



The World Bank Centre for Financial Reporting Reform



Schweizerische Eidgenossenschaft
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Report on the Observance of Standards
and Codes on Accounting and Auditing

Update



Slovenia

May 2014

Report No: ACS9620



CENTRE FOR FINANCIAL REPORTING REFORM (CFRR)

EUROPE AND CENTRAL ASIA

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Main Abbreviations and Acronyms

ACCA	Association of Chartered Certified Accountants
AJPES	Agency of the Republic of Slovenia for Public Legal Records and Related Services
APOA	Agency for the Public Oversight of Auditing
AZN	Insurance Supervision Agency
ATVP	Securities Market Agency
BCBS	Basel Committee on Banking Supervision
BS	Bank of Slovenia
CAP	Certified Accounting Practitioner
CIPA	Certified International Professional Accountant
KPK	Commission for Prevention of Corruption
CPD	Continuing Professional Development
EU	European Union
GDI	Gross Domestic Income
FIG	Financial Industrial Group
IAASB	International Auditing and Assurance Standards Board
IAESB	International Accounting Education Standards Board
IAIS	International Association of Insurance Supervisors
IAPS	International Auditing Practice Statement
IAS	International Accounting Standards (included in IFRS)
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IES	International Education Standard
IESBA	International Ethics Standards Board for Accountants
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards (including IAS)
IMF	International Monetary Fund
ISA	International Standards on Auditing
ISQC	International Standards on Quality Control
JSC	Joint stock company
LLC	Limited liability company
MoF	Ministry of Finance
NAS	National Accounting Standards
NBFIs	Non-Banking Financial Institutions
NSPF	Non-State Pension Fund
PIE	Public interest entity
ROSC	Reports on the Observance and Standards of Codes
SAD	Statutory Audit Directive
SAI	Supreme Audit Institution
SAS	Slovenian Accounting Standards
SCRFSM	State Commission for Regulation of Financial Services Markets

SSCMC	State Securities and Capital Markets Commission
SIA	Slovenian Institute of Auditors
SME	Small and Medium-Sized Enterprises
SMO	Statement of Membership Obligations of IFAC
SOD	State Fund
SOE	State Owned Enterprise

CURRENCY: EURO (EUR)

1 USD = 1.38615 USD as of May 4, 2014

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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 Slovenia between December 2013 and February 2014. The World Bank team was led by Andrei Busuioc, Sr. Financial Management Specialist, (CFRR), and included Ranjan Ganguli, international consultant (ECCAT), Shamim Diouman, international consultant (ECCAT), Ana Cristina Hirata Baros, international consultant (ECCAT), Svetlana Platon, consultant (ECCAT), Hector Alfonso, international consultant (ECCAT), Jamil Sopher, international consultant (ECCAT), and Blanka Vezjak, local consultant (ECCAT). The general oversight of this task was performed by Henri Fortin, Head, CFRR (ECCAT). The review was conducted through a participatory process involving in-country authorities and stakeholders.

The team wishes to thank Matija Laco, Country Economist, ECSP2; and Gabriela Kusz, Senior Financial management Specialist, MNAFM, Gilbert Gélard, international consultant (ECCAT) and former IASB member, and Tamás SZABÓ, Policy officer, European Commission, DG MARKT – Internal Market and Services, Unit F3 – Accounting and Financial Reporting, for their comments on the draft report. Similarly, the team expresses thanks to Ismail Radwan, Country Program Coordinator, Central/South Europe and Baltics and Hongjoo Hahm, Country Manager for Croatia and Slovenia, for their guidance and support provided.

The team acknowledges the extensive cooperation and assistance received from the staff of the Ministry of Finance of Slovenia, the Slovenian Institute of Auditors, the Bank of Slovenia, the Agency for the Public Oversight of Auditing, as well as other local organizations that provided inputs to the ROSC review.

Preface

This report provides an assessment of accounting, financial reporting and auditing requirements and practices within the enterprise and financial sectors of Slovenia and makes policy recommendations for their improvement. It uses as benchmarks the EU *acquis communautaire*¹ and norms as well as International Financial Reporting Standards (IFRS), International Standards on Auditing (ISA) and the obligations of the International Federation of Accountants (IFAC). 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 updates an earlier assessment published in 2004.

¹ The *acquis communautaire* is the accumulated body of European Union (EU) law and obligations. It comprises all EU treaties and laws (directives, regulations and decisions), declarations and resolutions, international agreements as well as the judgments of the Court of Justice. It also includes action that EU governments take together in the Area of Freedom, Security and Justice and under the Common Foreign and Security Policy.

Executive Summary

Overall: sound progress in reforms reflected in improved legislation but monitoring and enforcement issues still remain

- 1 **Since the 2004 A&A ROSC, Slovenia has introduced significant reforms, improving the statutory framework and establishing new functions or institutions in line with the EU *acquis communautaire*. As a result, it has a reasonably good legislative framework.** A public oversight system of auditors was introduced and an Agency for Public Oversight of Auditing has been created. Also, legislative provisions to strengthen audit quality have been introduced. In addition, legislative improvements included increasing the legal accountability of those preparing financial statements; requiring auditors to have professional indemnity insurance; safeguards related to auditors' dismissal during the audit; the adoption of IFRS for some public interest entities²; ISA are required for audits of financial statements since 1993 and the progress was made in their practical application; and improvements in academic accountancy education. However, there is relatively little demand for high quality general purpose financial statements and, further undermining the supply of such information, limited monitoring and enforcement capacity.
- 2 **Some reforms still need further attention, especially those enhancing monitoring and enforcing legislative provisions and standards.** The various regulators - including banking, insurance and securities - and the new audit oversight agency need further institutional capacity strengthening, including developing appropriate tools, methodologies and skills.

Country Context: economy in recession and severe banking crisis

Slovenia is a country in southern Central Europe with a population of 2.06 million, and a GDP per capita was US\$ 22,015 in 2012. It is an independent democratic republic and has been a member of the European Union since 2004.

Slovenia was the fastest growing Eurozone member in 2007; however, it was hard hit by the global financial crisis of 2008 and is currently experiencing a double-dip recession. In contrast to most European economies, the recovery in 2010-11 was short-lived and minimal, and real GDP continues to fall. After declining by 2.5% in 2012, the Slovenian economy contracted by a further 1.1 percent in 2013. It is expected that in 2014 there will be 0.6 percent growth of GDP and 1.3 percent in 2015.

² Public interest entity (PIE) is not a term specifically defined in Slovenian legislation. In other EU jurisdictions, PIEs comprise listed companies, banks, insurance companies as well as other companies that the government regards as significant, for example in terms of their contribution to the economy. Throughout this report, except where noted, the term PIE in Slovenian context is used to refer to listed companies, banks and insurance companies.

Fiscal consolidation remains vital to reduce economic uncertainty and ensure uninterrupted access to foreign financing. The general government debt-to-GDP ratio more than doubled from 22 percent in 2008 to 54.4 percent in 2012, 71.7 percent in 2013 and is projected to increase further to 80.9 percent. The debt-to-GDP ratio remains a concern given the large contingent liabilities related to the clean-up of the banking sector. Long-term sovereign debt and certain banks were downgraded in 2012, and again in February 2013.

In 2012, Slovenia had approximately 58,000 active businesses with limited liability ownership, of which 98.9 percent were micro-, small- and medium-sized entities (MSMEs). Only 3 percent of all companies (1,844 entities) are obliged to have their financial statements audited including 104 public interest entities (PIEs). The role of State-Owned Enterprises (SOEs) is significant: they generated one sixth of the value added of the Slovenian economy and employed one out of eight people in the corporate sector in 2011. More than 30 percent of companies in Slovenia are state-owned or state-controlled. The European Commission, in its 2014 Anti-Corruption report³, noted a number of issues regarding conflicts of interest in state-owned or state-controlled companies.

Improved corporate sector financial reporting and auditing can contribute to the country's further economic development and help restore investors and lenders confidence in the market; this is especially relevant for the banking sector and SOEs which are key types of entities in Slovenia.

Legislative framework compliant with the EU *acquis communautaire*

- 3 **Slovenia made a substantial effort to meet its EU membership obligations. Most of the provisions of the *acquis communautaire*, related to financial reporting and auditing, have been adopted.** Some of the requirements of the recently issued New Accounting Directive still need to be transposed into national legislation. Thus, Slovenia made significant progress since 2004 to improve the statutory framework for accounting and auditing⁴ consistent with good international practices and the *acquis communautaire* including:

- the establishment of a public oversight system for the audit profession in 2009 by creating the Agency for Public Oversight of Auditing (APOA) ;
- the requirement that public interest entities (PIEs) apply IFRS for their consolidated financial statements (listed companies continue to have the option to report in accordance with local Slovenian Accounting Standards (SAS) in their legal entity financial statements);
- differentiated financial reporting requirements for micro, small and medium-sized enterprises (MSMEs), including less demanding disclosure requirements; however, the requirements for consolidated financial reporting are more demanding than the minimum requirements of the *acquis*;

³ See <http://ec.europa.eu/anti-corruption-report>

⁴ The status of implementation of the 2004 A&A ROSC Recommendations is presented in Annex 4.

- audit requirements comply with the acquis, and are generally required for entities with limited liability of ownership except those below the size thresholds which are set at the maximum level allowed by the EU accounting directives; International Standards on Auditing (ISA) are adopted in Slovenia;
- increased and explicit accountability of companies' supervisory boards and boards of directors for the preparation of their financial statements and annual reports;
- enhanced regulation to strengthen audit quality, notably including the introduction of safeguards for the dismissal of auditors which helps ensure auditor's independence;
- enhanced financial transparency requirements for listed companies; and
- improved education and training requirements based on relevant provisions of the EU statutory audit directive.

- 4 Further legislative improvements that are still required include: giving shareholders the de facto right to approve financial statements; streamlining the Auditing Act and revising its scope, as well as improving governance of the oversight and quality assurance system; transposing the new requirements of the revised EU accounting directive, especially its simplification provisions; further improving national accounting standards-setting; and further improving the content of national accounting standards by simplifying requirements for micro- and small entities, while following good international benchmarks for large and medium-sized entities.

The review of audited financial statements: progress since 2004

- 5 **Despite some disclosure issues, financial statements review indicated a relatively high degree of compliance with relevant financial reporting standards.** This indicates progress in compliance compared with 2004 A&A ROSC and is applicable to both public interest entities (PIEs) and small and medium-sized entities. However, some of financial statements did not fully comply with certain disclosure requirements, and quality of unaudited financial statements by small entities which do not have audit requirement is weak. Therefore, the quality of economic decisions may suffer due to incompleteness of financial statements disclosures.

Limited demand for financial reporting impacts the demand for proper enforcement

- 6 **Relatively low demand for high quality financial reporting has a negative impact on demand for monitoring and enforcement.** The securities market is relatively small and plays a limited role in the Slovenian economy. The banking sector is significant, amounting to around 130 percent of GDP in terms of assets, and government-controlled banks account for approximately 55 percent of the financial system. Due to significant state ownership in the economy, substantial loans are often granted by political rather than commercial criteria⁵. As a consequence, banks' non-performing loan ratios reached 16.3 percent in June 2013 for all types of loans and 25.5 percent for corporate loans, amongst the highest for OECD countries. The banking sector is in need of significant recapitalization in order to revive growth and ensure stability. In addition, there is limited foreign direct investment (FDI) in

⁵ See http://ec.europa.eu/dgs/home-affairs/what-we-do/policies/organized-crime-and-human-trafficking/corruption/anti-corruption-report/docs/2014_acr_slovenia_chapter_en.pdf for relevant extracts

Slovenia compared to peer countries, as Slovenian inward FDI stock is one of the lowest of the new EU Member States⁶. Moreover, companies' governance arrangements with respect to general purpose financial statements need further improvements, in terms of the general functioning of audit committees and supervisory boards as well the limited role of shareholders in financial statements approval.

- 7 This combination of circumstances - a small securities market, significant political ties to the economy via state-controlled banks and SOEs, and less effective governance arrangements of companies, including SOEs - results in little demand for high quality general purpose financial statements. In addition, the state does not have a strong ownership function for SOEs and does not systematically assess the fiscal risk of SOEs to the public budget in a comprehensive manner. Good quality financial information is a crucial prerequisite for strong accountability by SOEs and is critical for the current country circumstances.
- 8 **It is anticipated that the situation will change and that demand for high quality general purpose financial statements will increase.** Most significant will be the impact of the so-called Banking Union, the recently agreed single resolution mechanism to deal with failing banks making the European Central Bank (ECB), rather than national regulators, responsible for deciding whether a Eurozone bank is likely to fail and should be bailed out from a common fund⁷. The ECB is therefore likely to subject the most important Slovenian banks to greater scrutiny and demand that high quality and appropriately scrutinized financial statements from loan recipients play a more significant role in the determination of the quality of banks' loan portfolios, rather than the current situation where political criteria often dominate.
- 9 **Increasing political will to (commit to and) implement the country's privatization strategy will both rationalize the way the state manages remaining SOEs, and will lead to increased demand for high quality financial statements.** This should include completing the process of transferring ownership of SOEs to the Slovenian State Holding Company (SDH) and establishing appropriate scrutiny over SOEs financial reporting, which is an important input for assessing the fiscal risks by SOEs to the public budget.
- 10 **The policy recommendations described in this report will help Slovenian policy makers to anticipate this increased demand for high quality financial reporting.** A possible additional positive by-product of implementing the policy recommendations, especially for the private sector, is that good accounting and auditing should facilitate investment and improve the business climate for Slovenian enterprises while also enhancing their access to credit and foreign direct investment.

⁶ EUROPEAN ECONOMY, Occasional Papers 142 | April 2013, Macroeconomic Imbalances Slovenia, 2013; http://ec.europa.eu/economy_finance/publications/occasional_paper/2013/op142_en.htm

⁷ <http://www.europarl.europa.eu/news/en/news-room/content/20140319IPR39310/html/Parliament-negotiators-rescue-seriously-damaged-bank-resolution-system>

Limited monitoring and enforcement capacity weakens practical application of the legislation

- 11 **The market perceives the reliability of financial information with limited confidence.** This is particularly relevant in the context of the recent economic crisis which had a severe impact on Slovenia's banking sector. The institutions and functions in Slovenia responsible for regulation and enforcement of corporate financial reporting are complete and include the Bank of Slovenia (BS), the Insurance Supervision Agency (AZN), the Securities Market Agency (ATVP), the Agency of the Republic of Slovenia for Public Legal Records and Related Services (AJPES), Ljubljana Stock Exchange (LSE) and State Fund (SOD) responsible for SOEs oversight. **However, these institutions have limited capacity or resources to monitor and enforce general purpose financial statements.** The recent banking crisis demonstrated that financial information prepared by banks failed to properly reflect all the risks in their operations, and the banking regulator could not make a timely and proper assessment of the banking sector situation.
- 12 **Audit public oversight and quality assurance function still require strengthening.** Governance of the institutions responsible for these functions (APOA and SIA) need further improvements to be able to provide confidence to the market and improve perceptions by users of financial information and the public in general that these institutions are effectively protecting the public interest. Additionally, the APOA and SIA need to enhance methodologies and capacity to discharge their respective public oversight and quality assurance responsibilities over the audit profession. The Slovenian Parliament, through its structure of Parliamentary Committees, has an oversight role over all these institutions. However, although foreseen by the law, Parliament is not active on financial reporting and auditing issues nor does it act as a vocal protector of public interest in this area. This is reflected in the low and declining annual budget allocated to the APOA and parliamentary inaction in terms of monitoring the implementation of the Auditing Act, including the activities of the APOA and SIA and the need to resolve issues in their working relationship. The combination of these factors contribute to relatively limited confidence in the reliability of financial information available on the market.

Pressures over the accounting and auditing profession negatively impacts the quality

- 13 **There are a large number of people working in accounting and auditing for the size of the economy which creates pressure over the profession and as a consequence has a negative impact on the quality.** Slovenia has approximately 12-18,000 accountants, with approximately 8,000 working for accounting service providers and 56 audit firms in Slovenia employing approximately 140 active qualified auditors. The number of auditors is above the needs of the market to satisfy the current statutory audit requirements of less than 2,000 audits. This oversupply of audit professionals, having ever fewer audit clients, has considerably impacted audit income - auditors and audit clients report recent year-on-year reductions in audit fees in the order of 30 percent. Therefore, this combination of circumstances likely negatively impacts the quality of general purpose financial statements. Additionally, audit firms, other than those who are members of international networks, do not have up-to-date ISA-compliant audit methodologies and have limited resources to invest in it.

Policy recommendations: simplify certain aspects and focus on compliance

- 14 **The country needs to resolve significant imbalances in the economy and strengthen the state owned enterprises governance so that good quality financial reporting can be valued by relevant users.** A sound financial reporting and auditing framework will contribute to economic stability and help prevent the negative consequences of economic crisis. The recent economic downturn, which led to a severe banking crisis in Slovenia, demonstrated that weaknesses in the financial reporting infrastructure prevented issues in the system being identified early and meant that banks' financial statements were slow to reflect the extent of the problems or risks involved.
- 15 **Given the banking crisis and the slow economic recovery, reforms need to enhance the reliability of financial information for investors and bankers, especially in financial sector, and focus on simplification of financial reporting requirements for smaller entities.** There is a need for initiatives to enhance public confidence in the quality of financial reporting of public interest entities, including listed companies, banks and insurance companies. As many significant entities in Slovenia are wholly or partially owned by state, good practices in those entities may serve as a good example for the rest of economy, and enhanced public confidence may contribute to an increase in private investments in the country.
- 16 This report outlines the following main policy recommendations:

A. High priority recommendations:

- transposing fully the requirements of the *acquis communautaire* (new EU accounting directive);
- in relation to the above point simplify the framework for national financial reporting and consider adopting the IFRS for SMEs and the member states option for micro-entities;
- strengthening the capacity of financial sector regulators to enforce financial reporting by regulated entities;
- devising and implementing methodologies for public oversight, quality assurance; and assisting small audit practices to improve their audit methodologies;
- strengthening the governance of the SIA and APOA and improving funding arrangements for APOA;
- strengthening the governance arrangements of SOEs related to financial reporting and creating a systematic approach for reviewing and analyzing SOEs financial statements (as a key input for assessing the fiscal risks of SOEs);
- the authorities and stakeholders need to foster and further promote demand for high quality financial reporting, and strengthening governance and enforcement are essential prerequisites for it.

B. Other recommendations

- revising the Auditing Act to focus on audit services only and remove regulation on non-audit services; the Auditing Act will also need to transpose new requirements of the revised Statutory audit directive once issued and the

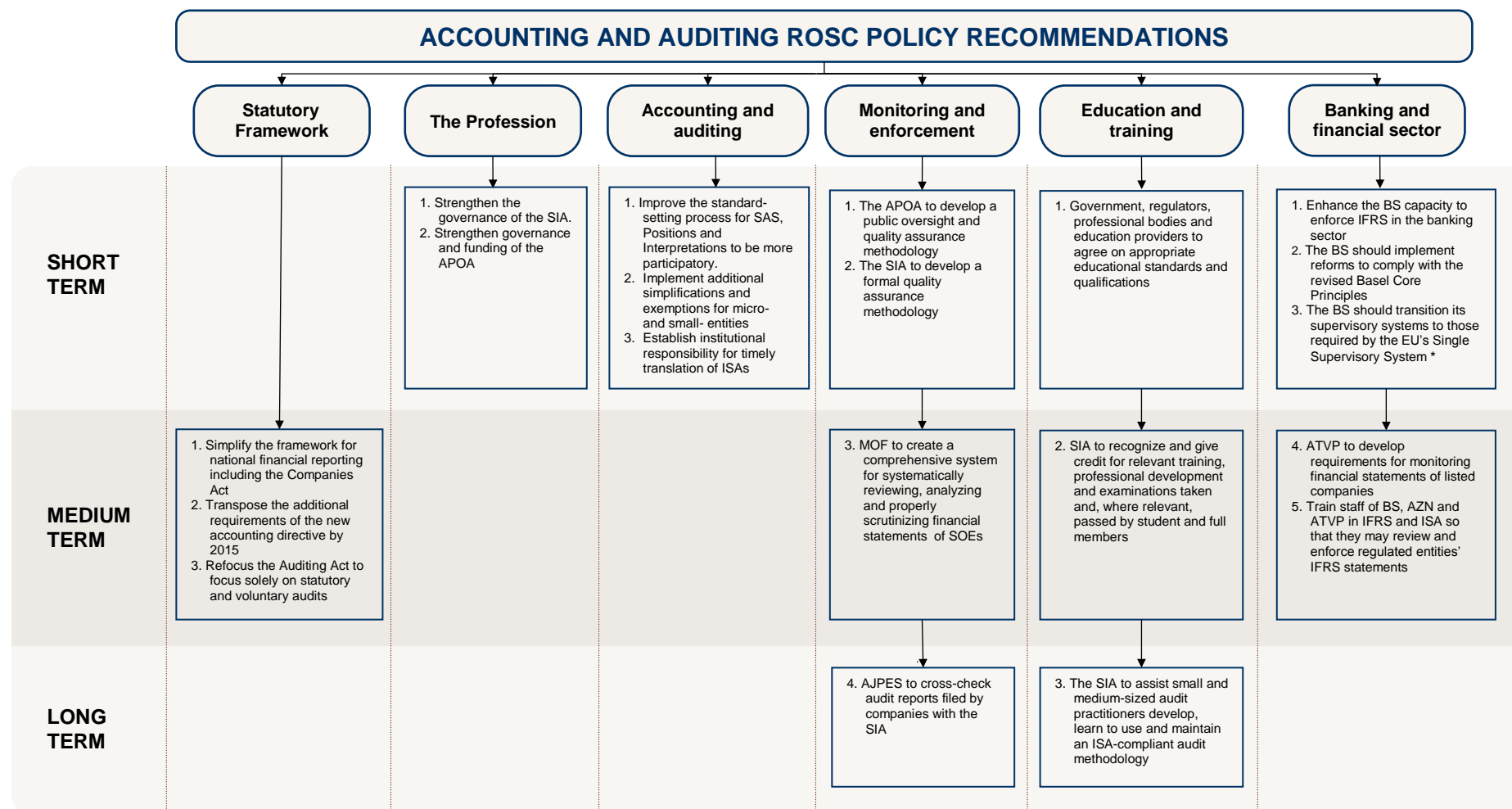
Regulation on specific requirements regarding statutory audit of public interest entities will have to be implemented in practice⁸;

- adopting transparent, predictable and sustainable processes for the introduction of any new financial reporting requirements and use relevant international benchmarks and the requirements of the acquis in accounting standards-setting; and
- continue improving accounting and auditing education programs for students, accountants, auditors in line with international education standards (IES) and continuous education for financial sector regulators.

- 17 A diagrammatic representation of the main policy recommendations follows below. Real and meaningful reform can only take place when there is a demand for high quality general purpose financial statements, particularly from the state and its relevant authorities responsible for SOEs oversight, financial sector regulators and audit oversight. Good quality financial information is essential to perform relevant oversight and enforcement tasks and contributes to effective protection of the public interest.

⁸ The adoption is expected by June 2014.

Accounting and Auditing ROSC Policy Recommendations



* - Already in progress.

I. Introduction

- 1 This assessment of accounting and auditing practices in Slovenia is part of a joint initiative of the World Bank and International Monetary Fund (IMF) to prepare Reports on the Observance of Standards and Codes (ROSC). 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 mandatory requirements and actual practice. This is the second A&A ROSC for Slovenia and based on information collected in 2013 - early 2014. The first one was published in 2004⁹.

A. Country Context

- 2 **The Republic of Slovenia is a country in southern Central Europe, with a population of approximately 2.06 million**¹⁰. Slovenia—a north-west part of the former Yugoslavia—became an independent state in June 1991 and is a democratic republic. The capital city is Ljubljana with population of approximately 0.3 million. The country has a short coastline in the Adriatic Sea with a major port at Koper. Approximately 42 percent of the country is mountainous and about half of the land is forest¹¹. It became a member state of the European Union in 2004. The state's authority is based on the principle of separation of legislative, executive and judicial powers, with a parliamentary system of government. The highest legislative authority is the National Assembly (90 deputies), which has the right to enact laws. The country has a legal tradition of civil law.
- 3 **Slovenia is a high-income, OECD-member country. In 2012 its Gross Domestic Product (GDP) per capita was US\$22,015.**¹² The economy is led by manufacturing, which represents 18.3 percent of GDP. The most important manufacturing industries are in metals, pharmaceuticals, electrical equipment, motor vehicles, machinery and equipment, rubber and plastic products, and chemicals, which together contributed over 60 percent of added value and employed more than half of those working in the manufacturing sector.¹³ The economy is generally export-dependent; good infrastructure and proximity to large European economies contributes to effective export-based development.
- 4 **In 2012, over 132,000 companies, cooperatives and sole proprietors were operating in Slovenia, including over 58,000 companies with limited liability legal form. The vast majority (98.9 percent) were micro, small and medium-sized enterprises (i.e. SMEs).**¹⁴ Fast-growing, technologically advanced and innovative SMEs represent

⁹ http://www.worldbank.org/ifa/rosc_aa_slv.pdf

¹⁰ http://www.stat.si/novica_prikazi.aspx?id=6028

¹¹ http://www.vlada.si/en/about_slovenia/geography/

¹² <http://www.stat.si/eng/indikatorji.asp?id=21>

¹³ Source: Slovenian Industrial Policy

¹⁴ http://www.ajpes.si/Registers/Annual_Reports/Information

potential for the future of Slovenia. Slovenian SMEs exceed the average contribution of European SMEs in terms of employment and contribution to added value in the economy. They represent 50.3 percent of added value and 59.9 percent of employment in the private, non-financial sector. There are around 700 large companies, which are also of great importance as drivers of the Slovenian economy, generating demand for the goods and services produced by SMEs.

