, others imply an obligation to issue financial statements in accordance with IFRS as issued by the IASB.

120. The financial statements of the two insurance companies and the investment fund state that they are prepared in accordance with local standards and do not comply with IFRS. The audit reports for one insurance company and the investment fund express unqualified opinions in terms of compliance with IFRS even though some accounting policies and disclosures do not comply with IFRS. The financial statements of the two insurance companies do not comply with IFRS. The financial statements of the investment fund state that they are prepared in accordance with **local** standards. The accounting policies adopted by the investment fund for the measurement of investments (financial assets) do not comply with the IAS 39 requirements for measurement at fair value. It is surprising, therefore, that the auditors expressed the opinion that the fund's financial statements present fairly the financial position and results in accordance with IFRS.

E. The Compliance Gap in RS

121. To assess the compliance gap for financial statements prepared under IFRS in the RS Entity, 11 sets of audited financial statements were reviewed. All financial statements selected were prepared as of the end of 2008. The sample included the financial statements of banks (3), insurance undertakings (2), an investment fund (1), and other companies of the

enterprise sector (5). Notwithstanding the statements of compliance within the financial statements or audit reports, however, only two of the 11 sets of financial statements complied with IFRS. Furthermore, the assessment of their compliance with IFRS was complicated by the extensive use of standard wording in accounting policies and other key disclosures.

F. IFRS Compliance Gap for the Enterprise Sector in the RS

122. The financial statements of the five companies in the enterprise sector state that they have been prepared in accordance with IFRS, as issued by the IASB, but one company disclosed exceptions from full compliance with IFRS. The audit reports on two other companies referred to extensive and significant departures from IFRS, and one company published an incomplete set of financial statements. Areas of non-compliance with IFRS identified included: (i) non-disclosure of information required by IFRS 7 *Financial Instruments*; (ii) measurement and disclosure of inventories, property, plant and equipment and intangible assets, (iii) the determination of impairment losses on receivables and other financial assets, (iv) the absence of recognition of employee benefit liabilities and (v) the correction of prior period errors. The financial statements of one company lacked accounting policies, notes, a cash-flow statement and a statement of changes in equity. Furthermore, there is some doubt whether some of the companies comply with IFRS as issued by the IASB for periods ending December 31, 2008.

123. There is evidence of some confusion about which IFRS, and as at what date, should have been, or had been, applied in the preparation of the financial statements. The financial statements should assert compliance with IFRS if, and only if, they comply with IASB-approved IFRS applicable to accounting periods ending on December 31, 2008. However, some financial statements imply that they comply with IFRS adopted at some earlier date or translated into local language at some earlier date.

G. IFRS Compliance Gap for the Financial Sector in the RS

124. The financial statements of the three banks stated that they were prepared in accordance with local requirements, which include IFRS as of 2005. Therefore, the financial statements are not IFRS financial statements (one bank makes such a statement). The audit reports on all four banks refer only to **local** accounting standards and regulations. As the financial statements are not IFRS financial statements, no assessment can be made of their compliance with IFRS.

125. The financial statements of the two insurance companies stated that they were prepared in accordance with IFRS, but the audit reports do not refer to compliance with IFRS and the financial statements fall well short of IFRS requirements. The financial statements of the two insurance companies do not include accounting policies and contain few of the disclosures required by IFRS.

126. The financial statements of the investment fund stated that they were prepared in accordance with IFRS. The financial statements appear to comply with IFRS, but the audit report refers only to local requirements. The financial statements comply with all IFRS that were mandatory for 2008 (including IFRS 7). The accounting policies appear to comply with IFRS, although there may be insufficient explanation of the determination of the fair values of investments.

IV. AUDITING STANDARDS AS DESIGNED AND AS PRACTICED

127. The Framework Law mandates the use of ISAs for conducting statutory audits, and nearly all audit reports assert that ISAs were used in the audit. Although many audit reports in the sample of financial statements reviewed referred to the use of ISA for conducting statutory audits, some of the reports referred only to local standards on auditing. In some cases, this could be because of the form of audit report used. Many local audit firms, however, referred to local standards on auditing instead of, or together with, ISAs. There were a few cases where member firms of international networks referred to local standards, and in one case did not refer to any auditing standards at all. This could imply a lack of auditor knowledge of ISAs.