B. Economic Context

- 5 **Slovenia was the fastest growing Eurozone member in 2007; however, it was hard hit by the global financial crisis of 2008 and is currently experiencing a double-dip recession.** In contrast to most European economies, the recovery in 2010-11 was short-lived and minimal, and real GDP continues to fall. After declining by 2.5 percent in 2012, the Slovenian economy contracted by 1.1 percent in 2013¹⁵, and it is expected that the GDP growth will be 0.6 percent in 2014 and 1.3 percent in 2015. The main drivers behind the deterioration of growth are: (i) a sharp decline in private consumption, and domestic demand; and (ii) a protracted weakness in investment. Household consumption has been hit by the decline in consumer purchasing power, high unemployment and the decline in consumer confidence, while the decline in government consumption is a reflection of fiscal consolidation. Investment has been affected by limited domestic and foreign demand, the high indebtedness of the corporate sector and constraints on financing. The export sector has remained the most resilient in the crisis, and is having a positive impact on GDP. The fiscal deficit increased dramatically in 2013, primarily as a result of the measures to restructure the banking system. The fiscal deficit is estimated to have increased from 4.0 percent of GDP in 2012 to 14.7 percent in 2013, although it amounted to 3.3 percent of GDP if bank restructuring measures were excluded. The underlying fiscal deficit is expected to amount 4.1 percent of GDP in 2014.
- 6 **Although Slovenia still ranks highly in the ease of doing business (33rd worldwide), it fell two places over the past year.**¹⁶ According to 2014 doing business indexes, the country has improved the effectiveness of paying taxes (ranked 54th compared to 59th in 2013) and enforcing contracts (52nd compared to 56th in 2013), but it has become more difficult to start a business (38th compared to 33rd in 2013) or get credit (109th compared to 105th in 2013). There are also some unfavorable indicators compared to the EU, for example it takes 3.5 years to enforce a contract in Slovenia compared to an EU11¹⁷ average of 1.5 years; and it takes 110 days to register a property, while the EU11 average is 34 days. Following the fall of the center-right coalition government in February 2013, the four-party caretaker government has promised to help the ailing banking sector, revive the economy, create new jobs, and improve competitiveness to ensure that the

¹⁵ https://www.stat.si/eng/novica_prikazi.aspx?id=6087

¹⁶ Doing Business 2014 Index: <http://www.doingbusiness.org/data/exploreeconomies/slovenia/>

¹⁷ The EU11 is the group of countries which acceded to the European Union in the period 2004-2013 – Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

country does not require a Euro zone bailout. The failure to adopt some initiatives earlier, such as a new SOEs law, and the current political crises indicates, however, that the country faces serious political and governance issues.

- 7 **Fiscal consolidation remains vital in reducing economic uncertainty and ensuring uninterrupted access to foreign financing.** The general government debt-to-GDP ratio more than doubled from 22 percent in 2008 to 54.4 percent in 2012, 71.7 percent in 2013 and is projected to increase further to 80.9 percent in 2014. The debt-to-GDP ratio remains a concern given the large contingent liabilities related to the clean-up of the banking sector. Long-term sovereign debt and certain banks were downgraded in 2012, and again in February and May 2013.¹⁸ Also, the Government recently adopted a new National Reform Programme 2014-2015¹⁹, which is the Government's medium-term plan on priority measures and projects focused on meeting the Europe 2020 Strategy. Together with the Stability Programme, the document, which is the main part of the European semester, provides the basis for member-specific recommendations, which the European Commission draws up by the end of each semester and which are then approved by the European Council. The government is encouraged to continue its efforts on, among others, the balancing of public finance, the stabilization of banking system and company restructuring, while curbing youth unemployment and promoting active employment policy. With the continuation of the government sponsored privatization process, three biggest SOEs (excluding NLB) - Nova Kreditna banka Maribor (NKBM), Slovenian telecommunication company Telekom Slovenije, and airport operator Aerodrom Ljubljana - are to be sold by the end of 2014.

C. Financial Sector

- 8 **The financial sector is comprised mainly of banks and insurance companies.** There are 23 banks, including 7 foreign-owned banks. Two banks are in the process of supervised winding down. There is a small securities market, but its size and importance relative to the economy has been declining in the aftermath of the economic crisis. Banks remain the most important financial institutions in Slovenia, accounting for more than 75 percent of financial system assets.
- 9 **Government-controlled financial institutions dominate the system.** The two largest banks and the largest insurance company belong to financial groups that are at least 50 percent directly or indirectly owned by the government.²⁰ Government controlled banks account for approximately 55 percent of the financial system in terms of assets or capital. The Slovenia Commission for Prevention of Corruption (KPK) recently reported that, with the vast majority of the banking sector being at least partially controlled by the state, loans were granted based on political criteria mainly rather than strict commercial criteria. Consequently, the KPK, jointly with the Court of Audit, proposed legislative

¹⁸ Slovenia's ratings by agency: Moody's: Ba1, negative outlook; S&P: A-, stable outlook; and Fitch: BBB+, negative outlook.

¹⁹ http://ec.europa.eu/europe2020/pdf/csr2014/nrp2014_slovenia_sl.pdf

²⁰ Financial Stability Report Bank of Slovenia - May 2013.

anti-corruption safeguards for the banking sector, including on transparency aspects. The banking issues were looked into by a Special Parliamentary Commission and work is still on-going together with the BS.

- 10 **The banking sector in Slovenia is in need of recapitalization in order to revive growth and ensure stability and the authorities took decisive policy actions in 2013 to stabilize the banking sector.** These included asset quality reviews (AQR), stress tests, the recapitalization of the state owned banks and also a private bank where the state had 2 percent ownership, and the transfer of NPLs to the Bank Asset Management Company (BAMC). The total assets of banks and savings banks (EUR 46.1 billion in 2012) amounted to 130 percent of GDP. However, non-performing loan (NPL) ratios reached 16.3 percent in June 2013 for all types of loans and 25.5 percent for corporate loans—the highest levels among OECD countries and increased after AQR as of the end of 2013. Despite a fall in NPLs by almost 10 percentage points (from 21 percent to around 12 percent in January 2014) due to the transfers to the BAMC (in process also after January 2014), these levels remain elevated. The deteriorating portfolio quality, together with constraints on refinancing from foreign financial markets, is hampering the banks' ability to manage liquidity effectively. A comprehensive approach to deal with NPLs and distressed assets on the banks' balance sheets, with the introduction of a state owned bad assets management company, a so called “Bad Bank”²¹, continues to be one of the priorities of the government. Bad assets are being transferred to the Bank Asset Management Company (BAMC), and banks are being recapitalized in accordance with the results of stress tests which were performed in December 2013. The purpose of the stress tests was to assess, with the help of independent international experts, the robustness of the Slovenian banking system in an adverse macroeconomic scenario, and to determine any capital shortfall that could arise at an individual bank or consequently across the entire banking system in the event of such a scenario being realized. The stress tests concluded that a total of EUR 3.012 billion is required for capital increases at NLB, NKBM and Abanka Vipava (Abanka).²² After the process has been completed, NLB, NKBM and Abanka will have overall capital adequacy ratios of around 15 percent. Nevertheless, the bank recapitalizations and transfers to BAMC have led to a significant increase in the public debt burden. Public debt rose from just 22 percent of GDP in 2008 to 54.4 percent in 2012, 71.7 percent in 2013 and widen further to 80.9% of GDP. Slovenia issued 3.5-year and 7-year government bonds on the euro area market in early April 2014, with a total nominal value of EUR 2 billion. More details on the recent developments and commendable efforts to stabilize the banking system are included in Annex 1.
- 11 **There were 15 insurance companies and two reinsurance companies operating in Slovenia in 2012.** In 2012 the insurance undertakings recorded nearly EUR 2 billion in gross premiums written, of which non-life premiums amounted to EUR 975.4 million, life premiums EUR 512.3 million and voluntary health insurance premiums EUR 468.4 million. The largest insurance company accounted for 33 percent of written premiums,

²¹ State-owned Bad Assets Management Company (BAMC).

²² NLB requires EUR 1,551 million, NKBM EUR 870 million and Abanka EUR 591 million.

while the three largest accounted for 61 percent of the market. The largest life insurance company covers 37 percent of the life insurance market, while the largest general insurance company covers 32 percent of the general insurance market. The market share of the largest reinsurance company increased to 57 percent.²³

- 12 **The securities market is relatively small in Slovenia and plays a limited role in the economy.** Market capitalization of the Prime Market of the Ljubljana Stock Exchange²⁴ was EUR 4.9 billion, equal to 13.8 percent of GDP, in 2012. This is relatively low compared to its peers in the Central and East Europe Stock Exchange Group; the market cap for the Vienna and Prague Stock Exchanges was EUR 80.4 and 28.2 billion, respectively, that same year.²⁵ Corporate shares accounted for the vast majority (89 percent) of market capitalization; shares in insurers accounted for 10 percent; and bank shares for less than 1 percent.²⁶ Although market capitalization went up 0.8 percent in 2012 (the first time since 2007), it was down again by 8.6 percent by March 2013. Almost half the trading volume on the Ljubljana Stock Exchange (46.6 percent) in 2012 was in shares of the pharmaceutical company KRKA, which is partially owned by the government.
- 13 **In addition to the banking, insurance and securities market, Slovenia also has other non-banking companies such as mutual funds, pension companies and mutual pension funds.** There were 126 mutual funds and 7 mutual pension funds as at end of September 2013, with net assets amounting to approximately EUR 3.2 billion in September 2013.
- 14 **Financial supervision in Slovenia is the responsibility of several agencies. This results in fragmentation of monitoring and enforcement in financial reporting, as each agency needs to create adequate capacity which is not always affordable.** The Bank of Slovenia (BS), and specifically its Banking Supervision Department, supervises banks. BS is responsible also for payments system oversight. The Securities Market Agency (ATVP) oversees the securities sector, and also regulates mutual funds and mutual pension funds. The Insurance Supervision Agency (AZN) mainly deals with the insurance sector. AZN is responsible for the supervision of (i) insurance companies and (ii) pension companies.

Financial Sector

- 15 **The role of State-Owned Enterprises (SOEs) in the economy of Slovenia is significant.** SOEs directly owned by the government represented a total book value of

²³ Financial Stability Report Bank of Slovenia - May 2013.

²⁴ Since 2009 the Ljubljana Stock exchange is part of Central and East Europe (CEE) Stock Exchange Group (CEESEG), which also comprise the Vienna Stock Exchange and the stock exchanges of Budapest and Prague.

²⁵ Source: European Central Bank Statistical Warehouse: <http://sdw.ecb.europa.eu/home.do>

²⁶ Financial Stability Report Bank of Slovenia - May 2013.

EUR 11.2 billion, or just over 24 percent of GDP, in 2012.²⁷ SOEs generated one sixth of the value added of the Slovenian economy and employed one out of eight people in the corporate sector in 2011²⁸. The state owns, directly or indirectly through its holding companies, stakes in at least 129 companies, including 50 companies in which the state owns between 50 and 100 percent of shares, 40 companies with significant ownership between 20 and 50 percent, and 39 companies with minority ownership of up to 20 percent²⁹. SOEs are dominant in sectors that in other developed economies are typically privately owned, e.g., the financial sector and telecommunications. Moreover, most of the companies included in the Ljubljana Stock Exchange's benchmark SBI TOP index are either state owned or the state has significant ownership (e.g. Telekom Slovenije).

- 16 **SOE governance is an important policy issue in Slovenia. Most significant SOEs are directly owned by the State, but holding companies also own significant portfolios.** In some cases the ownership is fragmented and several entities own different percentages of shares on behalf of the state.³⁰ The state's direct ownership was centralized under the umbrella of the Capital Assets Management Agency (AUKN). AUKN was to be replaced by the Slovenian State Holding Company (SDH), with the aim of consolidating and managing all state assets (owned directly and indirectly) under one structure, and allowing for the privatization of some of these assets. However, the political context since the beginning of 2013 has delayed the process of setting up SDH, and AUKN as a management structure was temporarily replaced by the State Fund (SOD). Formally, there is a privatization strategy however there seems to be a lack of political will to commit to and implement the strategy other than in a piecemeal and ad hoc manner. On June 21, 2013, the National Assembly authorized SOD to begin selling shares in 15 SOEs, including the second largest bank (NKBM), the largest telecom operator, Telekom Slovenije, and other smaller assets.³¹
- 17 **The most recent financial data shows that several SOEs have been accumulating losses and losing equity value, and a number of companies are in default position or have negative equity.** This is partially due to the current downturn, but also due to inefficient capital structures.

Industrial Sector

- 18 **The industrial sector is significant and important for the Slovenian economy in terms of jobs as well as asset value.** In 2012, 12 percent of companies operated in manufacturing, employing 37.6 percent of all workers. They generated 29.7 percent of

²⁷ SOD data as of August 31, 2013.

²⁸ http://ec.europa.eu/economy_finance/publications/country_focus/2013/pdf/cf_vol10_issue3_en.pdf

²⁹ Source: data as of August 31, 2013 offered to the team by SOD.

³⁰ The State owns various portfolios of shares directly but also through its holding companies: SOD, Slovenian Restitution Fund; KAD, Pension Fund; PDP, a Special Company for Corporate Advisory; DSU, which manages real estate; and MZ, insurance company.

³¹ <http://www.so-druzba.si/en-us/privatization>

total revenue, with 23.4 percent of all assets³². Manufacturing is also important for research and development activities in the business sector in Slovenia, approximately 80 percent of them are implemented in manufacturing, of which about one-third in the production of pharmaceutical products (mostly by one largest listed company in which the Government owns almost 25 percent of shares through two holding companies) and another third in the manufacture of metal products, electronics and optical products, electrical equipment, machinery, motor vehicles, and other vehicles and vessels. Industry has a significant effect on productivity and employment in other activities. As evaluated by the European Commission, every 100 jobs created in industry create 60 to 200 additional new jobs in industry related activities.

Sound corporate financial reporting infrastructure: an important element for addressing the country's economic issues

- 19 **Improved corporate sector financial reporting and auditing can contribute to the country's further economic development and help restore investors and lenders confidence in the market; this is especially relevant for the banking sector and SOEs which are key types of entities in Slovenia.** Timely and reliable financial information enables an enterprise to improve its managerial and governance decisions; it enables the enterprise to be credible trade and investment partners; and allows enterprises to be credible borrowers, domestically and internationally. This has consequences for banking financial reporting and how risks associated with credit decisions are reflected in banks' financial statements. A major effort to produce timely and reliable financial information, in accordance with Slovenia's new laws and rules, can improve the investment climate, the business environment and the availability of credit for Slovenian enterprises, enabling them to follow expansionary strategies that should stimulate the economy. Moreover, banks following good credit practices that rely on timely and reliable information will make better credit decisions, at a time when they are all under pressure to absorb expanded government borrowings and lend to the private sector. Credit decisions should properly calibrate the risks involved and include them in banks financial statements. Improved accounting, auditing and financial reporting alone is not enough to solve the country's problems, but it can contribute to the economic stimulus and raise public confidence in sound financial reporting and mechanisms that protect the public interest.

A&A ROSC objectives and areas of specific focus

- 20 **The purpose of this A&A ROSC Update for Slovenia is twofold.** First, it measures progress since the previous A&A ROSC in 2004, including the extent to which its policy recommendations have been implemented. This is part of a required monitoring and evaluation component of the Financial Reporting Technical Assistance Project (FRTAP, closing June 2014), whose purpose is to enhance the implementation of the *acquis*

³² AJPES: Information on the business operations of companies in 2012;
http://www.ajpes.si/Registers/Annual_Reports/Information

communautaire as it relates to financial reporting in Slovenia³³. Second, the Update seeks to support financial sector stability and sustainable development in the financial and private sectors. Reliable financial information is the cornerstone of a robust and stable financial system; this report identifies how financial reporting requirements and their enforcement can be strengthened in order to bolster confidence in Slovenian market and how a good financial reporting infrastructure can help in forecasting and timely responding to an economic crisis, including a banking crisis.

- 21 **While this report covers the accounting, audit, and reporting frameworks for the corporate sector as a whole, it pays particular attention to the following key areas that are important in the current economic context of Slovenia: the financial sector, SOEs, SMEs, and audit regulation mechanisms.** As the requirements of the EU *acquis communautaire* and international standards have already been adopted in the financial sector this assessment focuses on the proper application of these requirements, with the view that improved financial information raises the capacity of regulators to maintain financial stability, and improve the level of trust in the financial system, in the context of an ongoing recapitalization exercise. In the SOEs, the report focuses on the requirements applicable to them and how well these are enforced, as well as to what extent the government uses the financial reporting and audit process to monitor SOEs and hold their management teams accountable. This report also considers SMEs financial reporting, including how current requirements compare with the latest revisions to the EU Accounting Directive, which further simplified requirements for smaller companies. Finally, audit oversight and quality assurance systems are assessed, including the feasibility of incorporating the audit oversight body as part of the financial sector supervisor.

³³ Financial Reporting Technical Assistance Project (FRTAP) is funded under the Swiss-Slovenian Cooperation Programme and implemented by the World Bank Centre for Financial reporting Reform (CFRR); www.worldbank.org/cfrr

II. Institutional Framework³⁴

A. Statutory Framework

- 22 This section describes the statutory framework for corporate financial reporting and benchmarks it, where relevant, to the EU *acquis communautaire*. The statutory framework is an important element for creating adequate standards and requirements for various types of entities in Slovenia. It should be compliant with EU requirements and good international practice, including setting formal requirements for financial reporting that aim to support economic decisions. It should also facilitate economic development and be less of an administrative burden, especially for smaller entities that only need basic information for them and their users to be able to take relevant economic decisions. Thus, a robust statutory framework is essential for setting a good financial reporting infrastructure and in facilitating the supply of good financial information to the market.
- 23 **The Companies Act regulates business activities in Slovenia; it is based on the *acquis communautaire* and the German legal tradition.** Nearly all companies, including those with foreign ownership, are set up as limited liability companies (d.o.o.), and they make up the largest share of employment and revenues among registered companies. Joint-stock companies (d.d.) represent only one percent of all companies, but employ nearly one-quarter of individuals employed in incorporated companies, and bring in over one-quarter of revenues of all companies. Only joint-stock companies may issue shares, and thus be listed on the stock exchange. Companies are given the option of having a two-tier (supervisory board and management board) or one-tier management structure (board of directors).³⁵ Large or listed joint stock companies tend to prefer a two-tier management structure.

Table 1: Companies by legal form (2012)

	Number of registered companies (% of total)	Number of Employment (% of total)	Annual Revenues (% of total)
<i>Limited Liability Companies</i>	56,889 (95.2% of total)	327,393 (75.3%)	56,716,471 (72.0%)
<i>Joint Stock Companies</i>	644 (1.1%)	103,577 (23.8%)	21,076,654 (26.8%)
<i>Other</i>	2,193 (3.7%)	4,088 (0.9%)	930,378 (1.2%)

³⁴ 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.

³⁵ Art. 253 of the Companies Act.

- 24 **According to the Companies Act, the shareholders General Meeting does not have an explicit obligation to approve annual financial statements.** As recommended by the 2004 ROSC A&A (see annex 4 for details), the Companies Act now requires management and “control bodies” (i.e., the supervisory board in a two-tier system, or board of directors in a one-tier system) to be responsible for ensuring that annual reports are drawn up and published in accordance with applicable statutes and standards.³⁶ The supervisory board is responsible for approving the financial statements of the company.³⁷ The Annual General Meeting of shareholders (AGM) does not generally approve financial statements.³⁸ It does so only if the control bodies fail to approve financial statements, or if this task has been delegated to it from the control bodies or management. Further, in a one-tier system, the company’s bylaws may determine that its financial statements require AGM approval. The Criminal Code states that intentional presentation and submission of false financial statements is a criminal offense, punishable by up to two years imprisonment³⁹.
- 25 **Most of the provisions of the *acquis communautaire*, as it relates to accounting, audit, and financial reporting have been adopted; there are, however, a few issues that still need to be addressed.** While some new provisions of the New EU Accounting Directive⁴⁰ have already been transposed into Slovenian Accounting Standards (SAS), Slovenian authorities still need to transpose remaining requirements by the deadline of 2015. These areas are described in further detail in paragraphs 27, 33, and 34.
- 26 **The Parliament has an oversight role over institutions responsible for corporate financial reporting and SOEs, but its engagement is limited and as a result the role in protecting public interest can be undermined.** Parliament, through its structure of Parliamentary Committees, has an oversight role over the regulated sectors including the banking supervisor (BS), securities market regulator (ATVP), insurance supervisor (AZN), audit oversight body (APOA), Institute of Auditors (SIA), and SOEs. However, Parliament does not appear to engage much on financial reporting and auditing issues from the public interest perspective, particularly with the APOA and SIA, as is reflected in the low and declining annual budget allocated to the APOA; its limited action in terms of monitoring the implementation of the Auditing Act; and its lack of engagement in resolving issues between the APOA and SIA.

³⁶ Art. 60a of the Companies Act.

³⁷ Art. 282 of the Companies Act.

³⁸ Art. 293 of the Companies Act.

³⁹ Art. 235 of the Criminal Code (KZ-1). The article refers broadly to company books, documents or files; the ROSC team assumes this includes financial statements, especially for cases when the false information was presented intentionally by those in charge with governance.

⁴⁰ Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC.

The Statutory Framework for Accounting and Financial Reporting

- 27 **Although public interest entities (PIEs)⁴¹ are not specifically defined in Slovenian legislation, listed companies, banks and insurance companies are subject to more demanding requirements when it comes to financial reporting and audit.** The more demanding requirements include the requirements to apply EU endorsed IFRS, and transparency reporting by auditors of listed entities. While there is no incompatibility with the current Directives, the lack of a formal PIE definition in the domestic legislation could lead to misunderstandings in transposing the provisions of the Accounting and Auditing Directives. Slovenian authorities may wish to set forth a legal definition of PIEs, in line with the definition under the New Accounting Directive.⁴² Also, the definition of publicly accountable entity in IFRS for SMEs may be a useful reference in that regard.
- 28 **Non-PIEs are generally subject to robust financial reporting requirements, in line with the *acquis communautaire*.** These requirements include applying SAS for individual and group financial statements and audit requirements for entities meeting the size criteria compliant with the EU accounting directives in force.
- 29 **The Companies Act includes provisions on accounting, audit, and financial reporting for all companies.** It transposes the “old” Accounting Directives (Fourth and Seventh Company Law Directives on legal entity and consolidated financial reporting, respectively) and regulates the implementation of Regulation 1606/2002, which requires the application of International Financial Reporting Standards (IFRS) for the consolidated accounts of listed companies. Banks and insurance companies must prepare their financial statements according to IFRS as endorsed by the EU for individual and group financial statements. Listed entities are required to apply IFRS only for group financial statements. Table 2 summarizes the requirements relating to accounting, audit, and reporting by Slovenian enterprises.

⁴¹ Public interest entities are defined in the *acquis* as: (a) entities whose transferable securities are admitted to trading on a regulated market of any Member State; (b) credit institutions; (c) insurance undertakings; or (d) designated by Member States as public interest entities, for instance undertakings that are of significant public relevance because of the nature of their business, their size or the number of their employees.

⁴² Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC.

Table 2: Summary of financial reporting, auditing and publication requirements

	Regulatory /oversight organization	Accounting standards	Audit requirements (no. of entities ⁴³)	Public Availability
Listed companies, including SOEs	ATVP / additionally SOD for SOEs	IFRS for consolidated SAS or IFRS for legal entity	Yes (66)	Yes, on AJPES and companies' websites; and Info Storage http://www.oam.si/
Non-listed companies, including SOEs	None / additionally SOD for SOEs	Slovenian Accounting Standards (SAS) or IFRS	(1,740)	Yes, on AJPES website
Large			Yes	
Medium			Yes	
Small & Micro			No	
Banks, including state owned	BS / additionally SOD for SOEs	IFRS for consolidated and legal entity	Yes (23)	Yes, on AJPES and companies' websites
Insurance, including state owned and reinsurance company	AZN	IFRS for consolidated and legal entity	Yes (17)	Yes, on AJPES and companies' websites

Note: The IFRS in the table above are IFRS as endorsed by the EU.

- 30 **The Companies Act includes some detailed accounting requirements that are duplicated in Slovenian Accounting Standards (SAS) or included in IFRS. This creates complications as there are some inconsistencies, and changes to the reporting framework require changes to the Companies Act.** For example financial statements are more narrowly defined in the Companies Act compared to SAS or IFRS; the legal definition includes notes as a separate component of the annual report and not as part of financial statements as defined by SAS and IFRS. Also, the formats of the Balance sheet and Income statement are prescribed by both articles 65 and 66 of the Companies Act as well as in SAS 24 and SAS 25. It is not necessary to transpose all requirements of the *acquis* into the Companies Act. The new Accounting Directive⁴⁴

⁴³ Source: information from Slovenian Institute of Auditors.

⁴⁴ Article 53.

specifically states that transposition can be achieved using various legal instruments, such as laws, regulations and administrative provisions. The Slovenian authorities may wish to consider retaining certain higher level aspects of the financial reporting requirements in the Companies Act (such as for example the need to produce financial statements, audit requirements, etc.) and leaving details in the SAS (such disclosure requirements).

- 31 **Companies are required to use a unified chart of accounts and prescribed layouts of financial statements which may create an additional burden, and sometimes inconsistencies, for companies that apply IFRS and multinational companies with parent entities outside Slovenia.** The Companies Act⁴⁵ requires entities to use a unified chart of accounts;⁴⁶ insurance companies also have to apply unified charts of accounts issued by their regulator.⁴⁷ For banks, the BS has issued regulations for the layout of financial statements that are based on Financial Reporting Data (FINREP)⁴⁸ and compliant with IFRS. Banks also keep their general ledger according their own Chart of Accounts from which are drawn their primary financial statements. For others the Companies Act prescribes layouts, and entities that apply SAS or IFRS have to use them for reporting. While the Companies Act requirements are not necessarily inconsistent with IFRS, they may create some issues in the presentation of financial statements as IFRS are more flexible with the layouts and allow entities to present relevant information only and focus on material items.
- 32 **The Energy Act⁴⁹ requires energy companies to follow certain accounting rules related to revenue recognition that may hinder the effective application of SAS and IFRS by energy companies.** In practice, some energy companies comply with the requirements of the Energy Act and disregard the requirements of SAS and IFRS. As a result, those energy companies receive qualified audit opinions on this particular issue. Although the law was changed in February 2014, the issue is not resolved and the energy companies will continue facing the same issue as the revised law does not give an unambiguous precedence to SAS and IFRS in revenue recognition.
- 33 **Slovenian size thresholds for MSMEs generally follow the maximum limits permitted by the directives in force.** The Companies Act classifies companies according to size: micro, small, medium and large, based on the number of employees, turnover, and balance sheet total. Certain types of companies are never considered to be an MSME regardless of size, namely banks, insurance companies, stock exchanges, and any company required to prepare IFRS-based consolidated financial statements. The

⁴⁵ Article 54 (3).

⁴⁶ Unified charts of accounts are developed by the Slovenian Institute of Auditors (SIA) and endorsed by the ministers responsible for the economy and finance. SIA recently issued new charts of accounts which apply for companies, sole proprietors, farmers' households, cooperatives, non-profit organizations-private law entities, associations and disability organizations.

⁴⁷ <http://www.si-revizija.si/publikacije/dokumenti/KO-enotni.pdf>

⁴⁸ FINREP is a standardised EU-wide framework for reporting financial (accounting) data. It comprises templates for reporting the income statement and the balance sheet, as well as breakdowns of other data.

⁴⁹ Art 46.a.

current thresholds will need to be revised and aligned with those set out under the new accounting directive (see table 3 below).

Table 3: Definition of MSMEs (new EU thresholds in parentheses)

	Micro	Small	Medium	Large
Average number of employees	1 - 10	11 - 50	51 - 250	> 250
Annual turnover	< EUR 2 million (< EUR 700,000)	EUR 2 - 8.8 million (EUR 700,000 - 8 million)	EUR 8.8 - 35 million (EUR 8 - 40 million)	> EUR 35 million (> EUR 40 million)
Total assets	< EUR 2 million (< EUR 350,000)	EUR 2 - 4.4 million (EUR 350,000 - 4 million)	EUR 4.4 - 17.5 million (EUR 4 - 20 million)	> EUR 17.5 million (> EUR 20 million)

- 34 **In line with EU requirements, Slovenia has differentiated requirements for micro, small and medium-sized enterprises (MSMEs), including less demanding disclosure requirements.**⁵⁰ The following exemptions are currently given to MSMEs: (i) small and medium-sized entities are allowed to submit abridged balance sheets; (ii) small and medium-sized entities are allowed to draw up abridged profit and loss accounts, subject to prescribed limits; (iii) small companies whose securities are not traded on a regulated market are exempted from preparation of the business report. In addition, entities not subject to auditing must satisfy only the disclosure requirements in compliance with the Companies Act and some SAS. They are not required to disclose all information and data required by SAS. Slovenian authorities will need to consider the implementation of additional simplifications and exemptions provided by the New Accounting Directive, such as the exemption for micro entities from the obligation to present 'Prepayments and accrued income' and 'Accruals and deferred income'. Additional details are provided in Annex 2.
- 35 **All companies are required to prepare annual financial statements comprising a balance sheet, statement of profit and loss, and notes.** Slovenian companies outside the regulated sectors are required to apply SAS in their consolidated and legal entity financial statements.⁵¹ They are permitted to apply EU endorsed IFRS if their general meeting decides to do so, while the general meeting does not have an explicit

⁵⁰ Article 55 of the Companies Act covers MSMEs.

⁵¹ Article 54 of the Companies Act sets out the financial reporting standards to be used by Slovenian companies.

responsibility for approving financial statements (this is the responsibility of the supervisory board). If the IFRS option is taken, they must apply it for a period of at least five years. In addition, medium and large companies—as well as listed small companies—are required to prepare a cash flow statement, and statement of changes in equity.⁵² Medium and large companies—and small listed companies—are also required to prepare a business report (the Companies Act defines management report as business report) stating the development and results of the company's operations and its financial position, including a description of the essential risks and uncertainties to which the company is exposed.⁵³ Listed companies may include a corporate governance report in the business report, indicating which Corporate Governance code is applied by the company and reporting on compliance; or produce a separate corporate governance statement - in this case the business report should refer to it. The full set of reports (financial statements, notes, and management/business report) is referred to as the annual report in Slovenian legislation, which is not entirely consistent with the terminology used in the New Accounting Directive; in addition, as described in paragraph 0, the composition of financial statements is not entirely consistent with SAS or IFRS.

- 36 **All companies are required to file their financial statements with a public body within eight months of the year end.**⁵⁴ While the new accounting directive allows publication within a period of twelve months after the balance sheet date, it is considered good international practice to do so within six months. Companies must submit a complete set of their annual legal entity and consolidated financial statements, as well as the audit report (if applicable), to the Agency of the Republic of Slovenia for Public Legal Records and Related Services (AJPES). Medium and large-sized companies—as well as small listed companies—must submit their annual report and auditor's report to AJPES within eight months of the end of the financial year. For small unlisted companies (which do not require an audit), the deadline is three months. The information submitted to AJPES is made available to the public on the Agency's website.⁵⁵ Public data, including full sets of financial statements, is available free of charge; preparation of copies and transcripts of annual reports requires payment of a fee (http://www.ajpes.si/Registers/Annual_Reports/Re-use); also, credit rating information is accessible against a fee while annual reports are available on-line free of charge. For 2012, as of January 13, 2014, AJPES had published 72,699 annual reports of sole proprietors, 21,751 of associations and 61,513 of companies and cooperatives of which 1,740 had been audited and 520 were consolidated.
- 37 **In line with EU directive and IAS regulation, groups of companies are required to prepare consolidated financial statements; listed groups as well as groups of banks and insurance companies must do so in accordance with IFRS.**⁵⁶ A company established in Slovenia which is the parent company of one or more subsidiary

⁵² Art. 60 of the Companies Act.

⁵³ Art. 70 of the Companies Act.

⁵⁴ Art. 58 of the Companies Act.

⁵⁵ AJPES publishes the annual reports, consolidated annual reports and auditors' reports on its website, <http://www.ajpes.si/JOLP/>.

⁵⁶ Art. 56 of the Companies Act governs consolidated annual reports.

companies is required to prepare consolidated financial statements if either the parent or any of the subsidiaries is organized as a company with share capital, partnership or equivalent legal form (typically joint-stock company or limited liability company). A full set of consolidated financial statements comprises a consolidated balance sheet, a consolidated statement of profit and loss, a consolidated cash flow statement, a consolidated statement of changes in equity, and notes. Groups of companies are also required to issue a consolidated business report. The consolidated financial statements and business report must be prepared within four months of the year-end.⁵⁷ Groups that do not meet two of the following three thresholds set for medium-sized entities (i.e. groups that are smaller of medium-sized entities, and the criteria of assets and turnover increased by 20 percent) are exempted from having to prepare consolidated financial statements: annual turnover of EUR 10.56 million, assets of EUR 5.28 million, and the average number of employees 50. If any of the companies in the small group is a listed company, however, this exemption cannot be taken. The size criteria are more demanding in Slovenia than required by the EU directive in force; thus, the directive allows medium-sized entities to be exempted from preparing consolidated financial statements, while in Slovenia this exemption applies only to small and micro-entities.

- 38 **State-owned enterprises (SOEs) are subject to the same statutory requirements as private companies when it comes to accounting, audit, and financial reporting.** State-owned enterprises must be incorporated as a company under the requirements of the Companies Act and therefore must follow the same laws and regulations for financial reporting and auditing.

Financial Sector

- 39 **In general, the Slovenian financial reporting legal framework for the financial sector is comprehensive and regularly updated. The EU *acquis communautaire* and regulations have been fully adopted and implemented relative to the financial sector.** Disclosure and reporting requirements are strict, and adhere to EU requirements.
- 40 **Banks are required to prepare their legal entity and consolidated financial statements in accordance with EU-endorsed IFRS.**⁵⁸ The BS published a regulation⁵⁹ regarding the preparation of statutory general-purpose financial statements. Banks must prepare their financial statements in accordance with IFRS and this regulation and submit unaudited legal entity annual financial statements to the BS no later than a month after the end of the financial year, and consolidated unaudited financial statements within two months of the year-end. Banks listed on the Ljubljana Stock Exchange (LJSE) must publish their annual report, including audited financial statements, within four months of

⁵⁷ Art. 54 of the Companies Act.

⁵⁸ According to the Companies Act and Banking Act (Article 203).

⁵⁹ Regulation on the Books of Account and Annual Reports of Banks and Savings banks. Official Gazette of the Republic of Slovenia, No. 17/12 and 104/13.

the end of the business year and must ensure that they are publicly available for at least five years after publication.⁶⁰

- 41 **Banks apply the Basel II framework⁶¹ for capital adequacy, as well as standards and guidelines published by the European Banking Authority.** The BS, as other EU banking regulators, is in the middle of Basel III implementation phase⁶².
- 42 **Prudential reporting requirements for banks are based on general purpose financial reporting data with additional disclosures where relevant, e.g., loan loss provisions according to prudential rules are disclosed separately in general purpose financial statements.** For prudential purposes and prudential reporting, BS has issued detailed regulations for banks to submit data in a specific format. For example, in accordance with the BS Regulation on the Books of Account and Annual Reports of Banks and Savings banks, BS has prescribed specific formats for banks to submit financial statements data to the BS on a regular basis based on Financial Reporting Data (FINREP)⁶³ regulations issued by the European Banking Authority. In addition, for the purpose of prudential supervision on a consolidated basis, the BS has issued specific regulations for banks to submit unaudited consolidated financial statements data on a regular basis.⁶⁴ The banking group, for prudential purposes, is defined differently from general financial reporting requirements based on IFRS. The differences are likely to remain under Basel III implementation in the EU through “Capital Requirements Directive IV”.⁶⁵ These differences will have an impact on the way IFRS are enforced by the BS and the reconciliation of data between general purpose and prudential reporting. Finally, Article 207 of the Banking Act sets disclosure provisions for banks complying with the Basel capital requirements framework; it transposes the specific requirements of the Directive 2006/48/ES for transparency of banks for Pillar 3 disclosures.
- 43 **Insurance companies prepare their consolidated and legal entity financial statements according to IFRS.⁶⁶** Insurance companies must submit their unaudited annual report for the financial year no later than within three months after the end of the

⁶⁰ Per Art. 110 of the Financial Instruments Market Act and regulations of the securities market regulator.

⁶¹ Basel II is the international capital adequacy framework for banks issued by the Basel Committee on Banking Supervision.

⁶² Basel III is the latest version of the international capital adequacy framework for banks issued by the Basel Committee on Banking Supervision and supersedes Basel II.

⁶³ FINREP is a standardised EU-wide framework for reporting financial (accounting) data. It comprises templates for reporting the income statement and the balance sheet, as well as breakdowns of other data.

⁶⁴ Per requirements contained in BS Regulations on Supervision of Banks and Savings Banks on Consolidated Basis and the Basel II framework.

⁶⁵ Note. The definition of the banking group for prudential purposes and prudential reporting in line with the current EU bank capital framework is represented by Directives 2006/48/EC (Banking Consolidating Directive or BCD) and 2006/49/EC (Capital Adequacy Directive or CAD) (both also known as Capital Requirement Directives or CRD) and reflecting the international agreements of the Basel Committee on Banking Supervision (Basel Committee) is different to the definition of the banking group for IFRS reporting purposes. These differences are likely to remain under CRD IV which is implementing Basel III in the EU.

⁶⁶ According to Article 155 of the Insurance Act in line with Article 54/11 of the Companies Act, insurance companies have to prepare financial statements according to IFRS as endorsed in the EU.

calendar year to the Insurance Supervision Agency (AZN), and reinsurance undertakings within four months after the end of the calendar year. In addition, the insurance undertaking is obliged to submit to the AZN an audited annual report and the auditor's report within eight days of receiving the auditor's report, or within six months of the end of the calendar year at the latest (reinsurance undertaking within seven months). AZN issues secondary rules and regulations for the preparation of certain items on the balance sheet, such as insurance liabilities. There is generally no contradiction between AZN rules and IFRS except in the case of equalization reserves (refer to paragraph 114 for a comparison of the Insurance Act and IFRS for more details).

- 44 **The Insurance Accounts Directive (IAD 91/674/EEC) was transposed in Slovenia in the Insurance Act, which includes provisions relating to the prudential reporting of insurance undertakings.** Prudential capital requirements for insurance companies are governed by Solvency I.⁶⁷ The Insurance Act also includes provisions in line with the actuarial principles for the measurement of insurance liabilities as laid down in the Solvency I framework.
- 45 **Other non-bank financial institutions (NBFIs) include pension companies, which are regulated by the Insurance Supervision Agency (AZN), as well as brokerage companies, mutual funds, and mutual pension funds, which are regulated by the Securities Market Agency (ATVP).** Mutual funds must make their annual report available to investors on subscription websites - these sites allow an investor (a holder or potential holder of an investment fund unit) to buy or file a request for redemption of investment fund units, but are not available to the general public. A paper copy must be provided to investors on request. Slovenian mutual funds do not have legal personality and as such do not fall under the scope of the Companies Act. They are regulated instead by the Investment Funds and Management Companies Act. However, asset management companies which manage the funds must publish their annual reports on their public website. Mutual pension funds must publish their annual report on their webpage and a paper copy is delivered to the investor upon request.
- 46 **In line with the requirements of the EU's Transparency Directive (2004/109/EC), listed companies must publish their annual report including financial statements within four months of the end of the business year and ensure that they are publicly available for at least five years after publication.**⁶⁸ A listed company must publish annual audited financial statements each year. It must also publish semi-annual financial statements, for the first six months of its business year, within two months of the end of this period which must be publicly available for at least five years.

⁶⁷ Solvency I is the name given to changes to the EU's insurer solvency regime made in 2002. The EU's insurer solvency regime was put in place in the 1970's. Solvency I did not fundamentally change the requirements, and in the process of making the changes it became clear that a more wide-ranging reform was required; this is why a new framework is needed: Solvency II, which is currently work in progress. The Solvency I Directives are for life insurers (2002/12/EC) and non-life insurers (2002/13/EC).

⁶⁸ Per Art. 110-114 of the Financial Instruments Market Act and regulations of the ATVP.

- 47 **Listing rules impose additional disclosure requirements for listed companies.** The equity market of Ljubljana Stock Exchange has the three sub-segments: Entry Market, Standard Market and Prime Market, and issuers within a particular sub-segment have different obligations. For example, Prime Market issuers are obliged to produce quarterly interim reports, pursuant to IAS 34 and the Guidelines on Disclosure for Prime Market Issuers, within 2 months of the period-end. As discussed further in paragraph 89, the ATPV does not have specific and detailed requirements for monitoring financial statements published by the listed companies.
- 48 **There are a significant number of non-profit organizations in Slovenia. In response to their demand for specific accounting guidance, SIA issued a special accounting standard for not-for-profit associations.** An association is an independent and non-profit entity established in accordance with the provisions of the Associations Act. In 2012, there were 21,622 associations with revenues totaling EUR 547 million. Associations may not distribute profits among members⁶⁹. Accounting and financial reporting requirements for associations and their federations are prescribed by SAS 33 Accounting Solutions in Associations and Disability Organizations. The annual report of an association must include: (i) balance sheet; (ii) income statement; (iii) notes to the financial statements; and (iv) a report on the operations of the association. The annual financial statements of associations whose revenues or expenses in the previous financial year exceeded EUR 1 million must be audited; there are approximately 60 associations that meet these criteria. The audit report needs to include an explanatory paragraph⁷⁰ confirming that: (i) the report on the operations is consistent with the financial statements; and (ii) all expenditure was in support of the association's activities and no funds were distributed among members. The audited financial statements and audit report of these associations must be submitted to AJPES within eight months of the year end (by August 31)⁷¹. More details on SAS 33 requirements are included in the Annex 2.
- 49 **The degree of alignment of corporate income tax legislation with financial reporting standards (SAS and IFRS) is high.** The 2006 tax reform resulted in closer alignment between the requirements of corporate income tax law and financial reporting standards. Thus, there is a clear reconciliation process between financial reporting requirements and tax base, and changes in SAS and IFRS often result in additional changes in corporate income tax law. The Introduction to SAS states that accounting standards do not cover taxation issues. Often, however, tax legislation is adjusted to reflect the SAS and IFRS accounting treatment for certain items or events, although the tax legislation does not specifically promote or refer to those accounting treatments. For the Government, relevant national tax laws supplement the requirements of professional standards, and are directed towards the preparation of tax returns rather than including the concepts that are already incorporated in financial reporting standards. The tax base for corporate income tax is accounting profit, determined as the surplus of revenues over expenses recognized in the income statement according to financial reporting standards, unless otherwise

⁶⁹ excess of revenue over expenses for all activities and other sources.

⁷⁰ Article 27 of the Associations Act.

⁷¹ Article 29 of the Associations Act.

stipulated by the Corporate Income Tax Act, and accounting profit is adjusted in calculation of taxable income in line with the Corporate Income Tax Act.

- 50 **Tax rules continue to have limited influence over general purpose financial reporting and this affects the quality of financial information, especially by smaller entities.** Although the reconciliation process and close alignment of tax rules with financial reporting standards help preparers to consistently follow financial reporting standards without being influenced by tax rules, there are cases when preparers prefer to apply tax rules instead of financial reporting requirements. This typically happens with smaller entities, especially if their financial statements are not audited. The following types of transactions are often recognized or influenced by tax requirements: depreciation, recognition of bad debts or similar transactions which are prescribed by the corporate income tax law.

The Statutory Framework for Auditing

- 51 **Statutory audit requirements are set out in the Companies Act and in the Auditing Act adopted in 2008; the latter transposes the Statutory Audit Directive (2006/43/EC) on statutory audits of annual accounts and consolidated accounts.** It also has provisions on quality assurance of statutory audits, and establishes the Slovenian Institute of Auditors (SIA) which is responsible for, *inter alia*, setting accounting and audit standards, licensing auditors, and supervising the work of auditors. The Act also establishes an Agency for the Public Oversight of Auditing, responsible for supervising the work of the SIA.
- 52 **Companies must undergo an annual financial statement audit, with the exception of small companies.**⁷² A statutory audit is mandated for the legal entity and consolidated financial statements of medium and large-sized entities and groups, as well as of all companies in the regulated sectors (i.e., listed companies, banks, and insurance companies). Auditors are required to examine the business report of these entities in order to ascertain whether it is consistent with the other elements of the annual report. Audits must be completed within six months of the end of the financial year. There are also some audit requirements included in specific laws, such as for example commercial public service providers are required to be audited in accordance with the Public Utilities Act.
- 53 **The Auditing Act may be interpreted as reserving various consulting services, including all assurance engagements and agreed-upon-procedures engagements, for the benefit only of licensed auditors, which is not required under the Statutory Audit Directive. Also, the law defines an audit as auditing of financial statements, other assurance engagements and agreed upon procedures; this definition is not consistent with International Standards on Auditing (ISA).** In addition to regulating annual independent audits required by law (i.e., statutory audits), the Auditing Act also

⁷² Article 57 of the Companies Act covers statutory audits.

stipulates that only audit firms or individual auditors may provide additional services, such as assurance engagements and agreed-upon-procedures engagements. These additional services are not required to be regulated under EU *acquis* unless they have an impact on auditors' independence. The Auditing Act also regulates appraisals including the licensing and supervisory schemes applicable to certified appraisers. Furthermore, the Directive's requirement to inform relevant authorities if a statutory auditor's approval is withdrawn does not seem to be transposed into domestic legislation.⁷³

- 54 **The annual general meeting of shareholders (AGM) is responsible for approving the auditor.**⁷⁴ The supervisory board proposes an auditor to the AGM (on the recommendation of the audit committee if there is one). The AGM approves the external auditor for a period of one year⁷⁵. A company must notify the Institute of Auditors and Agency for the Public Oversight of Auditing (APOA) of the dismissal or resignation of the auditor in writing and provide grounds for the dismissal or resignation.⁷⁶ There is a seven-year audit partner rotation requirement in place for all audits, with a cooling-off period of at least two years prior to re-engagement.⁷⁷ In practice, the selection process for auditors is usually organized and carried out by management. Management should have very limited involvement in the appointment of auditors, as this could result in undue influence and compromise auditor's independence.
- 55 **The supervisory board of a company may choose to form an audit committee; an audit committee⁷⁸ is required for listed companies, banks and insurance companies⁷⁹.** Audit committees must have a minimum of three members, at least one of whom must be an independent expert in accounting or auditing; this is in line with the requirements of SAD. The other members, including the chair, must be members of the supervisory board. The responsibilities of the audit committee include: proposing an independent auditor to the supervisory board; cooperating with the auditor in conducting annual audits; supervising and monitoring financial reporting by the company; reviewing and monitoring independence of the auditor, particularly as regards the provision of non-audit services, and monitoring the company's internal controls, internal audit, and risk management systems.
- 56 **The legislation contains provisions related to fines of auditors; however, it is not very clear whether auditors are liable to third parties for negligence in their audit.**

⁷³ Article 5 (3). Where the approval of a statutory auditor or of an audit firm is withdrawn for any reason, the competent authority of the Member State where the approval is withdrawn shall communicate that fact and the reasons for the withdrawal to the relevant competent authorities of Member States where the statutory auditor or audit firm is also approved which are entered in the first-named Member State's register in accordance with Article 16(1), point (c).

⁷⁴ Article 281 of Companies Act regulates the appointment of auditors in companies.

⁷⁵ In accordance with the Art. 239 (1) of Companies Act AGM decides on appointment of the auditor. Art. 47 (2) of Auditing Act requests an auditing contract shall be concluded separately in writing for each audit engagement.

⁷⁶ Art. 37(5) of the Auditing Act.

⁷⁷ Art. 45(2) of the Auditing Act.

⁷⁸ Art. 279-280 govern audit committees in joint-stock companies.

⁷⁹ Art. 279 and 289 of Companies Act, art. 75 (1) of Banking Act and art. 31.a of Insurance Act.