128. For the sample of the financial statements reviewed, several audit firms in both Bosnia and Herzegovina Entities used an “emphasis of matter” paragraph in their audit reports in situations that were not compatible with ISA 705 and 706. The statutory auditors of the banks selected for the compliance assessment were all member firms of international networks. Some audit firms used an emphasis of matter in their report instead of using a modified opinion when the financial statements as a whole were not free from material misstatements, or when audit firms were unable to obtain sufficient evidence to conclude that the statements were free from material misstatement. For example, in some FBH bank statutory audits, the auditors emphasized matters dealing with the implication of IFRS adoption as modified by regulatory requirements, which is not an appropriate use of an emphasis of matter. In other cases, they used an emphasis of matter to deal with the lack of consolidation of entities. Instead, they should have qualified their opinion if the absence of consolidating certain entities led to a material misstatement. The emphasis of matter should be restricted to the few situations described in ISAs, including going concern of an audited entity and subsequent events. RS auditors also stated compliance with 2005 IFRS, when IFRS mandatory for 2008 should have been used. A better enforcement system based on quality assurance and public oversight would ensure that audit reports are in line with ISAs.

129. Several audit reports made reference to local standards, while the financial reporting standards subject to the audit were stated to be prepared in accordance with IFRS or vice-versa. While this can be common in some countries that have converged their own standards with IFRS, in Bosnia and Herzegovina, this could be seen as a way for the auditors to evade the question of accounting policy compliance with IFRS. Other auditors have referred to IFRS as the standards under which financial standards are prepared, while companies refer to local standards. The reference to local standards seems odd, as by law the only accounting standards that apply are IFRS as issued by the IASB.

130. The overall lack of compliance with IFRS of the reviewed financial statements casts a shadow on the ability of the audit profession, including audit firms that are members of international networks, to enforce compliance of the use of IFRS for the preparation of financial statements as required by the Framework Law and the Entities’ A&A Laws. The sample of financial statements reviewed for the preparation of this report hints to the inability of audit firms to modify their opinion when the accounting policies used to prepare financial statements significantly departed from IFRS. It could also point to the audit profession’s – including some member firms of international networks – lack of understanding of IFRS. This hints to a possible lack of quality of the audit profession and advocates for the urgency of effective implementation of the quality assurance and oversight system established under the Entities’ A&A Law.

V. PERCEPTION OF THE QUALITY OF FINANCIAL REPORTING

131. Some banks report that, as part of the loan application process, they use audited financial statements to assess the repayment capacity of large and medium sized enterprises. The financial statements of medium-sized enterprises are perceived to be improving as more information is being disclosed than a few years ago. The analysis of financial statements for the largest companies is often performed by central credit analysis departments located at banks' headquarters. Banks, however, do not use any scoring methodology for the quality of financial statements, nor do they benchmark financial statements against checklists of required disclosures under IFRS. The quality of financial statements has little influence on the collateral required. Collateral is linked to the type of loan agreed on with the borrower.

132. The fact that financial statements are audited should not be seen as systematically adding quality to financial statements. While a high-quality audit may bring quality to financial statements, a poor quality audit does not do so. In the absence of any quality assurance system the value of an audit cannot be asserted.

VI. POLICY RECOMMENDATIONS

133. Without attempting to provide a detailed tactical design for reform, this report sketches out policy recommendations to enhance the quality of corporate financial reporting in Bosnia and Herzegovina. The findings and recommendations of this report should help the State and Entity authorities to design Action Plans, which will be implemented at Entity level.

134. Statutory Framework: While the ROSC team views the Framework Law and implementing laws to be moving in the right direction for implementing the *acquis communautaire* as it relates to accounting and auditing, it recommends that the RS and FBH Implementing Laws and the BH A&A Commission pay due attention to the following issues.

135. The Entities should set up a coordination mechanism that will allow parallel alignment of their laws and regulations with the relevant provisions of the *acquis communautaire*. The entities should update the A&A laws that were passed in 2009 in the medium term, to incorporate further the requirements of the relevant *acquis communautaire* into their provisions and ensure consistency between these laws through a coordination mechanism. A coordination mechanism would offer to Bosnia and Herzegovina the opportunity to promote the adoption of the same policy choices available within the *acquis*, implemented by parallel arrangements expressed in updated Entity Laws, and ultimately facilitate negotiations with the European Commission and contribute to EU accession. This development would assist in dealing with the specific issues addressed below:

Financial Reporting

- **This report emphasizes the findings of the EU Commission progress report on the need for greater coordination between the Entities on accounting and auditing reform.** In this context, Bosnia and Herzegovina should create a coordination mechanism based on the existing members of the RS Advisory Council for Accounting and Auditing, and a similar group nominated by the FBH Minister of Finance. The Entities should cooperate to further contribute to the design of a harmonized accounting and auditing framework in Bosnia and Herzegovina and assess the changes needed in light of the existing and forthcoming *acquis communautaire*.
- **IFRS should apply to the financial statements of public-interest entities, but not to those of SMEs.** Bosnia and Herzegovina has rightly adopted IFRS and the Implementing

Laws of the Entities use three criteria to define public accountability: (a) having securities listed; (b) the nature of the business (for example, banks and insurance companies); and (c) the size of the business (exceeding thresholds regarding total yearly income or number of people employed). The requirement of IFRS in Bosnia and Herzegovina that is out of line with the capacity of the country to provide accountancy services under IFRS as it had been foreseen by the 2004 ROSC. That ROSC had foreseen that the effective date of 2005 for applying IFRS would be a tough challenge for most companies and that such rapid implementation could result in noncompliance. The absence of effective capacity building and effective enforcement mechanisms has contributed to a low level of compliance with IFRS.

- **Both entities should take advantage of the reduced requirement of IFRS for SMEs**, which represent a major IASB effort to simplify accounting standards without departing from the underpinning concepts of IFRS. The IFRS for SMEs standard represents a more appropriate choice than *full* IFRS in terms of cost and benefits for non-public interest companies. FBH has already introduced IFRS for SMEs in the Accounting & Auditing Law and RS allows its use for the 2011 financial statements of non-public interest entities. Both Entities will need to decide on which companies should apply IFRS for SMEs. The next step will be to further align their accounting standards (IFRS for SMEs) with the provisions of the Fourth and the Seventh Company Law Directive, by choosing the options and setting additional provisions that will enable such compliance. Finally, both Entities should take advantage of any simplifications of corporate financial reporting that the EU might allow for small entities. It should be noted, however, that some provisions of the A&A Law are not in line with the IFRS for SMEs requirement that companies draw up a cash-flow statement and a statement of changes in equity.
- **The Entities should harmonize their formats for corporate financial reporting and align them with the requirements of the Fourth Company Law Directive.** The Entities may wish to delay this harmonization to take into account the modification of this Directive expected in 2011.

136. Filing and Publication

- **The Entities should implement the requirements of the First Company Law Directive, including the electronic publication of financial statements.** In implementing the directive, they should also aim at harmonizing their deadlines for the filing of financial statements and ensure the availability of audited financial statements for public interest entities within four months after the end of the year.

137. Auditing

- **The Quality Assurance and the Public Oversight Systems in both Entities will need to design their manuals and operational guidelines and train their staff effectively.** While the quality assurance systems chosen by each Entity are different, they will represent a step towards alignment with the provision of the Statutory Directive – but only if properly implemented.
- **The Quality Assurance Systems, whether they are independent or within a MoF, should primarily focus on quality assurance of the work of audit firms and auditors, starting with the statutory audits of public-interest entities.** Quality assurance of the work of accountants is important, too, but of a second order. The initially intended focus on securing quality assurance systems for both groups risks undermining the necessary focus of the public oversight system.
- **To contribute to an effective public oversight system, audit firms performing audits of public-interest entities should publish transparency reports on an annual basis.** The Entities should introduce this requirement in their accounting and auditing legal framework as it would be an important element of the quality assurance and public

oversight systems. The requirements and elements of the transparency reports are set out in the Statutory Audit Directive.

- The Entities' governments should raise awareness of PIEs about the benefits implementing audit committees ("audit board") **required under of the Statutory Directive**. The Statutory Directive states that each public-interest company must have an audit committee. At least one member of the audit committee must be independent and have competence in accounting and auditing. The entities' bylaws should describe precisely what the responsibilities of the audit committee are, as set out in Article 41 of the Statutory Directive, that is, to monitor the financial reporting process, the systems of internal control, internal audit and risk management, the statutory audit of individual and consolidated financial statements; to review and monitor the independence of the statutory auditor or audit firm; and to recommend the appointment of the auditor to the decision-making body.

138. The Profession

- **Professional bodies** not associated with IFAC are encouraged to actively pursue membership with that body.
- **As the BH A&A Commission has delegated its obligation to them, professional bodies should make updated translations of IFRS, clarified ISAs and the IFAC Code of Ethics available to accountants, auditors, students and companies, beyond simply integrating them into CPD programs.** Because these standards are mandated by the Framework Law, as well as the Entities Law, Governments should ensure that these translations are made available without unreasonable delays. The translations should be done in cooperation with authorities and professional bodies of neighboring countries, such as Serbia and Croatia, sharing similar languages and alphabets. Serbia and Croatia already have translation agreements with the IFRS Foundation and IFAC, respectively. Entity Governments should also participate in discussions with neighboring countries to ensure the continuous and long-term availability of the standards.