According to the Companies Act, auditors are liable to the companies they audit and their shareholders—but not necessarily to third parties—for damages resulting from a violation of auditing rules.⁸⁰ In contrast, the Auditing Act requires auditors to have liability insurance for damages caused to an audited entity or third parties due to violations of audit rules or an audit contract. Auditors, principals of audit firms, and audit firms themselves may also be fined for noncompliance with relevant provisions of the Auditing Act. Fines range from EUR 2,100 to 6,300 for auditors and principals of audit firms, and from EUR 4,200 to EUR 21,000 for audit firms.⁸¹ The Agency for the Public Oversight of Auditing can apply additional administrative sanctions, namely reprimands and withdrawals of audit licenses.⁸² Auditors can also face criminal prosecution for certifying fraudulent or false financial reports, punishable by up to two years of imprisonment, although there were no such cases in Slovenia.⁸³

57 **Auditors are required to have professional indemnity insurance which is readily available on the market and sufficient to cover the level of actual claims.** The auditors' liability is limited by a statutory cap, except in cases where their actions were intentional or due to gross negligence.⁸⁴ Auditors are required to take out liability insurance for damages caused to an audited company or third parties due to violations of audit rules or an audit contract. The insurance policy must be at least equal to the greater of: the value of the largest audit contract that year, multiplied by 15; or the sum of fees for auditing services of all auditing contracts over the course of the year, multiplied by 2.5.⁸⁵ The minimum level of professional indemnity insurance for auditors as required by the Auditing Act, despite having no particular empirical basis, appears both readily available on the market and sufficient to cover the level of actual claims - which to-date have been negligible given the practicality of pursuing claims.

58 **For banks, an additional audit on compliance with the bank's risk management rules is required.**⁸⁶ This additional compliance audit may give supervisors a better understanding of the risks faced by the bank. The additional auditor review of compliance with risk management rules encompasses a review of (a) the treatment of the following risks: credit risk, market risks, interest rate risk, operational risk, liquidity risk; and (b) own funds, capital requirements and internal capital adequacy. An additional auditor's report on compliance with risk management rules is then prepared by the auditor and submitted to the BS including the following: (a) any deficiencies identified during the audit review of the respective areas listed in the regulation; (b) the follow-up

⁸⁰ Art. 57(3) of the Companies Act governs auditor liability to the company.

⁸¹ Art. 162-164 of the Auditing Act.

⁸² Art. 53-56 of the Auditing Act.

⁸³ Art. 235 of the Criminal Code refers to certifying false business document; it can be implicitly considered that if such documents (i.e. financial statements) were false, those charged with governance and auditors may be prosecuted.

⁸⁴ The auditor is liable for damages up to EUR 150,000 for small companies; EUR 500,000 for medium-sized companies; and EUR 1 million for large companies. Source: Article 57(3) of the Companies Act.

⁸⁵ Art. 67 of the Auditing Act.

⁸⁶ Per BS regulation on the Minimum Scope and Content of the Additional Audits' Review of Compliance with Risk Management Rules by Banks and Savings Banks.

of findings in relation to the auditor's recommendations from previous years; and (c) recommendations regarding improvements in policies, processes and procedures.

- 59 **The BS does not have the power to reject and rescind the appointment of a banks' external auditor and as such there is no positive or negative list of bank auditors. This is not in line with Basel Core Principles for Effective Banking Supervision (BCP)⁸⁷.** One of the criteria in BCP principle 27 “Financial Reporting and External Audit” is that the supervisor has the power to reject and rescind the appointment of an external auditor who is deemed to have inadequate expertise or independence, or is not subject to or does not adhere to established professional standards. The BS has no say in the appointment, resignation or dismissal of the firm of external auditors. The bank informs the BS regarding the appointment or dismissal of the auditor by submitting a copy of the minutes of the meeting of shareholders. The BS does, however, have the authority to require that the auditor amend or modify the audit report, or reject the audit report and request that the audit be performed by another certified auditor at the bank's expense. However, the power of the BS to request for a change in auditor may be removed in the new draft Banking Act; this may need to be revised to comply with BCP.
- 60 **There are varying audit rotation requirements in place for the financial sector.** In the banking sector, the *key audit partner* is required to rotate after seven consecutive years. The new draft Banking Act may propose compulsory rotation of auditors of banks (see paragraph 17 of Annex 1). For insurance companies, pension funds and mutual funds, the *audit firm* must be rotated after five consecutive years. Additionally, for pension funds, the financial statements of the fund and of the company managing it are expected to be audited by the same auditor even if there is no legislation requiring it.
- 61 **State-owned enterprises are subject to the same audit requirements as other companies incorporated under the Companies Act. In addition, the Slovenian Court of Auditors (Supreme Audit Institution, SAI) has a right to audit any company in which the government has majority ownership. This requirement does not extend to any subsidiaries even if these are wholly or majority owned by SOEs, which creates an impediment for the SAI.** SOEs are subject to the same statutory requirements as private companies when it comes to requirements: all SOEs, except small non-listed, are subject to audit requirements; the AGM is responsible for the appointment of auditors (SOD employees represent the state if the state ownership is more than 50 percent); and listed SOEs must form an audit committee (non-listed entities typically do not have one). The Court of Auditors does not duplicate financial statement audits; it typically focuses on performance and value for money audits and use financial statements audited by private sector auditors in their work.

⁸⁷ <http://www.bis.org/publ/bcbs230.pdf>

B. The Profession

- 62 This section describes the development of the accounting and auditing profession in Slovenia and its contribution to effective accounting and auditing institutional framework. Financial reporting infrastructure should support the country's economic development with a profession of a size and capacity adequate to serve the economy. Professional accountancy organizations should both represent their members, and contribute to the effective regulation of the profession.
- 63 **It is estimated that there are between 12,000 and 18,000 accountants⁸⁸ in Slovenia. There are three professional organizations of accountants in Slovenia.** It is further estimated that 85 percent of all sole proprietors and legal entities outsource their accounting to approximately 4,500 accounting service providers who in turn employ around 8,000 accountants. The remaining 15 percent of sole proprietors and legal entities perform their own in-house accounting. It is generally agreed that there is an oversupply of accountants providing outsourced accounting services than the market requires. This situation is thought to have arisen because many accountants who have been down-sized as a consequence of the economic downturn in Slovenia, and who would otherwise be unemployed, chose to establish businesses providing such outsourcing services. In the absence of a regulated market for accounting and accounting services, there is now a natural need for accountants to distinguish themselves from their competitors in order to survive and establish market share. This oversupply is also reflected in the audit services market where fees are extremely competitive and have reduced significantly over the past few years. There are three professional organizations of accountants in Slovenia, all of whom offer their members a way of distinguishing themselves on the market: the Slovenian Institute of Auditors⁸⁹; the Association of Accountants, Treasurers and Auditors of Slovenia; and the Chamber of Accounting Services.⁹⁰
- 64 **The leading professional body for accountants and auditors remains the Slovenian Institute of Auditors (SIA).** The SIA was established in 1993 and has a wide range of responsibilities accorded to it by the Auditing Act including to: (a) adopt and publish a variety of professional rules including accounting and auditing standards, corporate finance standards and rules, internal auditing rules, information systems auditing rules, and valuation rules; (b) organize professional education and examinations; (c) issue licenses for audit firms, certified auditors and certified appraisers, and thereafter quality control their work; (d) organize continuing professional education; and (e) maintain registers of auditors, including of audit firms and individuals. Only individuals can be members of SIA and there is not corporate membership. As of end of December 2013, it counted amongst its members 195 (2003: 189) certified auditors with a license to perform audits of whom 140 (2003: 140) are engaged in public practice within 56 (2003: 42) registered audit firms. The SIA also counts amongst its members: 173 certified

⁸⁸ The terms, accountants and accounting, are used throughout this report respectively to refer also to bookkeepers and bookkeeping.

⁸⁹ See <http://www.si-revizija.si/>

⁹⁰ See <http://cas.gzs.si/slo/>

appraisers⁹¹, 317 auditors, 201 qualified internal auditors, 250 qualified accountants, 79 accountants, 19 qualified corporate treasurers, 106 qualified information systems auditors and 122 qualified tax experts. The SIA's 2012 income was Euro 1.3 million of which Euro 528k⁹² related to its role as the professional body for statutory auditors on which it incurred costs of Euro 418k. The remainder of its income derived from its roles as the professional body for internal auditors, accountants, information systems auditors, tax advisers and appraisers and related to membership fees, CPD training, conferences and exams.

- 65 **The SIA has been a full member of the International Federation of Accountants (IFAC) since 1995 and is the only Slovenian member of IFAC.** In October 2013, the SIA worked together with IFAC⁹³ to update its IFAC Compliance Action Plan⁹⁴ which indicates that the SIA is making progress in achieving IFAC compliance. Specific observations in respect of the SIA's compliance with IFAC's Statements of Membership Obligations (SMOs)⁹⁵ are presented in the table below.

Table 4: SIA Compliance with IFAC SMOs

IFAC Statement of Membership Obligation	Status
SMO 1 Quality Assurance	The SIA has implemented a quality assurance review system; it would benefit from adopting a formal Quality Assurance review methodology. See paragraph 94.
SMO 2 International Education Standards for Professional Accountants and Other Pronouncements Issued by the IAESB	The SIA needs to update its professional accounting education program for consistency with IFAC's IAESB International Accounting Education Standards - see paragraph 78.

⁹¹ 71 business appraisers, 91 real estate appraisers and 11 appraisers of machines and equipment.

⁹² Euro 319k of the SIA's 2012 income related to its quality assurance activities.

⁹³ See <http://www.ifac.org/about-ifac/membership/compliance-program/compliance-responses?MBID=SLOV1>

⁹⁴ See http://www.ifac.org/sites/default/files/compliance-assessment/part_3/201310_Slovenia_SIA.pdf

⁹⁵ IFAC SMOs are designed to provide clear benchmarks to current and potential IFAC member organizations to assist them in ensuring high quality performance by accountants worldwide. SMOs cover quality assurance, education standards, auditing standards, ethics, investigation and discipline, etc. For additional information, refer to <http://www.ifac.org/about-ifac/membership/compliance-program>.

IFAC Statement of Membership Obligation	Status
SMO 3 International Standards and Other Pronouncements Issued by the IAASB	The Auditing Act already requires all statutory audits to be performed in accordance with International Standards on Auditing (ISA) - see paragraph 121. The SIA's role is limited to ensuring implementation which is addressed through SMO 1 above.
SMO 4 IESBA <i>Code of Ethics for Professional Accountants</i>	The Auditing Act already requires application of IFAC's IESBA Code of Ethics - see paragraph 71. The SIA's role is limited to ensuring implementation which is addressed through SMO 1 above.
SMO 5 International Public Sector Accounting Standards and Other Pronouncements Issued by the IPSASB	The SIA has no direct responsibility for public sector accounting standards but is an advocate for IPSAS in the appropriate forums.
SMO 6 Investigation and Discipline	The Auditing Act provides for an investigative and disciplinary system consistent with SMO 6 with the investigative element implemented by both the SIA and APOA and the disciplinary element implemented solely by the APOA – see paragraph 56.
SMO 7 International Financial Reporting Standards and Other Pronouncements Issued by the IASB	The Companies Act already effectively requires public interest entities as defined by IFAC's IESBA Code of Ethics to produce financial statements in accordance with IFRS and provides for simplified financial reporting standards for other entities - see paragraph 29.

- 66 **The governance structure of the SIA does not necessarily represent effectively the public interest or SIA membership. This also raises the question whether the SIA is an organization based on and governed by its membership.** The SIA is managed by a nine-member Governing Council representing various bodies as specified in the Auditing Act. Three of these bodies should have limited role even if they are represented as their active role may weaken the SIA's governance. For reasons of legislative convenience and historical accident it seems that the SIA was founded by the Association of Accountants, Treasurers and Auditors of Slovenia (AATAS) however, in consequence, one place on the SIA's Governing Council has been explicitly reserved for a nominee of the AATAS - even though a representative of another body may be more appropriate and

add greater value. In addition, the SIA Governing Council includes two members appointed by government - one by the Minister of Finance (MOF) and a second by the Minister of Economic Development and Technology (MOEDT) - which creates an apparent conflict of interest because of the key role of government, through the APOA, in the oversight of the SIA. The Governing Council composition may need revision to include members appointed by or representing bodies charged with oversight of the SIA, including those from government and particularly those from the MOF or MOEDT, only with the status of observers; similarly, a place with the status of observer on the Governing Council be allocated to a member nominated by the AATAS. The revision will need respective changes in the Auditing Act, which would also need to clarify whether the SIA is a membership based organization.

- 67 **The SIA has a seven-member Auditing Council, a nine-member Expert Council and five thematic committees** (accounting, corporate finance, tax, valuations, information systems' auditing, and internal auditing). The SIA has six permanent staff, including a Director appointed by the Governing Council. For the same reasons outlined above in respect of the composition of the SIA's Governing Council, the SIA's Auditing Council and Expert Council should no longer include representatives from the MOF, MOEDT or other government bodies.
- 68 **The Association of Accountants, Treasurers and Auditors of Slovenia (AATAS) operates as a federation of 30 local associations with a membership of around 6,000-7,000 individuals.** The local associations have no membership criteria save for payment of a nominal annual membership fee which varies between EUR5-10. Thus membership of the associations and the federation is not regarded as an indicator of quality. The AATAS engages around 20 consultants and staff to deliver on its two main activities: publishing (primarily a monthly magazine with a circulation of approximately 6,300); and organizing various 2-4 day courses and half-day seminars on topical issues which also provide networking opportunities.
- 69 **The Chamber of Accounting Services (CAS) is a special interest group of the Chamber of Commerce and Industry of Slovenia (CCIS) for companies and individuals who provide accounting services.** Of the approximately 8,500 CCIS members, approximately 624 are additionally members of the CAS - quite a small proportion of the previously cited estimate of 4,500 accounting service providers. The CAS had previously advocated a licensing scheme for accounting services providers but, recognizing the absence of sufficient support for such an approach, has now chosen instead to raise the profile of CAS members. It has therefore introduced quality standards in the form of a Code with which its members are committed to comply and aims to have least 75 percent of its members with an accounting qualification by 2017. Consistent with this approach, the CAS maintains a Catalogue of Accounting Service Providers⁹⁶ listing those CAS members (currently 74) deemed to comply with the Code, have adequate practical experience and professional indemnity insurance, and have received adequate training at the CAS, CCIS and SIA. The CAS is governed by an eight-member Board, has

⁹⁶ See http://www.gzs.si/katalogi/zacetna_stran_kataloga.asp?kat=006&jezik=ang

two full-time staff and annual income in the region of EUR180,000 including annual fees of EUR 250 per member and other revenues from conferences, an annual congress, and examinations.

- 70 **It is estimated that there are approximately 75 accountants in Slovenia holding a foreign qualification**, such as, for example, that administered by the UK Association of Chartered Certified Accountants (ACCA)⁹⁷, almost all of whom work either for an accounting firm that is a member of an international network or for a company with significant foreign investment. It is understood that there are currently few students studying for foreign qualifications, reflecting the relatively poor state of the accounting and auditing market as discussed earlier in this report.
- 71 **The ethical and independence requirements for auditors are in line with those under the *acquis communautaire*, and IFAC's Code of Ethics for Professional Accountants.** Auditors are required to submit, in writing, to the audit committee of the audited company a statement on their independence on an annual basis. They are also required to disclose on an annual basis all additional services performed for the company, discuss threats to their independence, and mitigation measures.⁹⁸
- 72 **The Auditing Act specifies various requirements regarding the independence and objectivity of auditors and audit firms who must anyway adhere to the IFAC Code of Ethics** for Professional Accountants as discussed in paragraph 71. Compliance is assessed through the SIA's quality assurance reviews as discussed in paragraph 0.

C. Professional Education and Training

- 73 **There is a gap between the needs and the availability of education and training for the vast majority of accountants.** Somewhere between 11,000 and 17,000 accountants⁹⁹ have limited access to accountancy-related training other than, as mentioned in paragraph 62, the magazine distributed by the Association of Accountants, Treasurers and Auditors of Slovenia (AATAS). Given the complexity and widespread applicability of the SAS and its high alignment with taxation, see paragraph 49, as well as the uneven compliance with those standards, as described in paragraphs 115 - 117 below, there would appear to be a need to provide training and education for accountants.
- 74 **Some financial sector industry-specific training is available for accountants; for example, in the areas of banking and securities regulation. The training is delivered by the Banking Association in collaboration with BS.** However, representatives of commercial banks and leading industrial companies indicated that the current training

⁹⁷ According to the ACCA website there are 50 of its members in Slovenia.

⁹⁸ Art. 39 of the Auditing Act.

⁹⁹ See paragraph 68 for estimate of total number of accountants from which a round 1,000 was deducted being those members of the Slovenian Institute of Auditors as detailed in paragraph 69 for whom CPD is either compulsory (for auditors) or relatively easy to access (for others).

offered on IFRS and changes in IFRS is not sufficient, especially for banking and financial sector employees. There may be scope for more sustainable and frequent training. IFRS knowledge is currently largely obtained through self-study or from the international audit firms (mostly the large international networks). This issue is especially relevant for local companies since foreign owned entities can access training programs offered by their parent companies. There is also limited financial sector industry-specific training available for accountants in the insurance sector. The representatives of banks and companies also recognized that the number of adequately educated (IFRS educated) accountants in the market is not sufficient, and that even large companies have difficulties in attracting appropriate personnel capable of ensuring accurate preparation of IFRS-compliant financial statements. As a consequence, where IFRS financial statements are prepared, these may be influenced by the audit firm (usually large international networks) with the company itself, in some cases, having limited understanding of their content. This could be in breach of ethical/independence rules by auditors.

- 75 **The government, regulators, professional bodies and education providers should work together to decide on appropriate target educational standards and qualifications suitable for Slovenia's large pool of people working in accounting.** Participants in the financial reporting process need to be encouraged to gain the education and training they need to meet requirements made of them in their role. This covers preparers in all sizes of entity, regulators, auditors as well as taxation officers.
- 76 **Since 2004, academic education curricula at university level has been updated to include relevant aspects of IFRS and ISA** (see also annex 4 for details of 2004 policy recommendations). The two main universities of Ljubljana and Maribor deliver accounting and audit-related three-year undergraduate and two-year graduate masters degrees in economics and business to approximately 140 undergraduate students and 60 masters students per annum. The degrees are fully subscribed and include mandatory courses covering the basics of SAS and their related IFRS. Courses reflect subject materials proposed in the EU's SAD, as transposed in the Auditing Act, and are taught by a mixture of in-house, visiting and expatriate teaching staff. There is, though, scope for curricula improvements in terms of coverage, for example including financial management subjects for accounting graduates. University teaching staff is expected to keep up-to-date with accounting and auditing developments through: continuing education, some of which is paid for by the universities; membership of European accounting associations; and practical work such as membership of companies' audit committees or supervisory boards.
- 77 **The professional education and training system has been improved incrementally since the 2004 A&A ROSC but would benefit from further improvements** (see also annex 4 for details of 2004 policy recommendations). The Slovenian Institute of Auditors (SIA) only recognizes professional training, exams, and any formal continuing professional training (CPD), that it delivers to its full and student members. Thus, prospective statutory auditors receive neither credit for, nor exemptions from, courses or exams set and delivered by the SIA even if they have already covered these subjects at other institutions such as the universities of Ljubljana and Maribor (and notwithstanding

that some trainers used by the SIA are from those very same institutions). The SIA requires that its members have 80 hours of CPD over the course of two years which may include formal training¹⁰⁰. Although the SIA could theoretically recognize formal training delivered to staff of accounting firms, such as those belonging to international networks, it is only willing to do so if courses are delivered on the territory of Slovenia, not at a network center which may be outside Slovenia, and open to all relevant members of the SIA, not just the staff of the firm. Student members of the SIA, such as prospective statutory auditors, are effectively obliged to study and sit exams in subjects that they have already completed. Full members, such as statutory auditors, must undertake SIA formal training courses even if they already had such training for example offered by their employer; sometimes it may cover subjects they may already have attended as delivered by their employer, although the members can attend other subjects available. This would appear to create inefficiencies in terms of time and costs in that both students and full members effectively are required to pay twice and spend additional time for learning, and sometimes the same subjects. The current situation makes the SIA vulnerable to accusations that it is insensitive to its students', full members' and their firms' time and cost constraints and that perhaps its primary objective from the delivery of training is the generation of revenues because training revenues account for a substantial proportion of the SIA's total income. Subject to some form of evaluation, it would be beneficial if SIA recognizes and gives credit for external CPD training. *Note. The SIA position is that employer of a statutory auditor is not a reliable and competent source for verifiable CPD.*

- 78 **The Slovenian Institute of Auditors (SIA) needs to update its professional accounting education program for consistency with IFAC's IAESB International Accounting Education Standards (IES).** The major improvements are needed on Professional Skills and General Education (IES 3), Professional Values, and Attitudes (IES 4), and monitoring Practical Experience Requirements (IES 5). Some of the SIA requirements are higher compared to IES or comparable professional accountancy organizations (e.g. entry requirements or number of years of experience), but these appear to be more quantitative rather than qualitative (e.g. number of years) and these can be challenged as adding little, if any, benefits. The table below describes compliance with each IES.

¹⁰⁰ The CPD requirements for certified auditors changed in 2009 and these are conditions for license renewal. Major changes are as follows: (i) Increase of necessary CPD hours in period of 2 years from 60 to 80; (ii) Recognition of self-education such as reading literature; (iii) Recognition of seminars; (iv) New conditions for recognition of seminars outside Slovenia; (v) APOA's responsibility to quality control over education programs organized by Institute or Audit firms.

Table 5: SIA Compliance with IFAC's IAESB IAESs

IFAC's IAESB International Accounting Education Standard	Status
IES 1 Entry Requirements to a Program of Professional Accounting Education ¹⁰¹	The SIA requires individual prospective members to have a masters degree and as such is considerably higher and thus more onerous than many other professional accountancy organizations that usually require a qualification equivalent to that for admission into a recognized university degree program. IES 1 requires entry requirements that will allow entrance only to those with a reasonable chance of successfully completing the professional accounting education program, while not representing excessive barriers to entry. It also requires an explanation of the rationale of the entry requirements as well as information publicly available to help individuals assess their own chances of successfully completing the professional accounting education program. The rationale for the SIA's entry requirement is not specified; information is not publicly available that would help individuals assess their own chances of successfully completing the professional accounting education program; and it is not clearly defined what benefit, if any, this high requirement brings as compared to other professional accountancy organizations.
IES 2 Content of Professional Accounting Education Programs	The SIA's professional education requirement mirrors the EC requirement for a statutory auditor per Article 8 of the Statutory Audit Directive which itself is consistent with IES 2.
IES 3 Professional Skills and General Education	The SIA does not explicitly assess these aspects of its prospective members by, for example, requiring such members to maintain records of education and application as well as feedback from supervisors.
IES 4 Professional Values, Ethics and Attitudes	The SIA's program includes a module on professional ethics and independence but does not include modules that deal explicitly with values and attitudes.
IES 5 Practical Experience	Mirroring the EC requirement for a statutory auditor per Article 10.1 of the Statutory Audit Directive and consistent

¹⁰¹ IES 1 is equivalent to the EC requirement for a statutory auditor per Article 6 of the Statutory Audit Directive.

IFAC's IAESB International Accounting Education Standard	Status
Requirements	<p>with IES 5, the SIA requires prospective statutory audit members to have at least three years of audit experience of which two-thirds is with an existing statutory auditor. However, the SIA also requires prospective statutory audit members to have five years of work experience including the above-mentioned three years of audit experience, with no particular justification for this additional requirement. Furthermore, the SIA neither assesses the suitability of practical training providers, including statutory auditors, to provide appropriate practical experience nor does it require prospective members to maintain records of practical experience so that it may assess its appropriateness.</p>
IES 6 Assessment of Professional Capabilities and Competence	<p>Consistent with the above comments re IES 3 and IES 5, the SIA does not require prospective members to maintain records of education and application of professional skills and general education or practical experience so that it may assess its appropriateness. Rather, the SIA chooses to rely on a relatively simple letter of confirmation of employment from the practical training provider including statutory auditors.</p>
IES 7 Continuing Professional Development: a Program of Lifelong Learning and Continuing Development of Professional Competence	<p>Consistent with IES 7, the SIA requires its members to have at least 80 hours of CPD every two years. As discussed in paragraph 77, there are issues with the SIA's training requirements including primarily that it does not readily recognize training delivered by other organizations.</p>
IES 8 Competence Requirements for Audit Professionals	<p>The requirements of IES 8 are effectively described above in relation to IES 1 - IES 7.</p>

D. Setting Accounting and Auditing Standards

- 79 **Slovenian Accounting Standards (SAS) are set by the Slovenian Accounting Standards Committee of the Slovenian Institute of Auditors and enacted by the Expert Council of the Institute. The Companies act (art. 54) requires that SAS should transpose relevant EU accounting directives and should not contradict IFRS, which is in itself an issue as IFRS and the EU accounting directive have some differences.** The SAS Committee has a permanent chairperson, appointed by the Expert Council, and six members. The Committee comprises at least two university professors of accounting and auditing, two certified auditors, and two qualified accountants¹⁰². A three-member working group, comprising a chairperson and two members¹⁰³, is appointed by the Committee and entrusted with the drafting of individual SAS. In cases when specific SAS deal with certain industries, the working group may include a subject matter expert¹⁰⁴.
- 80 **The entire process of preparing and adopting the SAS is financed by the Institute, and it includes stages of drafting, exposing for comments and approval.** The working group presents a draft standard to the Committee, which reviews and presents it to the Expert Council¹⁰⁵. Once approved by the Council the draft, including the names of the members of the working group, is published in the Institute's open publication for public consultation. The minimum comment period is three months. The working group revises the draft based on the comments received and presents a final draft to the Committee, where it is reviewed then submitted to the Expert Council. Following Council approval, the draft standard needs to be approved by the Minister of the Economy and the Minister of Finance before being published in the Official Journal. Even though neither ministry is directly involved in the accounting standards-setting process, they have authorizing power. The ROSC team was informed that there were cases when accounting standards were sent back to the SIA for further improvement and/or clarification.
- 81 **Positions and Interpretations¹⁰⁶ of the Institute are adopted following the same procedure as standards, but do not have a public comment period which is not in line with good practice of standards-setting process.** They are also adopted by the Expert Council of the Institute.¹⁰⁷ Normally interpretations are issued for contentious or

¹⁰² The qualified accountants in Slovenia are called "verified accountants" and the qualification is granted by the SIA.

¹⁰³ As a rule one of the members must be a university professor of accounting and auditing, another must be a certified auditor, and the third must come from the ranks of verified accountants.

¹⁰⁴ He/She could be a verified business finance expert, a verified tax expert, a verified internal auditor, a verified expert for business and asset valuation, or a verified information systems auditor. In addition to this sort of experts who are members of the Institute, other external experts may also be included in the process of preparing an SAS.

¹⁰⁵ The draft standard must be approved by at least two thirds of the Committee members.

¹⁰⁶ There is no clarity what is the difference between positions and Interpretations.

¹⁰⁷ The SIA issued and published 17 Interpretations to SASs.

complicated issues and therefore a public debate should take place, similar to the accounting standards-setting process¹⁰⁸.

- 82 **The accounting standard-setting process has not changed significantly since the 2004 A&A ROSC and would benefit from some improvements to make it more transparent and inclusive: by greater involvement of users of financial reporting information and the publication of more background information and the basis for conclusions.** Although the standards-setting process is exposed for public comments, it does not currently involve other stakeholders, including regulators (such as the Ministries of Economy and Finance who ultimately authorize the issue of SAS) or the business community (actual and potential users of financial information like investors, bankers, financial analytics) in the development of standards. Despite the potential for more transparent standards-setting, as described above, stakeholders appear satisfied with the current process and outputs, including those relating to Positions and Interpretations. See annex 4 for details on the 2004 policy recommendations. Also, the Institute has not established a system to deal with urgent standard setting or relevant interpretations issues for matters not covered by existing standards or when the normal standard setting process is not appropriate or practical. Such a system would help reduce reliance on the audit profession to interpret standards, and ensure more consistent SAS application by users in areas not specifically regulated by SAS for which the existing hierarchy does not offer reasonable solutions.
- 83 **SAS development would benefit from improvements in terms of process (to become more participatory and inclusive) and their content would benefit from a more systematic approach on the basis of international benchmarks relevant to non-PIEs and EU requirements.** These issues, however, are not significant compared to the compliance gap (see Section III). When developing SAS, the standards setter would benefit from a more systematic approach, for example maintaining a detailed benchmarking tool that would ensure that the standards follow good international practice or are developed to comply with relevant EU directives. As no bases for conclusions are published, it is difficult to assess on a systematic basis whether the provisions of SAS indeed follow the relevant benchmarks. The Companies Act requires that the SAS shall transpose the content of Directive 78/660/EEC and Directive 83/349/EEC and their concepts shall not be contrary to IFRS¹⁰⁹, but the detailed evidence of following these benchmarks is not maintained by the standards setter.
- 84 **International Standards on Auditing (ISA) have been adopted and required for all audits; therefore there is no standard setting process, per se. However, the legislation is not clear on who is responsible for the translation of ISA.** The Auditing Act requires that all auditors apply ISA as issued by the International Auditing and Assurance Standards Board (IAASB).¹¹⁰ According to the Auditing Act, the APOA is

¹⁰⁸ For instance, IFRIC Interpretations are developed in accordance with a due process of consultation and debate, including making draft Interpretations available for public comment.

¹⁰⁹ Companies Act, Article 54 (9).

¹¹⁰ Auditing Act, Article 4.

responsible for oversight of standards adoption while the SIA is responsible for adoption of auditing rules; however, the institutional responsibility for official translation is not prescribed by legislation. As of June 30, 2013, ISA has been translated into the Slovene language by the SIA following IFAC's translation procedure, with the support of the Financial Reporting Technical Assistance Project (FRTAP) funded under the Swiss-Slovenian Cooperation Program. However, there is a need to establish institutional responsibility, as well as a sustainable mechanism, for the timely translation of amendments to existing ISAs, as well as any new ISAs that may be issued. This might be challenging because Slovenia regulates not just audits but also non-audit services in the Audit Law (see section II.A), and thus all IFAC's IAASB standards and pronouncements—not just ISAs—have to be translated and updated.

E. Enforcing Accounting and Auditing Standards

- 85 Enforcement mechanisms are important for the effective functioning of statutory and institutional frameworks. Appropriate mechanisms, checks and balances should support the effective functioning of the system and facilitate implementation of financial reporting and auditing standards, which are important for supplying good quality financial information and are needed to underpin financial stability and public confidence in the market. In Slovenia, limited enforcement appears to be related to limited demand for sound quality financial reporting by users and also regulators.

Enforcing Accounting (Financial Reporting) Standards

- 86 **There is no systematic or sampling approach to review or enforce financial reporting standards, except limited enforcement for entities in regulated sectors.** The AJPES collects and publishes annual reports, consolidated annual reports and auditors' reports¹¹¹. When collecting the data, AJPES performs only basic checks, such as arithmetic ones. It does not perform any other checks of submitted data, even on a sample or risk basis, such as of the appropriateness or application of financial reporting standards or whether the auditor is registered with the Slovenian Institute of Auditors (SIA). AJPES would do well to, at a minimum, institute a system of cross-checking audit reports with the SIA to ensure that only duly authorized auditors are producing audit reports. This would also assist the SIA in monitoring the activities of its auditors and help ensure that auditors' annual returns fully reflect all audits performed.
- 87 **The BS broadly complies with recently revised Basel Core Principles (BCP) related to corporate governance, financial reporting, auditing and transparency but significant improvements could be made to ensure better enforcement of such requirements.** More specifically the areas for improvements are:

¹¹¹ In cases of failure to submit annual reports AJPES conducts and decides in minor offence proceedings in accordance with the provisions of the Minor Offences Act and other relevant regulations in substantive case defining specific actions as offences (i.e. Companies Act, Associations Act, Accounting Act, Cooperatives Act, Social Entrepreneurship Act).

- i. Relationship between BS and auditors: Currently, the BS organizes once or twice per year joint meetings with external auditors of banks and bilateral meetings with individual banks, if necessary. However, the BS does not always organize systematic meetings with external auditors of each bank to discuss enforcement of IFRS and ISA and quality of disclosures for example. This complies with one of the criteria of BCP 27 “Financial reporting and external audit”, which requires that a supervisor should meet periodically with auditors to discuss issues of common interests related to banking operations. Nevertheless, the 2004 ROSC A&A also recommended that the authority of regulators over auditors be strengthened (see annex 4), and this has not been fully implemented;
- ii. Systematic review of financial statements: Although the BS regularly reviews the financial statements of each bank to ensure compliance with IFRS, this should be performed on more systematic and detailed manner. The BS may not, therefore, fully comply with BCP 28 “Disclosure and Transparency” which requires the supervisor to determine that the required disclosures include both qualitative and quantitative information on a bank’s financial performance, financial position, risk management strategies and practices, risk exposures, aggregate exposures to related parties, transactions with related parties, accounting policies, and basic business, management, governance and remuneration. The scope and content of information provided, and the level of disaggregation and detail, should be commensurate with the risk profile and systemic importance of the bank;
- iii. Supervision of governance arrangements of banks: The BS should also improve their supervisory techniques to ensure that banks have proper and effective internal control mechanisms, such as effective audit committees and supervisory board to fully comply with BCP 26. BCP 26 states that the supervisor should require banks to have adequate internal control frameworks to establish and maintain a properly controlled operating environment for the conduct of their business, taking into account their risk profile (for more details on BCP please refer to Annex 1 *Banking Sector Financial reporting: review and findings*).

88 **Banking supervision is being reformed at the European Union level and these reforms will also impact supervision in Slovenia. Of key importance is the transition to the EU Single Supervisory Mechanism (SSM) also known as the Banking Union. The BS will need to amend its supervisory tasks, responsibilities and methodology to be compatible with the requirements of the Banking Union.** In order to achieve this, BS will need additional human resources and a new organizational structure and processes. The currently used quantitative indicators and qualitative estimates in the assessment of the banks’ risk profile, and the system of micro-prudential risk indicators, will need to be expanded and supplemented with macro-prudential risk indicators. This would require a more systematic and regular analysis and assessment of financial statements data by supervisors of BS. (For more information on Banking Union please refer to Annex 1 *Banking Sector Financial reporting: review and findings*).

89 **The Securities Market Agency (ATVP) does not have specific and detailed requirements for monitoring financial statements published by the listed companies,**

including assessing whether the financial statements comply with IFRS. The only monitoring performed by the ATVP is to verify: if listed companies publish their financial statements in due time in accordance with the law; if financial statements are audited and include the audit reports; and whether audit reports contain audit qualifications or not. Their monitoring does not include, for example, a detailed review of the disclosures, or an analysis and assessment of the accounting policies. Two key reasons why the ATVP does not conduct detailed review and analysis of the financial statements are limited number of staff and insufficient IFRS expertise. The Ljubljana Stock Exchange (LSE) only monitors high level compliance by issuers, by performing checks regarding their obligation to publish financial statements within the prescribed timeline, whether they are audited, and if the audit report is included in the annual report. The LSE also checks other disclosure requirements but does not perform any detailed monitoring or review of the financial statements and annual report.

- 90 **The insurance regulator, AZN, performs limited reviews of insurance companies' financial statements.** The insurance entities it supervises are grouped into three classes: High Risk, Medium Risk and Low Risk. The scope and depth of the statutory financial statements review for High Risk entities are wider and more detailed than for Low Risk entities. There are no systematic and regular meetings between AZN and the insurance entities/auditors to discuss accounting issues. Communication between AZN and the insurance entities/auditors depends on the findings following the high-level review of financial statements by the insurance supervisors. AZN is currently reviewing its approach towards risk-based supervision and review of financial statements to make it more systematic and on a regular basis. However, these reforms have only recently started and, to be well implemented, AZN will need to provide their staff with some additional IFRS knowledge and expertise, especially in most recent updates relevant to insurance industry.

Enforcing Auditing Standards: Quality Assurance and Public Oversight

- 91 **The two institutions responsible for quality assurance and public oversight, set out in the Auditing Act, are the Slovenian Institute of Auditors (SIA) and the Agency for Public Oversight of Auditing (APOA).** The SIA is responsible for performing quality assurance of all certified auditors. In a positive development since the 2004 A&A ROSC (see annex 4), and to satisfy the requirements of the EU Statutory Audit Directive (SAD), the APOA was created and essentially charged with overseeing the activities of the SIA.
- 92 **The SIA performs quality assurance reviews (QAR) every three years of firms that audit listed companies, and every six years of all other audit firms.** This is consistent with the EC Statutory Audit Directive (SAD). The SIA's QAR process is overseen by the SIA's seven-member Audit Council, which is responsible for approving the annual plan, as well as the individual results and conclusions of the QARs. Three staff and one external consultant of the SIA perform all QARs. The SIA requires all audit firms to submit quarterly and annual returns on their activities, including audits. From these

returns, the SIA identifies which audit firms are active in the statutory audit market and, of those, which ones are performing audits of PIEs. The SIA might want to cross-check the audit firms' quarterly and annual returns with the information held at AJPES to ensure that all statutory audits are accounted for and thus subject to the quality assurance regime.

- 93 **Members of the SIA's Audit Council need additional appropriate experience to meaningfully challenge the SIA's QAR plans and results; SIA's four-person QAR team also needs access to various sectors experience and expertise to perform QARs of audits in those sectors.** The Audit Council could benefit from input from appropriately experienced experts from time-to-time, perhaps from other professional bodies' quality assurance functions. Similarly, the SIA's QAR team could benefit from inviting specialist personnel to assist in the QAR of audits in specialist sectors, perhaps including representatives from regulators such as the Bank of Slovenia. The SIA's team would also benefit from expanding its range of experience through, for example, visits, interchange or secondment with QAR teams of other European professional accountancy bodies.
- 94 **The SIA does not follow a formal QAR methodology** but rather uses various reporting templates (developed piecemeal over many years based on the SIA's experience) as aide memoires to guide its reviews. The SIA needs to formalize its QAR methodology to include, among other things, a requirement to produce and retain documentation demonstrating compliance with the methodology to the SIA's Audit Council, the APOA, and relevant quality assurance and public oversight bodies in foreign jurisdictions seeking to rely on Slovenia's quality assurance and public oversight systems.
- 95 **The Agency for the Public Oversight of Auditing (APOA) was established by the Auditing Act and became fully operational in 2009.** The establishment of such a body is a requirement of the Statutory Audit Directive, and was also recommended under the 2004 ROSC A&A (see annex 4). The APOA is essentially charged with overseeing the activities of the Slovenian Institute of Auditors (SIA) in that it oversees all of the SIA's activities relating to auditing and appraisals. The APOA comprises five permanent staff, including the Director, and is managed by an Expert Council, comprising nine representatives appointed by the Minister of Finance (MOF) and nominated by the Securities Market Agency, the Bank of Slovenia, the Insurance Supervision Agency, the SIA, the Ljubljana Stock Exchange, the Ministry of Economic Development and Technology (MOEDT), the MOF, and either the University of Ljubljana or the University of Maribor.
- 96 **The APOA faces governance challenges and its funding is not adequate.** The Auditing Act states that a place on the APOA's Expert Council is reserved for a nominee of the SIA. This creates an apparent conflict of interest given the APOA's role to oversee the activities of the SIA. It could be replaced by something more closely reflecting the EU's Statutory Auditing Directive which simply sanctions a minority of practitioners to

be involved in the governance of the public oversight system¹¹². Such a formulation would help demonstrate that notwithstanding the preferences of the SIA, the MOF may freely appoint any practitioner who the MOF believes would better and perhaps more independently contribute to the governance of the APOA.

97 **Funding for APOA has declined in recent years.** Around 90 percent of the APOA's financing comes from the state budget, with the remainder coming from penalties imposed by the APOA on auditors and audit firms as discussed later in this report. The APOA appears to negotiate the level of state funding in the same manner as other Slovenian ministries, departments and agencies however the level of funding has been in steady decline since it was established (2010 = Euros 320,000; 2011 = Euros 310,000; and 2012 = Euros 279,000). The level of APOA funding and expenditures should be reviewed in conjunction with the recommendations of this report, particularly those regarding the need for the APOA to develop methodologies for the direct inspection of statutory audit firms and auditors as well as the activities of the SIA. In terms of raising this additional funding, the APOA and government may wish to consider broadening the sources of the APOA's income to include levies on the SIA, audit firms and the equivalent of public interest entities. The APOA is a member of the International Forum of Independent Audit Regulators¹¹³. As AOPA develops as institution, it would be beneficial if it benchmarks itself to the IFIAR's core principles.

98 **The APOA is responsible for the public oversight of auditing and, therefore, essentially charged with overseeing the activities of the SIA (see paragraph 70); it faces, however, certain constraints in performing its duties.** The working relationships of APOA and SIA would benefit from improvements in their cooperation agreement intended to clarify working relationship issues set out in the Auditing Act and in actual practice. In particular the areas for improvements include: the timeliness and adequacy of information exchanged between the two organizations; and the selection and inspection of statutory auditors and audit firms. Amongst other consequences, this has caused considerable confusion, particularly amongst practicing audit firms and auditors, as to the precise roles of and differences between the two institutions, resulting in misinformed questions of the necessity of maintaining the two distinct institutions. The APOA and SIA might benefit from mediated negotiations of their cooperation agreement to better clarify their roles and responsibilities.

99 **The APOA is currently exploring the possibility to develop methodology for the direct inspection of statutory audit firms and auditors, and for the supervision of SIA activities.** The APOA would benefit from technical assistance to devise robust work programs; this is especially relevant in the context of EU audit reform, which is likely to require the APOA to perform direct inspections of auditors and audits of PIEs.

¹¹² See Article 32 of the Statutory Auditing Directive.

¹¹³ <https://www.ifiar.org/>

- 100 **The APOA publishes annual reports consistent with the requirements of the EU's Statutory Audit Directive¹¹⁴ which give a good overview of the APOA and its activities.** The latest report available, being that for 2013, describes the APOA's position with respect to each of the main principles of public oversight as described in the Statutory Audit Directive, namely: its governance arrangements; its responsibilities; its rights where necessary to conduct investigations in relation to statutory auditors and statutory audit firms and its right to take appropriate action; as well as its funding. In addition, the APOA reports on its annual: goals; activities including the extent to which statutory auditors and audit firms were inspected, the extent of cooperation with the SIA, and the results of its inspections and investigations; domestic and international cooperation, and main challenges for the future.

F. Other Governance aspects, including SOEs

- 101 **Corporate governance arrangements and practices of SOEs in Slovenia, including those related to financial reporting and its enforcement by the state as an owner, need strengthening to ensure that the State acts as a responsible shareholder. Appropriate mechanisms need to be in place to make SOEs management accountable - in general and for reliable financial reporting in particular.** A recent EC macroeconomic imbalances reports for Slovenia¹¹⁵ points out that SOEs create significant imbalances in the Slovenian economy and that existing institutional arrangements are not conducive to appropriate checks and balances. Often there is cross-ownership of entities (one entity owns another one and vice-versa), or the state ownership is fragmented (some SOEs are owned by several state holding entities and each of them has minor stake while the state as a whole has a majority). This makes it more difficult for the state to act as a responsible shareholder and enforce financial reporting by SOEs - by having effective audit committees that are able to influence management behaviour and making management accountable for good quality transparent financial reporting, as well as performing an adequate scrutiny and enforcement of SOEs financial information.
- 102 **The current governance arrangements of SOEs, and the role of audit committees in practice, are not conducive to effective application of audit standards and ensuring auditors' independence.** As previously mentioned, the state must strengthen SOEs governance function, as audit committees are currently not vocal or influential. Conflicts of interest do not enable them to properly exercise their role of overseeing the audit process and effectively communicate with auditors, as well as challenge them when needed. This is particularly relevant in the context of practical application and enforcement of ISA 260 *Communication with those charged with governance*.

¹¹⁴ See <http://anr.si/en/Reports/>

¹¹⁵ EUROPEAN ECONOMY, Occasional Papers 142 | April 2013, Macroeconomic Imbalances Slovenia, 2013; http://ec.europa.eu/economy_finance/publications/occasional_paper/2013/op142_en.htm; and EUROPEAN ECONOMY, Occasional Papers 187 | March 2014, Macroeconomic Imbalances Slovenia, 2014; http://ec.europa.eu/economy_finance/publications/occasional_paper/2014/pdf/ocp187_en.pdf

- 103 **In practice, although audit committees meet regularly and play an active role in selecting auditors, their effectiveness could be enhanced if they play a more active role in the auditing process and engage with relevant stakeholders more proactively.** Audit committees play an active role in the selection and appointment of auditors: they make recommendations in relation to the appointment, re-appointment, and dismissal of the auditors. It is also the role of the audit committee to facilitate the work of the auditors and ensure that their views and recommendations are properly implemented. There is room for improvement in this. Auditors sometimes face difficulties, for example, in communicating their views and recommendations to senior management, and departments involved in preparing financial statements, on improving the quality of disclosures and valuations techniques and on the use of more up to date variables and inputs for the valuations of assets. Audit Committees should also act on behalf of the shareholders to ensure that financial statements are prepared according to international standards and norms.
- 104 **The State does not have a comprehensive system for assessing the fiscal risks of SOEs; this is especially relevant in the context of the recent economic and banking crisis and the fact that the state had to contribute significant resources to recapitalise some SOEs, including banks.** Currently the Ministry of Finance only monitors and reports on SOEs debt and guarantees but not on the fiscal risks that SOEs may cause to the public budget in general. The Government does not produce a consolidated fiscal risk report on an annual basis. It is considered good practice for a central government to collect at least semi-annual financial statements and annual audited financial statements from SOEs and prepare a consolidated fiscal risk report.^{116 117} SOD collects some financial statements, but only for entities owned by the State and by SOD directly; it does not cover entities owned by other holding companies such as KAD, and no comprehensive fiscal risk assessment is undertaken. The new Slovenia Sovereign Holding Act¹¹⁸ aim to improve the governance of SOEs by assigning the role of a state agent to SOD mainly, however, the new law was adopted in March 2014 and although it contains significant improvements in SOE governance¹¹⁹, certain ownership fragmentation is kept and the SOD will not consolidate the state ownership in full (for example KAD will continue to exist as an independent entity). Also, a recent EC anticorruption report made several recommendations to strengthen SOE governance in Slovenia.¹²⁰

¹¹⁶ www.pefa.org, PI-9

¹¹⁷ OECD Economic Surveys Slovenia, April 2013, http://www.oecd.org/eco/surveys/Overview_Slovenia.pdf

¹¹⁸ The proposed draft of the revised Law was published in September, 2013, http://www.mf.gov.si/fileadmin/mf.gov.si/pageuploads/Finan%C4%8Dno_premo%C5%BEenje_in_poro%C5%A1tva/Predpisi_v_pripravi/ZSDH-1_predlog.pdf, and approved in March 2014, http://www.zdrufenje-ni.si/db/doc/upl/zsdh_1___28.3.2014.pdf

¹¹⁹ The ROSC team did not review the new Law in detail.

¹²⁰ The report recommended introducing mechanisms to “prevent, detect, and sanction conflicts of interest in supervisory boards of state-owned, state-controlled companies and companies where the State holds significant shares; extend Supervisor's scope to cover transactions and contracts of state-owned, state-controlled companies and companies where the State holds significant shares; and ensure anti-corruption checks and guarantees for holdings of state-owned companies and privatization procedures. The official EC

III. Accounting Standards as Designed and as Practiced

- 105 This chapter articulates how financial reporting standards are designed and practiced. They must be robust enough to ensure that entities can provide suitable financial information for economic decision making, but sufficiently simple for smaller entities that do not need complex financial information for economic decisions. Actual practice in Slovenia is assessed by reviewing examples of financial statements to assess whether they appear to deliver the expected quality and quantity of financial information according to the specific accounting standards for various types of entities.

A. The accounting standards gap

- 106 **As EU endorsed IFRS are required for the consolidated financial statements of listed entities, as well as for consolidated and legal entity financial statements of banks and insurance companies, there is no standards gap in the area of financial reporting standards for such entities.** The EU endorsed IFRS are translated in local language and published by the EC.
- 107 **The ROSC team benchmarked Slovenian accounting standards against EU requirements, as well as against internationally recognized standard for non-PIEs, such as IFRS for SMEs.** In assessing SAS against EU requirements, the ROSC team used the new accounting directive issued in June 2013 and created a detailed transposition table. This directive has to be implemented in national legislation by 2015. Some of the conclusions that follow may be relevant to facilitate this process. The ROSC team also used a similar tool to analyze the extent to which SAS provisions are comparable with IFRS for SMEs.
- 108 **Most EU requirements relating to legal entity and consolidated financial statements from directives preceding the New Accounting Directive (i.e., Fourth and Seventh Council Directives) have been incorporated in SAS.** However, some areas are not fully transposed, such as amortization of goodwill or additional disclosure requirements when development costs are recognized as intangible assets. In addition, some requirements of the New Accounting Directive¹²¹ need to be transposed by 2015, including revising thresholds for entities and groups of entities, and reporting on payments to governments. The accounting standards setter is guided mainly by IFRS and the EU directives when

press release is at http://europa.eu/rapid/press-release_IP-14-86_en.htm. The full report and Slovenia annex is at http://ec.europa.eu/dgs/home-affairs/what-we-do/policies/organized-crime-and-human-trafficking/corruption/anti-corruption-report/index_en.htm

¹²¹ Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC.

setting SAS. However, detailed benchmarking tools or similar instruments that would ensure the consistency and completeness of SAS provisions are not used. Additional details on how the EU directives requirements are incorporated in SAS are described in the Annex 2.