139. Monitoring and Enforcement

- **The Securities Commissions of FBH and RS should be allocated adequate financial resources and personnel to step up the monitoring of financial information and to commence enforcement.** They should also develop a targeted approach to their monitoring, which should allow them to focus attention, effort and costs on specific areas of financial reporting where they would have an impact on the market expectations of users. Given the small size of both organizations, close collaboration on developing such a targeted approach should be combined with an exchange of experience with a well-resourced older EU Member State Securities Commission or Integrated Supervisor. This implies considering several angles:
 - **Market:** As noted in this report, the official segments of the Bosnia and Herzegovina stock exchanges are the most active, together with a few other securities listed on the free market. The monitoring of those most traded securities should be an absolute priority. A dedicated effort to monitor the financial statements of such companies might give a high degree of coverage with little, but focused and intensive, investigation effort. Because of the higher trading volumes of these companies, the impact of any accounting breach would be significant.
 - **Qualified audit reports:** The Securities Commissions should systematically investigate all instances where companies that have made a statement of compliance with IFRS but their auditors do not agree with that statement in their report. Further, any contradiction between the statement of compliance and the audit report that refers to different standards should also be investigated. The review of the

compliance gap with IFRS identified several discrepancies between companies' management statements of compliance and audit reports.

- **Industry:** An industry focus would allow the monitoring function to address and focus on key industry issues arising from application of IFRS. Initially, the industry focus might be better applied to a precise sector where there are only one or two large listed entities. These reviews could be supported by reviews of a restricted number of smaller companies to reflect the depth of the industry.
- **The Entities Insurance Supervisory Agencies should at least review the annual and semiannual financial statements of insurance companies and ensure the compliance of these financial statements with IFRS.** Monitoring and enforcement of IFRS accounting standards will contribute effectively to insurance supervision by ensuring that insurance technical provisions, and assets covering those provisions, are properly measured. Close cooperation with the future public oversight systems and interaction with auditors of insurance companies will be important.
- **Both Banking Supervisory Agencies should not only be concerned by the monitoring of regulatory reporting but also by the publication and audit of IFRS financial statements in line with the requirements of the Framework Law and the 2009 Entities' Accounting and Auditing Laws.** The RS Supervisory Banking Agency has recently taken steps towards achieving that objective but now faces the challenges of effectively implementing it. The FBH should also enforce the use of IFRS in general purpose financial statements.
- **Where a material misstatement in the financial information is detected, the Banking Supervisory Agencies, Securities Commissions, and Insurance Supervisory Agencies** should take actions to achieve appropriate disclosure and, where relevant, public correction of the misstatement (in line with the requirements of IFRS). Non-material departures from the reporting framework will not normally trigger public correction even though they deserve action as well (e.g., a statement sent to the infringer). Actions should be effective, promptly enacted and proportional to the impact of the detected infringement.

140. Education and Training: As it is responsible for professional education requirements, the BH A&A Commission should continuously shape the curricula on accounting and auditing at all levels of education:

- **The BH A&A Commission should conduct a thorough review of the curricula, reading lists, examination strategies and other requirements of the uniform professional accounting and auditing education program.** It should look to IAESB standards 2 to 6 and 8, as well as the Statutory Audit Directive, to ensure that the qualification structure ensures that the initial professional development needs of accountants and auditors remain relevant to the needs of Bosnia and Herzegovina's economy, are up to date and are supported by current and relevant educational materials.¹⁵ The recently revised IAESB Framework of International Accounting Education Standards needs to give more attention to increasing students' critical thinking skills, which includes the necessary ethical dimension of business management, and their ability to develop their professional judgment as they gain experience.
- **The BH A&A Commission** should make sure that continuous professional education includes necessary updates on *clarified* ISAs and changes in IFRS. As IFRS for SMEs has been adopted in FBH and are now allowed for use by non-public interest entities in the RS, the Commission should make sure that the annual program of CPD for 2010 and 2011 includes specific training on IFRS for SMEs and *clarified* ISAs. In addition, the

¹⁵ IES 2, Content of Professional Accounting Education Programs; IES 3, Professional Skills and General Education; IES 4, Professional Values, Ethics and Attitudes; IES 5, Practical Experience Requirements; IES 6, Assessment of Professional Capabilities and Competence; IES 8, Competence Requirements for Audit Professionals.

Commission should develop a tool for assessing the CPD needs of members and a feedback mechanism for CPD participants that will help shape the design of future programs. A culture shift from compelling attendance to motivating attendance would lead to an improvement in the range and quality of CPD courses offered, and would equip participants with enhanced competences.

- **Enhance training for regulators.** The staff of the Banking Supervisory Agencies, the Ministries of Finance and the Securities Commissions should receive meaningful theoretical and practical training to enforce accounting, financial reporting, and auditing standards. Training for regulators should encompass practical experience in banking, insurance and securities markets; legal and compliance issues; and accounting, auditing and financial issues.
- **Enhance English language skills.** In the context of economic integration, the accounting and auditing profession should actively enhance its English language skills.