- 109 **The main principles and concepts of IFRS are incorporated in SAS, but adjusted to the local circumstances and the needs of non-PIEs.** In many respects this is reasonable because it helps ensure that SAS are consistent with good international practice and it makes them easier for users familiar with the IFRS, especially international users, to understand. Furthermore, since SAS are designed for non-PIEs, they include areas that are relevant for SMEs and thus not covered by IFRS, and also simplify IFRS where relevant.
- 110 **While recognizing the importance of ensuring consistency between national accounting standards and IFRS, SAS should nevertheless be developed as standalone simplified standards suitable for non-PIEs, and contain a suitable hierarchy for issues not specifically addressed by SAS.** SAS contain many references to full IFRS which results in a complex set of accounting standards, and leaves room for interpretation in some cases. In addition to the complexity, the references to IFRS generate the need for constant updates in SAS, as IFRS changes are frequent and references become outdated. A hierarchy of accounting policies for cases that are not specifically covered is not clearly defined in SAS or any other part of legislation. Additional details and examples are provided in the Annex 2.
- 111 **The Slovenian accounting standards setter may wish to consider the relevance of IFRS for SMEs¹²² as a benchmark reference in SAS development.** This is because references to full IFRS may be too complex for non-PIEs, including some principles of valuation, measurement and disclosures. In addition, IFRS for SMEs could be considered by the local authorities as a policy option in future for non-PIEs, except for micro and small entities, and this will require changes in legislation¹²³. In this case the areas of incompatibility between IFRS for SMEs and the new accounting directive should be appropriately dealt with by the standards setter. *Note. The SIA expressed the position that IFRS for SMEs is not a relevant benchmark for the reasons of legislation in force; also SIA position is that having three tier financial reporting requirements are too complex for Slovenia.*

¹²² IFRS for SMEs is a simplified set of standards developed by the IASB and designed for entities that have no public accountability. It is based on full IFRS, but simplified in two aspects: (i) valuation and measurement – the standard uses simplified approaches and those that are less costly; and (ii) reduced disclosure requirements. The standard is also supported by illustrative financial statements and disclosure checklist. In addition, the IFRS Foundation dedicates significant resources for disseminating and implementing the standard; for example a detailed set of training material is developed and publicly accessible on IASB website in many languages. The standard also aims to be static with revisions only once every three years.

¹²³ The new accounting directive specifically indicates that member states cannot have additional requirements to those included in the directive for small and micro entities; IFRS for SMEs is more demanding and its adoption for small and micro entities would go against this requirement.

112 **SAS are largely compatible with the provisions of IFRS for SMEs¹²⁴ as SAS incorporate many of the key principles and concepts from full IFRS (also used as a reference while developing IFRS for SMEs).** There are, however, a number of differences between SAS and IFRS for SMEs identified by the ROSC team. A detailed summary of the analysis is included in Annex 2. Some differences exist because IFRS for SMEs, for simplification purposes, differ from full IFRS, on which SAS are mainly based. Differences between SAS and IFRS for SMEs include: (i) requirements for accounting of investments in associates and joint ventures; (ii) accounting treatments and measurement after recognition of the property, plant and equipment, investment property, government grants and borrowing costs in some cases; and (iii) accounting treatment of intangible assets at initial recognition and measurement after initial recognition. In addition, some areas which have the same accounting treatment in full IFRS and IFRS for SMEs appear to be treated differently in SAS. These include:

- i. **Accounting treatment of measurement of inventories in SAS 4 Inventories is different from IFRS for SMEs. This can result in an unfair presentation of the value of inventories, which in turn can be misleading for economic decision making.** *SAS 4 Inventories* allows, in justified circumstances, inventories to be measured, at one extreme, at contracted full cost, or at the other extreme, at variable production costs not including purchasing overheads¹²⁵. IFRS for SMEs¹²⁶ requires that an entity include in the cost of inventories all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. In addition, while *SAS 4 Inventories* requires inventories to be measured at the lower of initial cost and net realizable value, it appears that it doesn't explicitly require reversal of impairment when initial conditions no longer exists, as required by IFRS for SMEs¹²⁷.
- ii. **The provisions for classification of a financial instrument as liability or equity are not included in SAS. Consequently, liabilities might be understated, and equity overstated, thus having a negative impact on company ratios. The information could lead to uninformed economic decisions by users of financial statements.** It appears that financial instruments that meet the definition of a liability, and need to be classified as equity according to IFRS for SMEs¹²⁸ because they represent the residual interest in the net assets of the entity, may have different treatment in SAS. For instance, according to *SAS 8 Equity*, preference shares are part of share capital¹²⁹, while paragraph 22.5 of IFRS for SMEs states preference shares are classified as liabilities rather than equity.

¹²⁴ The ROSC team used a tool similar of Transposition Table and undertook a detailed analysis to what extent the provisions of SASs are comparable with IFRS for SMEs.

¹²⁵ *SAS 4 Inventories*, paragraph 4.13.

¹²⁶ IFRS for SMEs, paragraph 13.5.

¹²⁷ IFRS for SMEs, paragraphs 13.19 and 27.2–27.4.

¹²⁸ IFRS for SMEs, paragraphs 22.3 and 22.5.

¹²⁹ 8.36. This Standard uses some terms which need to be explained in order to define the key concepts. g) Preference shares are part of share capital. Their owners are usually not entitled to participate in the

- iii. **Some aspects of accounting for revenues arising from construction contracts in which the entity is the contractor, are treated differently in SAS and IFRS for SMEs. This could lead to an overstatement of revenues, especially in loss-making construction contracts.** For instance, while IFRS for SMEs explicitly requires¹³⁰ an entity to immediately recognize any costs whose recovery is not probable as an expense, SAS do not include such provisions with respect to construction contracts.
- 113 **Neither the BS nor AZN have issued any specific accounting requirements for banks or insurance companies.** As expected, there are some differences between prudential and capital requirements calculations and accounting requirements, for example such as the basis of consolidation for banks.
- 114 **For the insurance sector, there is a discrepancy between the requirements of the Insurance Act and IFRS regarding the creation of equalization reserves.** This is the only inconsistency between the Insurance Act and IFRS, and it is the result of an inconsistency between IFRS and the Insurance Directives,¹³¹ which have been implemented in Slovenia. The creation of equalization reserves is not allowed to be included in insurance liabilities under IFRS. To comply with IFRS, insurance companies include the equalization reserves in equity and not in insurance liabilities. This issue has been resolved at the EU level under the new Solvency II framework for insurance companies (Directive 2009/138D). AZN is also working with the Ministry of Finance on a new draft Insurance Act which will implement Solvency II in Slovenia.

B. The compliance gap

- 115 **The ROSC team reviewed a sample of financial statements to assess the extent to which they complied with the financial reporting standards in accordance with which they had been prepared (either SAS or IFRS).** The selected sample of financial statements included **eleven sets of SAS-based financial statements, and fourteen IFRS-based financial statements.** Types of entities were selected based on their importance to the national economy. Conclusions should be regarded with a degree of caution, given the limited sample size as well as inherent problems in examining the compliance gap as the reviewer of financial statements cannot be certain that everything that should have been disclosed was indeed disclosed. Furthermore, financial statements of entities in similar economic sectors could reasonably be expected to have similar formats and disclosures and therefore it is reasonably easy for those preparing financial statements to make them appear good simply by conforming to a “standard” format without regard to the entity’s underlying financial transactions and position.

management of the entity. If the entity has generated sufficient net profit, dividends on preference shares are paid at a specified percentage or amount.

¹³⁰ IFRS for SMEs, paragraph 23.24

¹³¹ Directive 73/239/EEC and Directive 91/674/EEC on the annual accounts and consolidated accounts of insurance companies.

- 116 **Despite some disclosure issues, financial statements review indicated relatively high degree of compliance with relevant financial reporting standards.** The reviews of financial statements indicated some progress in compliance compared with 2004 A&A ROSC and the information presented and disclosed in audited financial statements has a higher degree of compliance with relevant financial reporting standards. However, some of financial statements did not fully comply with certain disclosure requirements. Therefore, the quality of economic decisions may suffer due to incompleteness of financial statements disclosures. The team noted no significant differences between local audit firms or international networks in the volume or quality of information presented in audited financial statements. Despite some progress, there are areas of disclosures that could be improved, as described in detail below, which would contribute to the completeness of information relevant for decision making and follow the spirit of specific financial reporting standards.

SAS compliance

- 117 **The audited financial statements reviewed were largely compliant with SAS, except compliance with some relevant disclosure requirements. The quality of non-audited financial information is lower and disclosures are not in compliance with Companies Act and SAS.** The ROSC team reviewed a number of financial statements for the year ended December 31, 2012, together with their audit reports, to assess compliance with provisions of Companies Act and Slovenian Accounting Standards as relevant to reporting (SAS). The review included SAS-based audited financial statements of four large companies, two medium-sized companies and two medium-sized groups of companies and SAS-based non-audited financial statements of three small companies for a full ROSC review. All the financial statements reviewed are publicly available and accessible on the AJPES website. The companies operate in the energy sector, food industry, railway infrastructure, chemical sector, trade, and IT sector. Specific non-compliance issues are as follows:
- a. In the medium-sized companies and groups the missing disclosures mainly related to risks and risk management (SAS 5, 9 and 11)¹³²; there were no references to risk information in business reports; and large companies with public utility services did not disclose all separate accounting information, required by the SAS 35 – Accounting Monitoring of Public Utility Services;
 - b. The quality of disclosures in non-audited financial statements varied a great deal and was not in compliance with the Companies Act or SAS in two of the three reviewed sets of financial statements; only disclosures of one reviewed set complied with the requirements of the Companies Act and some SAS (small entities have to comply with reduced disclosure requirements that are included in the Companies Act and some SAS).

¹³² SAS 5 – Receivables (2006), SAS 9 – Long-term liabilities (2006), SAS 11 – Current liabilities (2006).

IFRS compliance by listed entities

- 118 **The review of both individual and consolidated financial statements for listed entities indicated generally a high degree of compliance with the requirements of IFRS as endorsed by the EU, but some disclosure issues were observed.** The ROSC team undertook full reviews of the IFRS-based financial statements of five large enterprises listed on the Ljubljana Stock Exchange and a limited analysis of one state-owned company. The entities reviewed are involved in the following sectors: airport, home appliances, supermarket, fuel distribution and telecommunication. The state-owned company mentioned is a holding company. All the financial statements involved are publicly available and accessible on-line. Although financial statements were complete and comprehensive, explanatory notes were lengthy and showed a tendency to excessive disclosure, particularly in areas such as accounting practices and financial instruments. However, in one case, insufficient information was given on the steps being taken to overcome financial difficulties experienced by the issuer, and several disclosure issues were observed in the other cases. None of these matters was significant enough to modify the above conclusion.

IFRS compliance by banks and insurance entities

- 119 **In general, the financial statements of banks and insurance companies were of reasonable quality. However, some failed to provide clear and sufficient entity specific notes.** The team reviewed the financial statements of six banks and two insurance companies. All the financial statements reviewed were prepared according to IFRS as endorsed by the EU. The financial statements were audited by large international networks of audit firms. In many cases the notes were general and high level, borrowing heavily from IFRS. The disclosures in financial statements should be more meaningful and relevant to the users. In addition to following the rules of the IFRS, it is often needed also to follow the spirit of the standards to be able to provide the true and fair information for the benefit of users. The following specific points were noted by the team:
- a. In all the financial statements reviewed, accounting policy notes refer extensively, or include direct quotes, from the accounting standards and make only limited references to entity specific information. This does not impact on compliance with IFRS but can be of limited use or add little value for users of financial statements looking for more information relevant to the entity;
 - b. In all financial statements reviewed, qualitative disclosures, i.e. notes to explain quantitative disclosures data, are limited and often high level. Although this does not impact compliance with IAS 1 *Presentation of Financial Statements* and IFRS 7 *Financial Instruments: Disclosures*, the inclusion of explanatory requirements would be a significant improvement to the quality of financial statements. Examples where explanatory notes are lacking or weak relate to disclosures on assumptions and inputs used for capital management, liquidity risk management and credit risk mitigation techniques - especially in the current context of the on-going banking crisis;

- c. The disclosures on impairment valuations regarding financial assets and assumptions, used to value collateral, discount rates, and cash-flow estimates, were insufficiently granular in one case (impairment valuations for different type of assets were not provided) and in all cases the explanatory notes lacked detail. This does not give users sufficient understanding of the valuations techniques used by the entities and is not in line with the spirit of IFRS 7 *Financial Instruments: Disclosures*. Users currently place little reliance on some parameters of financial statements, especially those that deal with valuations or risks. Improved disclosures would also contribute to improved perceptions of the reliability of financial information (see also section V *Perception of the quality of financial reporting*).

IV. Auditing Standards as Designed and as Practiced

- 120 Auditing standards provide a basis for auditors to follow to be able to provide an opinion on whether financial statements, in all material respects, present a true and fair view of the financial position and performance of an entity, in line with the requirements of specific accounting/financial reporting standards. This section, therefore, assesses whether auditing standards follow international benchmarks (ISA), and how these are applied in practice to increase the reliability of financial information for users, especially current or potential owners and creditors. While many countries have successfully adopted ISAs implementation is often an issue, as it requires changes in behavior and also rigorous and detailed methodologies, as well as deep understandings of businesses and the potential impact of poor quality audits. The appropriate implementation of auditing standards is essential for the reliability of published financial statements.

A. The auditing standards gap

- 121 **As Slovenia has adopted ISAs there is no standards gap, as such, in the area of auditing standards. However, the Auditing Act, as well as instructions issued by the Agency for the Public Oversight of Auditing (APOA), lay out very specific requirements which could be construed as creating additional auditing standards, some of which are not in line with ISA or good international practice.** In particular, article 39 of the Act requires that, of the total time spent on an audit: (i) the certified auditor who signs the audit report must account for at least 15 percent; and, (ii) other audit staff with a minimum of two years audit experience must account for at least 60 percent of the total time. Meanwhile, the APOA issued a recommendation which included a complex calculation of the maximum annual number of audit reports that a certified auditor may issue, depending on the size and nature of the audit engagements. While the motive for these requirements and recommendations is laudable, they are perceived by the audit profession as mandatory and fail to recognize the ISA's risk-based approach to auditing, they are not practical for large audits including audits of large groups of companies, and they are easily circumvented. Indeed, these requirements do not seem to have materially affected the way audit firms work except for the additional burden of maintaining creative time-keeping records for the sake of demonstrating compliance. All these and similar requirements should be reviewed and, ideally, removed.

B. The auditing standards compliance gap

- 122 **There is considerable pressure on the audit profession: the audit fees are reduced and the number of audit clients is declining; this also puts additional pressures on audit quality and auditors' independence.** Notwithstanding the relatively stable number of auditors compared with 2004, there has been a considerable reduction in the number of required audits as a result of two main factors: (i) the increase in the thresholds to define micro-, small-, medium- and large companies; and (ii) the economic downturn. The downturn in Slovenia's economy has led to audit professionals chasing ever fewer

audit clients. This considerably impacted audit income, with auditors and audit clients reporting recent year-on-year reductions in audit fees in the order of 30 percent. This in turn creates issues regarding auditors' independence and quality of work. It also creates conflicts for the auditors' professional body, the SIA, as it tries to balance its remit to promote and safeguard its members' interests with acting in the public interest. The profession is less likely in these constrained times to support simplification of financial reporting and auditing requirements, some of which are demanded by the new EU accounting directive. To counter this will require active political interest, strengthening the APOA, and ensuring that the determination of financial reporting and audit thresholds - as well as issuance of SAS - follows an orderly and transparent public consultation process.

- 123 **The ROSC team reviewed a sample of financial statements to assess the extent to which they complied, in practice, with ISA (mainly ISA 700 Forming an Opinion and Reporting on Financial Statements).** The sample was the same as the one used to assess the financial reporting standards compliance gap as described in paragraph 115; the same limitations apply in analysing a relatively small sample of audit reports and the team mainly reviewed the compliance with the ISA relevant to audit reporting. Also, given the “standard” format of audit reports, it is reasonably easy for the preparers of audit reports to make them appear good simply by conforming to the “standard” format without regard to the entity’s underlying financial transactions and position.
- 124 **The quality of ISA implementation is uneven for a variety of reasons including some misunderstanding of fundamental audit issues and limited training and capacity-building opportunities, as well as in some cases audit methodologies that are not always updated and ISA compliant.** Some statutory auditors and audit firms have limited capacity to develop and maintain an audit methodology and this may create difficulties in audit firms’ full compliance with ISA; fully documented audit methodologies are not a primarily driver of audit quality and other important elements such as skills, experience and attitudes/behaviors are key for achieving a sound audit quality, still such methodologies are important elements of ensuring that ISA and ISQC1 are properly complied with.. For the sake of illustration, based on in-country meetings with large, small and medium-sized audit practitioners: audit firms that are current members of international networks appeared to use their networks’ ISA-compliant audit methodologies; firms of former members of international networks appeared to use ISA-compliant methodologies as best as they could recollect them from their days working for the international networks; and other firms used methodologies derived from a technical assistance program from over two decades ago. Thus, some auditors did not appear to understand the implications of relying on external valuers nor did they appear to understand the appropriate audit procedures for issues regarding fair value. The SIA is currently in the process of assisting its members to centrally procure audit automation software that incorporates ISA-compliant methodology. This should be complemented by specific capacity-building for auditors and should reduce the auditing standards compliance gap, particularly for the smaller audit firms.

ISA compliance by auditors of listed entities

- 125 **Based on the review of audit reports of five sets of audited financial statements by listed entities and one SOE, it can be concluded that ISA relevant to audit reporting are generally complied with.** However, the team identified some issues, as described below.
- 126 **The paragraphs used by the auditors to express their conclusion on the consistency of the business reports with the audited financial statements was found to be incomplete in one case, and both incomplete and incorrectly worded in the others.** The reviewed auditors' reports failed to describe the relation of the auditor with the non-audited business information included in the annual report. In four of five cases of IFRS based audited financial statements the English-language translation of audit reports issued in Slovenian stated that the business information was "in conformity" with the financial statements rather than "consistent with" them as prescribed by ISA 720 "*The auditor's responsibilities relating to other information in documents containing audited financial statements*". Similar practice is observed in SAS-based financial statements. The SIA might want to issue guidance to statutory auditors on the issue of English-language translations including of audit reports with such guidance perhaps comprising sample translations of accounting and auditing terminology. This will help mitigate misunderstandings of English-language reports that are used by international users.
- 127 **The review of a large company audit report identified a case of noncompliance with the audit standard relevant to audit of group financial statements, where the group auditor is responsible for auditing all the components even if these were audited by a different auditor.** One of the audit reports for consolidated financial statements contained a scope restriction qualification apparently inadequate in the circumstances and not in compliance with ISA 600 "*Special considerations—audits of group financial statements (including the work of component auditors)*". The inadequacies detected are related to the failure of the qualification included in the audit opinion to (i) refer to the carrying values of the items affected by the scope restriction that originated it, (ii) refer to the reason for a restriction¹³³ and (iii) explain why the statement of comprehensive income is the only one mentioned as affected by this restriction. This indicates that auditors did not perform their work and did not report in line with ISA 600 requirements. Users of financial statements may not be able to take adequate decisions on the basis of these qualified financial statements.

ISA compliance by auditors of banks and insurance entities

- 128 **Based on the review of audit reports related to eight sets of audited financial statements by six banks and two insurance companies, it can be concluded that ISA**

¹³³ The audit report does not mention whether they had restricted access to information or not, which creates the impression that the auditors did not undertake the necessary effort to satisfy themselves on the carrying amounts of relevant components of consolidated financial statements.

are generally complied with by bank and insurance auditors. However, the team identified an issue, as described below.

- 129 **The emphasis of matter in the audit report in some financial statements of banks could have been improved by providing clearer explanations in the notes on capital adequacy, capital breaches and assumptions used to describe the on-going banking crisis and its impact on the banks' ability to operate on a going concern basis.** This would have helped users of financial statements and supervisors to better understand the risks facing the banks. Better explanations in the notes would also be in line with the spirit of the requirements of ISA 706 on Emphasis of Matter and ISA 570 on Going Concern, and add credibility to financial information from the user's perspective (see also the section V. *Perception of the quality of financial reporting*).

V. Perception of the Quality of Financial Reporting

- 130 **While perceptions of the quality of financial information had been improving recently, the recent financial and banking crisis has had a negative influence.** Perception of financial reporting is important as ultimately it is users who most benefit from accurate and reliable financial information. Limited faith in financial statements prepared by entities, audited by auditors and overseen by various regulators, is a clear indicator that trust is broken, or that the institutions meant to protect the public interest do not function effectively. The way financial reporting is perceived may also be reflected in reduced demand for good quality financial reporting.
- 131 **There is relatively little demand for high quality general purpose¹³⁴ financial statements in Slovenia.** The securities market is relatively small and plays a limited role in the Slovenian economy. Due to significant state ownership in the banking sector, and the economy in general, substantial loans are often granted according to political rather than commercial criteria¹³⁵. The state does not have a strong ownership function for SOEs and does not assess the fiscal risk of SOEs to the public budget in a comprehensive manner; this reduces the demand for sound quality financial information on behalf of the State. Companies' governance arrangements with respect to general purpose financial statements need further improvements, in terms of the general functioning of audit committees and supervisory boards as well the limited role of shareholders in financial statements approval. Limited foreign direct investment (FDI) in Slovenia compared to peer countries (Slovenian inward FDI stock is one of the lowest of the new EU Member States¹³⁶), perhaps contributed to by this lack of high-quality information, provides little external pressure for improvements. This combination of circumstances - a small securities market, significant political ties to the economy via state-controlled banks and SOEs, weak governance arrangements of companies, including SOEs, and little external pressure from FDI for better information - results in little demand for high quality general purpose financial statements.
- 132 **The banking industry's perception is that, generally, the quality of their clients' financial information is reasonably good; however limited IFRS and ISA expertise among banks' staff means that they may not fully understand or be able to properly analyze audited financial statements and audit reports.** As mentioned in Annex 1, limited financial reporting expertise among banks' credit officers and credit committee members may limit their ability to properly assess the credit worthiness of borrowers.
- 133 **Anecdotal evidence suggests that there is a difference in the perceived quality of audits and the value that an audit brings between the large international network**

¹³⁴ IFRS defines general purpose financial statements as those intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs.

¹³⁵ See http://ec.europa.eu/dgs/home-affairs/what-we-do/policies/organized-crime-and-human-trafficking/corruption/anti-corruption-report/docs/2014_acr_slovenia_chapter_en.pdf for relevant extracts.

¹³⁶ EUROPEAN ECONOMY, Occasional Papers 142 | April 2013, Macroeconomic Imbalances Slovenia, 2013; http://ec.europa.eu/economy_finance/publications/occasional_paper/2013/op142_en.htm

audit firms¹³⁷ and the rest. Smaller firms are perceived to have poor audit methodologies, a lack of familiarity with International Financial Reporting Standards (IFRS), and a lack of capacity to deal with complex issues including group audits. The SIA has chosen not to publish an audit methodology for use by its certified auditors because it believes this may create a conflict of interest when performing quality assurance reviews. However, recognizing that the overwhelming majority of statutory auditors and audit firms have limited capacity to develop and maintain an audit methodology, the SIA is currently in the process of assisting its members to centrally procure audit automation software that incorporates ISA-compliant methodology. This is commendable.

134 **Financial analysts and investors have reservations about the quality of financial information contained in financial statements.** Financial analysts and investors are particularly skeptical about the reliability of items in financial statements that involve significant professional judgments and assumptions, such as valuations and impairments of financial assets and liabilities. The following specific issues were highlighted by various users of financial information:

- a. While, generally, financial statements appear to be reliable, users place little reliance on financial assets, especially non-traded assets, because the assumptions are not reliable and are generally poorly disclosed in financial statements. Users tend to ignore or significantly discount such items when analyzing financial statements for decision making purposes;
- b. There is a perception that auditors are not skeptical enough and their independence is often compromised. Feedback from users included: a feeling that managers influence auditors and that financial statements were often signed off reflecting the information as better than reality and not representing a “true and fair view” in the spirit of financial reporting standards; some users indicated that, in practice, managers often appoint auditors and determine their fees, so they may put additional pressure on auditors when needed; there was a sense that there was little difference between audit firms belonging to large international networks or local firms, except the belief of some users that it was easier to influence local auditors;
- c. The quality of financial information is perceived to be suffering, largely because of issues of governance related to financial reporting, such as auditors appointment and dismissal, audit fees, and the roles of audit committees and boards, especially the ability of their members to influence decision making and challenge managers and auditors. This is made more acute in cases where the state has direct or indirect ownership or involvement in the company (SOEs and their subsidiaries). Independent directors are sometimes put in a difficult position to influence managers or auditors’ behavior; the situation is even worse in interconnected companies where managers in one company are representing owners of another company and vice-versa. Some users also indicated that there is little punishment

¹³⁷ The five largest audit firms in Slovenia are: PricewaterhouseCoopers, Ernst & Young, Deloitte, KPMG and BDO.

for board and audit committee members not exercising their duties properly in ensuring high quality of financial information;

- d. The institutions charged with protecting public interest in financial reporting, such as APOA and SIA, were not perceived as real protectors of public interest. The same applied to financial sector regulators, although the situation had been improving recently as a result of the financial crisis;
- e. Some users consider that SMEs financial reporting was not very reliable, especially those financial statements that are not audited. Banks often based their lending decision on collateral, and valuation for collateral is often misleading and unreliable in financial statements;
- f. The public availability of financial information is frequently delayed to July-August; this has implications for relevance, as decision makers often used un-audited financial information which may contain the information that presents better financial position compared to real situation.

135 **These perceptions confirm that, although there is a sound knowledge and understanding of modern financial reporting practices, the reliability of financial statements is often undermined by issues with corporate governance related to financial reporting.** This is partially because of the significant state involvement in ownership, and the limited capacity of individual board and audit committee members to influence financial reporting quality. Some commentators noted, however, that because the country is small, the business community is also small which makes it difficult to ensure independence and impartiality in economic decision making, as well as in auditing or governance functions of entities.

VI. Policy Recommendations

136 The principal objective of this ROSC assessment is to assist the authorities and other stakeholders in strengthening the financial and non-financial sectors' accounting, financial reporting and auditing practices, as a means to support certain relevant strategic objectives including:

- Enhancing the business climate and bolstering domestic and foreign direct and portfolio investment in the private sector;
- Strengthening the stability and competitiveness of the banking and non-banking financial sectors; and mitigating the risk of crises due to loan collection problems and weak capital base;
- Encouraging greater transparency in both State and privately-owned enterprises, enabling shareholders and the general public to assess management performance and influence its behavior;
- Aligning the normative and legal framework in the area of financial reporting, accounting and auditing with the good international practices;
- Facilitating SME access to credit by encouraging a shift from collateral-based lending decisions to lending decisions based on the financial performance of the prospective borrower, thereby supporting growth in the SME sector—while avoiding placing an undue administrative burden on these SMEs; and
- Helping to ensure that the financial reporting and auditing rules applicable to different types and sizes of entity are appropriate to the needs of those entities and the users of their financial statements.

A. Status of key policy recommendations of 2004 A&A ROSC: some implemented, others need further attention

137 **The systems already in place have to be implemented and enforced to enable institutions to function as intended.** Slovenia improved corporate financial reporting framework in line with the 2004 A&A ROSC recommendations¹³⁸ and the government created the regulatory and oversight agencies that are required for a well-functioning system. The reforms need to continue to ensure that practical implementation and enforcement are in place and indeed contribute to sound quality and reliability of financial reporting to support better economic decisions and governance mechanisms, including those in banking sector and SOEs.

138 **Despite a commendable effort to implement the 2004 A&A ROSC recommendations some need further attention, especially in monitoring and enforcement.** Annex 4 provides an overview of how the country addressed the key 2004 A&A ROSC policy recommendations. Some were fully implemented, such as increasing the accountability of

¹³⁸ The status of implementation of the 2004 ROSC A&A Recommendations is presented in Annex 4.

preparers of financial statements; introducing certain regulations to enhance audit quality (the requirements for professional indemnity insurance and safeguards against dismissal of auditors during the audit); as well as introducing disclosure requirements for listed companies. Some recommendations were partially implemented, such as improving the accounting standards-setting process; requiring IFRS for most of PIEs, except individual financial statements of listed companies; and enhancing the monitoring and enforcement capacity of the securities market regulator. Some recommendations have not yet been implemented, these include enhancing the authority of regulators over audit firms, and enhancing professional education and training.

B. Statutory Framework

- 139 **The authorities should simplify the framework for national financial reporting, including laws such as the Companies Act, in line with the requirements of the new accounting directive 2013/34/EU which contains limitations on requirements that a Member state can have for small entities, and also options for further simplifications for micro-entities.** Higher level aspects of financial reporting requirements could be retained in the Companies Act (for example the need to produce financial statements) and details addressed in the Slovenian Accounting Standards (such as disclosure requirements and the use of a unified chart of accounts). Use of the unified chart of accounts, developed by the SIA, may become voluntary for some entities rather than mandatory as currently required in the Companies Act. This would allow flexibility, particularly for multinational entities that use common accounting systems across different jurisdictions, as well as those that apply IFRS or report to overseas group companies. See paragraphs 30 and 31 for further details.
- 140 **The Slovenian authorities need to transpose the additional requirements of the new accounting directive 2013/34/EU¹³⁹ by 2015** including: (i) defining public interest entities (PIEs); (ii) revising and amending the thresholds for classification of entities (micro, small, medium-sized and large) and groups of entities (small, medium-sized and large); (iii) requiring that notes to the balance sheet and profit and loss account should be presented in the order in which items are presented in the said balance sheet and profit and loss account; and (iv) incorporating the provisions related to “Report on payments to governments”. See Annex 2 for further details.
- 141 **The Auditing Act should be revised to focus solely on statutory and voluntary audits of financial statements. The definition of an audit needs revision and other non-audit services to be regulated only to the extent that these services impact on statutory audits and on auditors’ independence.** The Auditing Act should focus exclusively on regulating statutory audits and statutory auditors. Non-audit services,

¹³⁹ Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC.

including appraisals, should not be regulated under the Auditing Act unless there are instances when these can compromise the auditor's independence. This applies also to similar requirements devised and issued separately by the APOA and SIA. See paragraph 53 for further details. The Auditing Act will also need to transpose new requirements of the revised Statutory audit directive once issued, and the Regulation on specific requirements regarding statutory audit of public interest entities will have to be implemented in practice¹⁴⁰. The authorities did not evaluate in detail the upcoming changes in the SAD and the requirements of the proposed new EU Regulation of the European Parliament and of the Council on specific requirements regarding statutory audit of public interest entities; these will have to be considered when revising the Auditing act. Finally, the law should fully implement the requirements of the Directive regarding notification of withdrawal of approval of auditors.

- 142 **The Energy Act needs revision so as unambiguously give precedence to the requirements of SAS and IFRS related to revenue recognition.** In case it is necessary and required for regulatory purposes, the law can require additional disclosures and notes to the financial statements. This should be similar in other industries if similar cases arise. See paragraph 32 for further details.

C. The Profession

- 143 **The governance of the SIA should be strengthened and better reflect the nature of the institute as a membership based organization, while other institutions (non-members) should be part of APOA governance structures so that the public interest is effectively represented.** The Governing Council of the SIA should be strengthened by comprising only members who are both independent and experts in one or more of the SIA's fields of activities. Thus, at the very least, the three representatives on the SIA's Governing Council of the founder, the Association of Accountants, Treasurers and Auditors of Slovenia (AATAS), the Ministry of Finance (MOF) and the Ministry of Economic Development and Technology (MOEDT) could have a status of observers, while the core members of Governing Council should consist of representatives elected by the SIA's membership. The Auditing Act should be changed to reflect this. Similarly, given the oversight role played by the MOF and MOEDT particularly through the Agency for the Public Oversight of Auditing (APOA), the SIA's Auditing Council, Expert Council should include any representatives from the MOF, MOEDT or other government bodies only with the status of observers. See paragraph 66 for further details.
- 144 **The governance of the APOA should be strengthened to better represent audit practitioners that may not necessarily be always appointed by SIA.** The Auditing Act's explicit reservation of a place on the APOA's Expert Council for a nominee of the SIA should be replaced by something more closely reflecting the EU's Statutory Auditing Directive - which simply sanctions a minority of practitioners to be involved in the

¹⁴⁰ The adoption is expected by June 2014.

governance of the public oversight system¹⁴¹. Such a formulation would help demonstrate that, notwithstanding the preferences of the SIA, which can also have a right to nominate a suitable candidate, the MOF may freely appoint any practitioner it believes would better, and perhaps more independently, contribute to the governance of the APOA, as well as provide useful insight to the oversight from the practitioners' point of view. An alternative could be to remove completely the profession from the oversight governing structure. Currently, the Auditing Act states that a place on the APOA's Expert Council is reserved for a nominee of the SIA. This creates an apparent conflict of interest given the APOA's role to oversee the activities of the SIA.

- 145 **APOA funding arrangements should also be improved to broaden the funding base so that the profession contributes to the funding of public oversight.** The level of APOA funding and expenditure should be reviewed in conjunction with the recommendations of this report, particularly those regarding the need for the APOA to develop methodologies for the direct inspection of statutory audit firms and auditors as well as the activities of the SIA. This is especially relevant in the context of EU audit reform, which most likely will result in a requirement that APOA performs direct inspections of auditors and audits of PIEs. In terms of raising this additional funding, the APOA and government may wish to consider broadening the sources of the APOA's income to include levies on the SIA, audit firms and the equivalent of public interest entities. See paragraph 70 for further details. In the longer term, if an integrated financial sector regulator is created in Slovenia, it would make sense for APOA to be included; see paragraph 155 and Annex 5 for details.

D. Accounting and Auditing Standards

- 146 **The SAS should be updated to incorporate fully the requirements of the new Accounting Directive.** More specifically, some areas remain to be fully transposed (including amortization of goodwill or additional disclosures requirements when development costs are recognized as intangible assets) and some requirements of the new accounting directive need to be transposed by 2015. For example, revising and amending the thresholds for classification of entities (micro, small, medium-sized and large) and groups of entities (small, medium-sized and large); requiring that notes to the balance sheet and profit and loss account should be presented in the order in which items are presented in the said balance sheet and profit and loss account; and incorporating the provisions related to the "Report on payments to governments.". However, SAS should be developed as a standalone simplified set of standards suitable for non-PIEs, perhaps with reference to IFRS for SMEs and contain a suitable hierarchy for accounting policies for issues not specifically addressed by SAS rather than require companies to refer to full IFRS. The standards setter should also consider a policy option of adopting the IFRS for SMEs. See paragraphs 108, 110 and 111 for further details.

¹⁴¹ See Article 32 of the Statutory Auditing Directive.

- 147 **The standard-setting process for SAS should be made more participatory and systematic in the way the relevant benchmarks are incorporated in SAS.** The standard-setting approach should be expanded to provide for broader consultation with preparers, users and auditors of financial statements as well as tax experts. The standards setter should publish responses to comments and basis for conclusions when the standards-setting process is finalized. The process of setting “Corporate Finance Standards and Rules” as well as “Positions” and “Interpretations” should be transparent and participatory. Consideration should be given to the systematic approach in using relevant international benchmarks in the standard-setting process together with clarification of the way future revisions will be made to keep the standards up-to-date. See paragraph 83 for further details.
- 148 **The Slovenian authorities should adopt additional simplifications and exemptions provided by EU Directive 2013/34/EU for micro entities and small entities and groups.** The new directive allows Member States to impose only minimum requirements that are prescribed in the directive for small entities, but contains also additional optional simplifications for micro-entities. The classification of entities is also stricter in the new directive and allows the Member States little flexibility in establishing the size thresholds for entities for the purpose of differentiated reporting requirements. This will increase significantly the exemptions and simplified requirements for SMEs and thereby reduce the cost of doing business while keeping basic accountability for small and micro-entities. See paragraph 34 and Annex 2 for further details.
- 149 **There is a need to establish institutional responsibility as well as a sustainable mechanism for the timely translation of amendments to existing ISAs as well as new ISAs.** The Auditing Act is currently unclear on the matter, although the SIA voluntarily took responsibility for the most recent set of translations. See paragraph 84 for further details.

E. Monitoring and Enforcement

- 150 **The AJPES should cross-check audit reports filed by companies with the SIA** to ensure that only duly authorized auditors are producing audit reports. See paragraph 86 for further details.
- 151 **The BS can and should play a more dynamic role in ensuring that the financial statements of banks are of high quality and contain meaningful disclosures on banking risks and risk management.** Systematic and regular review of financial statements by the BS will enable the regulator to enforce IFRS in the banking sector. To comply with BCP 27, the BS must have the power to reject and rescind the appointment of an external auditor who is deemed to have inadequate expertise or independence, or is not subject to or does not adhere to established professional standards. See paragraphs 59 and 29 and Annex 1 for further details. BS staff would require appropriate training to be able properly to perform this role as discussed below. The BS and AZN should also complement the supervisory assessment of banks and insurance companies by reviewing

disclosures related to risks and valuations in audited financial statements. Regular and systematic interactions between regulators and auditors should take place.

- 152 **The ATVP should develop specific and detailed requirements for monitoring financial statements published by listed companies** and thereafter systematically review listed companies' financial statements to ensure they comply with applicable financial reporting standards. See paragraph 89 for further details. ATVP staff would require appropriate training to be able properly to perform this role as discussed below.
- 153 **The state needs to improve SOEs governance function, including appointment of auditors and role and function of audit committees. In addition there is a need to create a system for systematically reviewing, analyzing and properly scrutinizing financial statements of SOEs, which is a key input for assessing the fiscal risks of SOEs for the public finances and the public budget in general.** This would include collecting at least six-monthly financial statements and annual audited financial statements from SOEs and preparing a consolidated fiscal risk report. In addition, the state needs to strengthen its SOEs governance function, as currently the audit committees are not vocal or influential. The existing conflicts of interest do not enable them to properly exercise their role of overseeing the audit process and effectively communicate with auditors, as well as challenge them when needed. See paragraph 101 for further details.
- 154 **The APOA should develop and adopt formal methodologies for the direct inspection of statutory audit firms and auditors as well as for the supervision of the activities of the SIA.** In addition, the APOA and SIA might benefit from mediated negotiations of their cooperation agreement to better clarify their roles and responsibilities.
- 155 **If Slovenia decides to restructure its financial sector supervision and create an integrated regulator, a consideration should be given to integrating the APOA into such a regulator.** Significant factors that would influence such a transformation include: better funding arrangements; coordinated supervisory efforts and better contribution of audit oversight to financial sector supervision as a whole; an integrated regulator would be likely to have more power to influence the behavior of regulated entities, including auditors. This transformation might also help resolve issues such as the relatively low demand for general purpose financial statements; the limited capacity to understand and enforce IFRS and derivative financial reporting standards as well as ISA; and the low and declining budget of the APOA. The Annex 5 describes in detail the feasibility of incorporating APOA into an integrated regulator, including some examples from international practice. Careful consideration would be needed in terms of timing, however, as such an initiative could, for example, be disruptive to the on-going reforms that BS has started to implement in the wake of the current banking crisis in Slovenia.
- 156 **The SIA is recommended to develop and adopt a formal Quality Assurance Review (QAR) methodology** for use during quality review inspections of audit firms and auditors. Its QAR team would benefit from inviting specialist personnel to assist in the QAR of audits in specialist sectors and from expanding its range of experience by, for

example, visits, interchange and secondments with QAR teams of other European professional accountancy bodies. The SIA's Audit Council could also benefit from occasional dialogue with QAR experts, perhaps from other international professional bodies' quality assurance functions. See paragraphs 93 and 94 for further details.

F. Education and Training

- 157 **Government, regulators, professional bodies and education providers should work together to decide on appropriate target educational standards and qualifications suitable for Slovenia's large pool of people working in accounting.** Participants in the financial reporting process need to be encouraged to gain the education and training they need to meet requirements and expectations. See paragraph 75 for further details.
- 158 **The staff of regulators, including those of the BS, AZN and ATVP, should receive practical training to enforce accounting, financial reporting and auditing standards.** Even if some training is available at the Banking Association, there is scope for a more sustainable and systematic training program. Training programs should focus on practical, legal and compliance issues in the banking and insurance sectors as well as the securities markets. See paragraphs 74 and 89 for further details.
- 159 **The SIA should recognize and give credit for all relevant training, professional development and examinations passed by student and full members** in determining whether such members have satisfied the SIA's requirements for qualification and continuing professional development. The SIA should require student members to maintain detailed records of work experience to confirm that prospective full members have appropriate professional skills, general education and practical experience. The SIA should explicitly assess the suitability of practical training providers used by student members and should both develop and deliver courses to students on professional values and attitudes. See paragraphs 77 and 78 for further details.
- 160 **The SIA should assist small and medium-sized audit practitioners develop, learn to use and maintain an ISA-compliant audit methodology** in order that they may properly implement the requirements of ISA. See paragraph 124 for further details.

Annex 1: Accounting and Auditing Standards and Codes in the Slovenian Banking Sector

A. Introduction

- 1 This annex of the Accounting and Auditing ROSC (A&A ROSC) is essentially an A&A ROSC that is focused exclusively on the banking sector of Slovenia. This separate annex has been produced because of the significance of the banking sector and presents all the banking issues in a single section. It identifies the key accounting and auditing standards and practices currently in force in the banking sector and interactions with prudential rules and regulations. The annex also identifies some key issues and challenges facing the banking sector such as poor governance and risk management practices that were among the determining factors that led to the current banking crisis.

B. Banking Sector Context

- 2 **The Slovenian banking system is one of the smallest in the euro area.** Total assets amounted to EUR 46 billion at the end of 2012, equivalent to 130 percent of GDP, the third lowest figure in the euro area. There are 23 banks, including 7 foreign-owned banks. As at 31 December 2013, two banks were in the process of supervised winding-down.
- 3 **Government-controlled financial institutions dominate the system.** Slovenia has the highest proportion of government ownership of the banking system in the euro area, at 44 percent. The two largest banks and the largest insurance company belong to financial groups that are at least 50 percent directly or indirectly owned by the government.¹⁴² Government controlled banks account for approximately 55 percent of the financial system in terms of assets or capital. The Slovenia Commission for Prevention of Corruption (KPK) recently reported that, with the vast majority of the banking sector being at least partially controlled by the state, loans were granted based on political criteria mainly rather than strict commercial criteria. Consequently, the KPK, jointly with the Court of Audit, proposed legislative anti-corruption safeguards for the banking sector, including on transparency aspects. Banking issues were looked into by a Special Parliamentary Commission and work is still on-going together with the BS.
- 4 **The on-going banking crisis has significantly affected confidence in the banking sector in Slovenia.** The banking sector is in need of recapitalization to revive growth and ensure stability. The total assets of banks and savings banks (EUR 46.1 billion in 2012) amounted to 130 percent of GDP. However, non-performing loan (NPL) ratios reached 16.3 percent in June 2013 for all types of loans and 25.5 percent for corporate loans—the highest levels among OECD countries. The deteriorating portfolio quality, together with

¹⁴² Financial Stability Report Bank of Slovenia - May 2013.

constraints on refinancing from foreign financial markets, is hampering the banks' ability to manage liquidity effectively.

- 5 **The banking sector in Slovenia is in need of recapitalization in order to revive growth and ensure stability.** The deteriorating portfolio quality, together with constraints on refinancing from foreign financial markets, is hampering the banks' ability to manage liquidity effectively. A comprehensive approach to deal with NPLs and distressed assets on the banks' balance sheets with the introduction of Bad Bank¹⁴³ continues to be one of the priorities of the new government. The actual transfer of bad assets to the Bad Bank is awaiting recapitalization to reflect the outcome of bank stress tests completed in December 2013. The stress tests assessed, with the help of independent international experts, the robustness of the Slovenian banking system in an unlikely adverse macroeconomic scenario, and determined any capital shortfall that could arise at an individual bank or consequently across the entire banking system, in the event of such a scenario. The stress tests concluded that a total of EUR 3.012 billion is required for capital increases at three banks: NLB requires EUR 1,551 million; NKBM EUR 870 million; and for Abanka the recapitalization process is not complete yet. However, the bank has so far received EUR 348 million of state aid. On completion, NLB, NKBM and Abanka will have overall capital adequacy ratios of around 15 percent.
- 6 **In mid-December 2013, the Slovenian authorities announced elements of their strategy for the restructuring of the financial sector based on the results of the Asset Quality Review (AQR) and Stress Testing exercise, identifying capital deficits of up to 13.7 percent of GDP under the adverse scenario.** After full burden sharing by holders of subordinated debt instruments, the remaining capital requirement of the three biggest banks provided by the government amounted 8.6 percent of GDP. The recapitalization measures for the two largest state-owned banks (NLB, NKBM) were subsequently approved by the European Commission with a temporarily approved rescue aid for Abanka (the third state-owned bank) and new aid in the form of a state recapitalization of 1.5 percent of GDP for Probanka and Factor Banka which have been undergoing an orderly wind-down process since September 2013 and will have exited the market by the end of 2016 as per the decision of the EC. Once the decisions were adopted, the recapitalization of five institutions totaling 9.2 percent of GDP was completed by way of cash and marketable sovereign securities.
- 7 **Slovenia's Bank Asset Management Company (BAMC) - the Bad Bank - was established in 2013, and originally, it was envisaged to be responsible for the recapitalization and ownership of banks.** The government subsequently limited the task of BAMC only to that of manager of selected NPLs. Through this, BAMC has legal powers to seek a quick resolution of impaired assets, be it by restructuring a company (when it holds more than 50 percent of the credits) or by liquidating it and selling its collateral and assets. It has the option of acquiring credits of impaired creditors from

¹⁴³ State-owned Bad Assets Management Company (BAMC).

other banks to facilitate corporate restructuring, but has to purchase those credits at market prices to avoid providing state aid.

- 8 **As part of the financial sector restructuring loans in the amount of 9.5 percent of GDP were transferred to the BAMC from the two largest banks (NLB and NKBM) at a transfer value of 2.9 percent of GDP or at a 69 percent discount from book value.** The transfer prices were determined in accordance with European Commission state aid rules and reflect the long-term real economic value of the loans. It is expected that NPLs with a book value of some 3.3 percent of GDP will be transferred from Abanka by mid-2014 at the transfer prices reflecting a similar discount. The authorities consider the BAMC sufficiently capitalized and do not envisage additional capital needs arising in 2014, which will ultimately depend on the volume of restructurings. BAMC may, however, incur some losses on the transferred NPLs. BAMC had no involvement in the selection of NPLs to be transferred or in the setting of their transfer values, had limited access to the details on the methodology used in the AQR, and, to date, it has received few of the detailed loan files underlying the transferred NPLs. As these files are received in the course of 2014, BAMC will perform its own due diligence of NPL values.
- 9 **The authorities are intending to make several changes to the law governing the BAMC. The intention of these amendments is to allow for an ownership structure of the BAMC similar to AMCs in other EU member states, to avoid fire sales and to maximize the return for the taxpayer.** More specifically the proposed amendments are: (i) increasing the lifetime of the BAMC significantly above the 5 years that is currently provided for in the legislation (ii) removing the yearly 10 percent divestment obligation, and (iii) providing for the possibility for the participation of private investors.
- 10 **The banking sector is regulated by the Bank of Slovenia.** The BS issues prudential regulations such as capital adequacy and liquidity requirements and monitors the banks' prudential and financial reporting for off-site supervision. With 1 of January 2014 the Regulation (EU) No 575/2013 of 26. June 2013 on prudential requirements for credit institutions (hereinafter CRR), together with the Directive 2013/36/EU of 26 June 2013 (on access to the activity of credit institutions and the prudential supervision of credit institutions; hereinafter CRD IV) were introduced in the EU. The CRR is already directly applicable (from January 1, 2014) for all EU credit institutions (also in Slovenia). One component of this framework is the analysis of financial statements of banks on a regular and systematic basis to identify banking risks.
- 11 **Improving corporate governance and transparency in the banking sector will remain a key challenge in the short and medium term in Slovenia.** Although Slovenia applies the same rules and regulations as other EU countries and IFRS and ISA are applied by stakeholders in the banking sector, the approach and philosophy of stakeholders towards these rules and regulations are not always consistent with international practices. Any reforms in this area will require a change in the behavior and mindset of stakeholders.

Statutory framework

- 12 **Banks prepare their financial statements in accordance with IFRS.** The BS has not issued any specific accounting requirements for banks. As expected, there are some differences between prudential and capital requirements calculations and accounting requirements such as the basis of consolidation.
- 13 **The relevant parts of Banking Accounts Directive 86/635/EEC are transposed in the Companies Act and the Banking Act, such as for example publication and auditing requirements.** However, requirements for the layout of financial statements, valuation rules, provisions are based on the IAS regulation 1606/2002/EC (i.e. EU endorsed IFRS) and therefore these parts of the Banking Accounts Directive (86/635/EEC) are not applicable. According to the Company Act and Banking Act (Article 203), banks prepare their financial statements in accordance with IFRS as adopted by the European Commission in accordance with Regulation (EC) 1606/2002. All banking accounting requirements are based on IFRS as adopted by the EU and banks prepare financial statements under IFRS as required by Article 54 of the Company Act. However the layouts of financial statements are prescribed by BS regulation, based on Financial Reporting Data (FINREP), issued by Committee of European Banking Supervision (CEBS)/European Banking Authority (EBA).

The Statutory Framework for the Banking Sector

- 14 **Banks apply the Basel II framework¹⁴⁴ for capital adequacy, as well as standards and guidelines published by the European Banking Authority.** The BS, as other EU banking regulators, is in the middle of Basel III implementation phase¹⁴⁵. The BS published a regulation¹⁴⁶ regarding the preparation of statutory financial statements. Banks prepare their financial statements according to IFRS and the regulation and submit unaudited annual financial statements to the BS no later than a month after the end of the financial year, and consolidated unaudited financial statements within two months after the year-end.
- 15 **Prudential reporting requirements for banks are based on general purpose financial reporting data with additional disclosures where relevant.** For prudential purposes and prudential reporting, BS has issued detailed regulations for banks. This includes specific formats for banks to submit financial statements data to the BS on a regular basis, based on Financial Reporting Data (FINREP)¹⁴⁷ regulations issued by the European

¹⁴⁴ Basel II is the international capital adequacy framework for banks issued by the Basel Committee on Banking Supervision.

¹⁴⁵ Basel III is the latest version of the international capital adequacy framework for banks issued by the Basel Committee on Banking Supervision and supersedes Basel II.

¹⁴⁶ Regulation on the Books of Account and Annual Reports of Banks and Savings banks, Official Gazette of the Republic of Slovenia, No. 17/12 and 104/13).

¹⁴⁷ FINREP is a standardised EU-wide framework for reporting financial (accounting) data. It comprises templates for reporting the income statement and the balance sheet, as well as breakdowns of other data.

Banking Authority, in accordance with the BS Regulation on the Books of Account. In addition, for the purpose of prudential supervision on a consolidated basis, the BS has issued specific regulations for banks to submit unaudited consolidated financial statements data on a regular basis, as required in the BS Regulations on Supervision of Banks and Savings Banks on Consolidated Basis and the Basel 2 framework. It is to be noted that the definition of the banking group for prudential purposes and prudential reporting in line with the current EU bank capital framework is represented by Directives 2006/48/EC (Banking Consolidating Directive or BCD) and 2006/49/EC (Capital Adequacy Directive or CAD) (both also known as Capital Requirement Directives or CRD) and reflecting the international agreements of the Basel Committee on Banking Supervision (Basel Committee). This is different to the definition of the banking group for IFRS reporting purposes. These differences are likely to remain under CRR which is implementing Basel III in the EU. Finally, Article 207 of the Banking Act transposes the specific requirements of the Directive 2006/48/ES for bank transparency for Pillar 3 disclosures in the Basel framework (from January 1, 2014 part of the CRR).

- 16 **The audit of a bank's annual report includes an additional audit on compliance with the bank's risk management rules, which is prescribed by the BS regulation on the Minimum Scope and Content of the Additional Audits' Review of Compliance with Risk Management Rules at Banks and Savings Banks.** The additional auditor review of compliance with risk management rules encompasses a review of (a) the treatment of the following risks: credit risk, market risks, interest rate risk, operational risk, liquidity risk; and (b) own funds, capital requirements and internal capital adequacy. On the basis of the additional review, an additional auditor's report on compliance with risk management rules is prepared by the auditor and submitted to the BS including the following: (a) any deficiencies identified during the audit review of the respective areas listed in the regulation; (b) the follow-up of findings in relation to the auditor's recommendations from previous years; and (c) recommendations regarding improvements in policies, processes and procedures.
- 17 **The BS, as is common in other jurisdictions, does not have the power to reject and rescind the appointment of a banks' external auditor and as such there is no positive or negative list of bank auditors.** However, the BS may require that the auditor amend or modify the audit report; or reject the audit report and request that the audit be performed by another certified auditor at the bank's expense. However, the power of the BS to request for a change in auditor may be removed in the new Banking Act. In the banking sector there is currently no mandatory rotation of audit firms, only rotation of the key audit partner within the audit firm after seven consecutive years. However, in the new Banking Act, once adopted, banks will be required to appoint an audit firm for not more than three years. After that period, banks could extend the auditor's appointment for another three years. After the period of six years, banks will be required to appoint another auditor for at least four years. The bank informs the BS of the appointment or dismissal of the auditor by submitting a copy of the minutes of the meeting of shareholders. The BS has no direct role in the appointment, resignation or dismissal of the firm of external auditors.

- 18 **Banks submit unaudited annual financial statements to the BS no later than a month after the end of the financial year and consolidated unaudited financial statements within two months after the year-end.** In accordance with regulations of the Securities market regulator, banks which are listed on the Ljubljana Stock Exchange (LSE) must publish their audited annual report within four months of the end of the business year and other banks within five months of the end of the business year. Banks must ensure that audited financial statements and annual reports are publicly available for at least five years after publication. Under draft new Banking Act once adopted, deadline for publication of annual report will be the same for all banks (within four months of the end of the business year).

C. Professional Education and Training

- 19 **IFRS and ISA expertise in Slovenia is reasonably good among key stakeholders but not as widespread and deep across all areas as it should be.** Corporate governance around financial reporting and auditing processes could be strengthened and made more robust and transparent. There is a lack of: (i) IFRS and ISA expertise and understanding of their effective roles among some stakeholders; and (ii) ownership of the financial reporting processes.

Expertise and understanding of IFRS and ISA

- 20 **IFRS expertise in the financial sector can only be found among a few professionals working for the regulators, banks, and audit firms (which are part of international audit firms) operating in Slovenia.** However, for IFRS and ISA to be fully implemented and enforced properly at all levels, more supervisors and staff working in the banking sectors at various levels should have a better and more comprehensive knowledge of IFRS and ISA in areas such as:
- i. IAS 39 - Financial Instruments: Recognition and Measurement
 - ii. IFRS 7 - Financial Instruments: Disclosures
 - iii. IAS 16 - Property, Plant and Equipment
 - iv. IAS 40 - Investment property
 - v. ISA 200 - Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing
 - vi. ISA 260 - Communication with Those Charged with Governance
 - vii. ISA 540 – Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures
- 21 **If IFRS and ISA expertise is disseminated more widely in the banking sector across all levels, this could significantly improve the implementation of international standards in the banking sector.**
- 22 **This limited IFRS and ISA expertise among banks' staff means that credit officers and credit committee members may not fully understand or be able to properly**

analyze audited financial statements and audit reports to assess the credit worthiness of borrowers. This could lead to a lack of proper risk assessment and risk management, resulting in bad loan management.

- 23 **To properly implement the reforms described in this annex, banks and the BS need staff with proper accounting and auditing expertise tailored for the banking sector.** A few staff have acquired certified auditing or accounting licenses and others have practical experience from previous work in audit firms or commercial banks in the accounting area. A few staff members have mathematical or legal backgrounds.

Ownership of the financial reporting processes

- 24 **Another effect of the lack of expertise and knowledge of IFRS and ISA is a lack of ownership regarding the preparation of IFRS financial statements,** i.e. the difference between preparers of financial statements and those who audit them. Better knowledge of IFRS and ISA across accounting, regulatory or compliance, risk management, and loan departments will help clarify the distinction between the role of those preparing financial statements and those who audit them. This understanding will make the role of external auditors more effective. The current lack of understanding and awareness of IFRS and ISA among preparers may result in lack of full compliance.
- 25 **Proper implementation of IFRS requires preparation, capture and submission of IFRS compliant data such as, valuations of collateral, discount rate based on yields from risk free bonds and other inputs used for valuations of illiquid equity instruments that maybe used as collateral for loans assessment.** IFRS also requires analysis of the performance of non-banking companies operating in various sectors which have taken loans from banks. This information is collected and used in various departments and at different levels in a bank. If the source data and analysis which may be collected manually or by various IT systems in a bank, are not IFRS or SAS compliant, then producing financial statements will be very challenging.
- 26 **The lack of expertise and awareness is one of the reasons why IFRS financial statements of banks in Slovenia are to some extent influenced by external auditors during the interim and year-end audit.** In some cases, it is only during the interim audit, with guidance from auditors that valuation techniques for assets and impairment are properly re-assessed and more up to date inputs or assumptions are used to value assets. It is not the responsibility of auditors to prepare financial statements. This is not in line with international benchmarks and threatens auditors' independence. ISA 200 "Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing" requires auditors to be independent from the process of preparing of financial statements. It is not the role of auditors to give guidance on valuations of assets.
- 27 **Valuations of investments, loans, impairments, and collaterals can have a significant impact on the profitability and regulatory capital of banks.** 2013 was the fourth

consecutive year that Slovenian banks have operated at a loss and increase in impairments was the decisive factor in this. The operating losses have had an adverse impact on capital adequacy of banks. Given the impact these valuations and impairments can have on regulatory capital, banks' management views on their timing, amount and how they are valued can be different to auditors. Bank's should apply IFRS requirements on valuations and impairment properly and should not wait for guidance from auditors.

- 28 **The role of audit committees.** Based on information collected during a number of stakeholder interviews it appears that, although audit committees meet on a regular basis and discuss key accounting and auditing issues, their effectiveness could be significantly enhanced if they played a more active role in the overall process and engaged with relevant stakeholders on a more proactive basis. In some cases, auditors have difficulty getting their views and recommendations to departments involved in the preparation of financial statements and to senior management, for example regarding improvement in quality of disclosures, better valuation techniques and the use of more up to date variables and inputs for assets valuations. It is one of the roles of the audit committee to facilitate the work of the auditors and ensure that their views and recommendations are properly implemented.

Enforcing Accounting and Auditing Standards

- 29 **Although the quality of financial statements of banks is considered of relatively good quality, enforcement of IFRS in the banking sector is low.** This could be one of the reasons why some banks were slow in reflecting a more realistic picture of impairment in their financial statements. International practices regarding enforcement of IFRS in the banking sector vary. In some countries it is delegated by the accounting and auditing regulatory body to the central bank. Although according to the Banking Act, the BS is currently responsible for enforcing and ensuring compliance with IFRS in the banking sector, it can and should play a more dynamic role in ensuring that financial statements of banks are of high quality and contain meaningful disclosures on banking risks and risk management. Systematic and regular review of financial statements by the BS will enable the regulator to enforce IFRS in the banking sector.
- 30 **As a prudential regulator the BS should perform systematic and regular reviews of financial statements to monitor and analyze new trends in the banking sector and understand interactions between the financial statements data and prudential data.** This is because prudential data are in some cases based on financial statements data and the relationships between the two sets can be strong. Reforms initiated by the BS in these areas are still at an early stage and will need to be further developed and consolidated so that supervisory practices are complemented by proper reviews and analysis of financial statements. These reforms if well implemented will also help to indirectly enforce and ensure compliance with IFRS.

Accounting and auditing standards as practiced

- 31 This section identifies some of the key issues and challenges for the banking sector regarding financial reporting and auditing in Slovenia. These include:
- i. Issues in corporate governance infrastructure and risk management;
 - ii. Public disclosures in annual financial statements, while are generally in line with IFRS, could be improved to incorporate more meaningful and better quality disclosures;
 - iii. A limited compliance with Basel Core Principles (BCPs) in the area of accounting, auditing and transparency; and
 - iv. Developments in EU regulations and regulatory framework will require new sets of skills for BS staff.

Governance Issues

- 32 A key issue identified by some stakeholders is the governance around the preparation and external audit of financial statements and poor risk management especially in state-owned banks. According to the Banking Act each bank must have an audit committee (according to Article 75 of the Banking Act, the banks' Supervisory Board should appoint an Audit Committee). However, the practices of audit committees functioning need strengthening (see paragraph 28 of this Annex for more details).
- 33 **Bank supervisory boards determine their activities schedule and issues to be dealt with each financial year.** These include the frequency and form of communication with the management board, the role of the supervisory board in assessing risk management systems, and the procedure of drawing up general meeting resolutions. The supervisory board is supported by an Audit Committee for issues regarding accounting and auditing. There are regular meetings between the Audit Committee and the external auditors.
- 34 **The process of selecting an auditor must be in line with international professional and ethical principles of auditing.** The current process, in which bank management, supervisory bodies and the audit committee (including one independent accounting or audit expert) take an active part, should ensure an independent and impartial audit of the company's financial statements. However, in practice, compliance with international practices can be challenging due to:
- A limited IFRS and ISA expertise among members of Supervisory Boards and Audit Committees;
 - Communication issues between audit committees and external auditors on problematic matters such as valuations, impairment and disclosure issues; and
 - The need for senior management to understand the added value of the audit and benefits of a well prepared financial statement and not view the auditing process as another costly compliance process.

- 35 **Even if the supervisory board selects the external auditors in an independent manner, and the appointment is ratified at the shareholders' meeting, the interactions and relationship between the supervisory board, audit committees and external audit may not be aligned with international best practices.** A properly functioning audit committee is an important element of enhancing audit quality and independence by auditors from management. The communication process between the supervisory board/audit committee and the external auditors should be strengthened and improved. One way to enhance the relationship among the parties involved in the financial reporting and auditing processes is to improve the experience and expertise of the members of the supervisory board and the audit committees on IFRS and ISA.
- 36 **The perception or appreciation of good quality financial statements is generally quite low.** Current corporate sector practices (including the banking sector to a lesser extent) do not create an environment where the accounting and audit functions can be fully effective and add value. Several factors may explain the difficulties or disincentives in complying with established corporate governance standards, including:
- *Limited understanding of the audit process and its value by those in charge of governance in corporate entities* - representatives of audit firms interviewed mentioned to the ROSC team that the preparation and audit of financial statements is sometimes viewed as another set of procedures that does not necessarily add value to the business.
 - *The need for and perception of quality of financial statements is relatively low.* The demand for transparent financial statements is still relatively low, due to collateral based lending, the early stage of development of the securities market and the modest level of foreign investment.
- 37 **The BS has already embarked on some reforms.** Recent amendments to the Banking Act in the area of governance include: (1) the determination of criteria for defining significant direct or indirect business contacts for the purpose of identifying conflicts of interest, and (2) the determination of criteria and procedures for the assessment of the suitability of management or supervisory board members or already appointed members holding such office. However, the impact of these reforms on the accounting and auditing processes may be limited.

Public disclosures and transparency

- 38 Banks' financial statements are prepared to a reasonably good standard and comply with the requirements of IFRS for presentation and disclosures. However, the notes and disclosures were not always easy to follow and could in some cases result in confusion.
- 39 **Banks tend to provide only the minimum disclosures related to their risk management without trying to make them more meaningful.** For example, if credit risk is likely to be the main risk exposure for banks in Slovenia, with market risk and liquidity risk relatively less significant, credit risk disclosures in financial statements could be improved. In addition to quantitative data, more qualitative information and

explanations of the bank's approach to manage, mitigate and assess credit risk could be included.

Compliance with revised Basel Core Principles and prudential framework¹⁴⁸

40 **The BS broadly complies with some recently revised Basel Core Principles (BCP) related to corporate governance, financial reporting, auditing and transparency but significant improvement can be made in these areas.** Areas for improvement include:

- The relationship between BS and bank auditors. One suggestion would be the establishment of systematic annual bilateral meetings between the BS and the auditor of each bank to discuss on-going and relevant bank specific issues such as impairment, valuations of collateral, liquidity positions, capital breaches, corporate governance, adequacy of IT systems, etc;
- Improvement in the quality of disclosures in financial statements and the perception of financial statements in the banking sector; and
- More effective role of audit committees and supervisory board.

41 **The revised BCPs recently published by the Basel Committee on Banking Supervision have four new principles that are related directly or indirectly to corporate governance, financial reporting, auditing and transparency.** By publishing these new principles, the BCBS emphasized that banking supervisors have a clear role to play to enforce good practice in the areas of corporate governance, accounting and auditing. Banking supervisors stand to gain by complying with these new principles because banks' corporate governance in the area of accounting and auditing will be improved and users of financial statements will get more reliable and relevant information. So it is in the interest of BS for these principles to be implemented in its supervisory framework. The four relevant principles are:

a. *Principle 14: Corporate governance*

The supervisor determines that banks and banking groups have robust corporate governance policies and processes covering, for example, strategic direction, group and organizational structure, control environment, responsibilities of the banks' Boards and senior management, and compensation. These policies and processes are commensurate with the risk profile and systemic importance of the bank.

b. *Principle 26: Internal control and audit*

The supervisor determines that banks have adequate internal control frameworks to establish and maintain a properly controlled operating environment for the conduct of their business taking into account their risk profile. These include clear

¹⁴⁸ Revised BCPs were recently issued by the Basel Committee to enhance sound corporate governance and effective risk management and public confidence in individual banks and the banking system. The revised BCPs were reorganized to foster their implementation by regulators and banks through a more logical structure. In this ROSC we are focusing only on the BCPs that are related to the financial reporting process, relationships between regulators and auditors, and importance of good disclosures in financial statements.

arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.

c. *Principle 27: Financial reporting and external audit*

The supervisor determines that banks and banking groups maintain adequate and reliable records, prepare financial statements in accordance with accounting policies and practices that are widely accepted internationally and annually publish information that fairly reflects their financial condition and performance and bears an independent external auditor's opinion. The supervisor also determines that banks and parent companies of banking groups have adequate governance and oversight of the external audit function.

d. *Principle 28: Disclosure and transparency*

The supervisor determines that banks and banking groups regularly publish information on a consolidated and, where appropriate, solo basis that is easily accessible and fairly reflects their financial condition, performance, risk exposures, risk management strategies and corporate governance policies and processes.

42 **The BS supervisory framework complies to some extent with these revised BCPs.** However, according to IMF, if BS improves its supervisory approach in these areas, it would be in a better position to¹⁴⁹:

- a. Identify risk management issues in banks and require banks to take remedial actions in a timely manner;
- b. Intervene in a timely manner to identify a rise in credit risk, put more pressure on banks for classifying more appropriately their claims on individual debtors and require additional provisioning when needed even if it can result in a deteriorated capital ratio;
- c. Encourage external auditors to review with a more critical bias the banks' loan portfolios;
- d. Develop on-site examinations of loan portfolios on larger samples and induce the banks to take a more conservative stance on collateral valuation.

Challenges of the new EU Regulatory framework

43 **Banking supervision is being reformed at the European Union level and these reforms will also impact supervision in Slovenia.** Of key importance is the transition to the EU Single Supervisory Mechanism (SSM). The regulation outlining the Single Supervisory Mechanism (Council Regulation (EU) No. 1024/2013) entered into force at

¹⁴⁹ IMF Country Report No. 12/325: Republic of Slovenia: Financial System Stability Assessment - December 2012.

the beginning of November 2013. The European Central Bank (ECB) will assume supervisory tasks in full in November 2014. These reforms are commonly known as the Banking Union. The Banking union is a set of three core elements: i) a single supervisory mechanism (SSM); ii) a single resolution mechanism (SRM); and iii) common deposit insurance. The regulation conferring the SSM tasks to the European Central Bank (ECB) entered into force in November 2013 with the ECB assuming the supervisory responsibilities on November 4, 2014. The European Parliament and the Council of the European Union also reached a provisional agreement on the SRM regulation in March 2014. In addition to these three pillars, there are three main supporting measures that are either considered prerequisites for the core pillars and/or used interim to enhance financial stability. These measures include the Single Rulebook harmonizing financial sector regulation at the national level, and composed of capital and liquidity requirements, as well as regulations on deposit insurance, resolution and recovery tools, and various types of financial instruments. Recently adopted measures include state aid rules for the failing banks and the definition of features for the European Stability Mechanism's (ESM) direct capitalization instrument to be used by the SSM once it is established.

- 44 **The new legislation imposes additional tasks on the banking supervisor and adaptation is required due to the establishment of the Single Supervisory Mechanism.** Supervision in EU countries must be enhanced, both in terms of additional human resources and necessary changes to the organizational structure and processes.
- 45 **Supervisory manuals, which cover the processes, procedures and methodology of supervision, will need to be largely harmonized with the SSM supervisory manual, even for banks that will not be directly included in the SSM.** Changes to the existing methodology in some EU countries will be required regarding the introduction of quantitative indicators and qualitative estimates in the assessment of the banks' risk profile. The system of micro-prudential risk indicators will need to be expanded and supplemented with macro-prudential risk indicators. This would require a more systematic and regular analysis and assessment of financial statements data by supervisors of BS.
- 46 **The new system of indicators will serve as the basis for monitoring the position of specific banks and the banking system as a whole, and for potential decisions on the use of resolution mechanisms.** BS is fully aware of these issues and challenges and has initiated reforms to address them.
- 47 **The reform of the financial system in the direction of a single supervisor is also envisaged in Slovenia.** A new structure of supervisory bodies could be established following the adoption of Solvency II rules in the new Slovenian Act on Governing Insurance and Stabilization of the Banking System.
- 48 **These changes will undoubtedly help the BS and other regulators deal with the challenges of the SSM but it is uncertain how smooth the transition to SSM and its further development will be.** The common EU rulebook being developed by the

European Banking Authority, that would be apply to all EU members and the SSM, could be challenging for the BS to implement since the BS staff will have less control of the new regulations and their implementation.

D. Recommendations

- 49 These recommendations are supporting the section VI. Policy recommendations and offers more details relevant to the banking sector.

Enforcement of IFRS

- 50 **The BS should be more active in enforcing and ensuring compliance with IFRS.** Comprehensive analysis of financial statements by regulators could assist them in this task and identify risks building up in the financial sector. One of the benefits for BS of enforcing IFRS is that they would also have more relevant data to complement prudential data and take appropriate supervisory actions in time.
- 51 Nonetheless, as in many countries around the world, the crisis revealed the need to strengthen risk management and corporate governance and **to ensure that supervisors are more forward looking and proactive in identifying and preventing banks from building up excessive risks such as for example excessive credit risk.** Hence, the need for high quality financial statements in Slovenia and their systematic review by the BS.

Complying with Revised BCPs

- 52 **The BS should implement reforms to comply with the revised BCPs dealing with financial reporting, auditing and corporate governance.** These will enhance financial reporting and auditing processes in the banking sector and strengthen the role of audit committees and the supervisory board.

Workshops and training activities to upgrade IFRS and ISA expertise

- 53 **The BS and banks should continue to organize frequent workshops and training activities on IFRS and ISA, tailored for the banking sector, for their staff and senior management.** This will give participants a better understanding of the importance and relevance of high quality financial statements and how good implementation of IFRS and ISA can improve compliance in this area.

Regulatory framework

- 54 **It may not be appropriate to change the supervisory architecture at the present time given the other challenges being faced.** The banking system requires intensive efforts to restore its soundness and profitability and the BS similarly to banking regulators in other

EU countries in the middle of the process of implementing Basel III/CRD IV as well as SSM entrance. So merging the different financial sector regulators into a single supervisor could be disruptive at this stage, but may be beneficial in the future.

Banking Union¹⁵⁰

55 **The BS should strengthen and align its supervisory mechanisms and tasks to the SSM so that the setup of the Banking Union is not disruptive.** For example, the BS under the new EU legislation (CRR and CRD IV) is obliged to:

- a. Align the BS supervisory manual with the EU Common Supervisory Handbook;
 - b. Collect financial statements data under the EU FINREP framework;
- Furthermore the BS should:
- c. Enhance assessment and analysis of FINREP data on a regular basis in a systematic way; and
 - d. Participate more actively in short-term staff exchange with other EU regulators and supervisory bodies and send its staff on short-term secondments to the EBA and ECB.

¹⁵⁰ The European Union has formally adopted the creation of a bank single supervisory mechanism (SSM), led by the European Central Bank, with the objective to strengthen the Economic and Monetary Union. This is commonly known as the Banking Union.

Annex 2: Analysis of Slovenian Accounting Standards

A. General overview of SAS

- 1 **The main principles and concepts of IFRS are incorporated in the SAS. In many respects this is reasonable as it helps ensure that SAS are consistent with good international practice and makes them easier for users familiar with IFRS, especially international users, to understand.** SAS are designed for non-PIEs; these can be considered a good result of national expertise and achievement in accounting regulation. They include areas not covered by IFRS and more relevant for SMEs, and also simplify IFRS where relevant. Since the 2004 A&A ROSC report SAS were revised, to transpose the requirements of the EU *acquis* relevant to accounting and to better align them with IFRS¹⁵¹. The current version of SAS was approved by the Minister of Finance and the Minister of the Economy of the Republic of Slovenia and has been in force since 1 January 2006. There are 30 general and 8 specific accounting standards. SAS deal with accounting as a whole, for both the external and internal needs of entities. They cover financial, cost and management accounting and are not focused exclusively on financial reporting for external users. SAS 1–19 deal with the methods of presenting economic categories in terms of substance, SAS 24–27 deal with the methods of presenting economic categories in terms of the format used for external reporting, while SAS 20–23, and SAS 28–30 cover mostly internal management records of entities: budgeting, bookkeeping, accounting supervision, accounting analyses and accounting reporting. SAS 33–40 deal with the particularities of accounting in different types of entities and with specific accounting matters that are not covered by general assumptions and principles in SAS¹⁵². For mandatory external reporting, entities shall apply SAS 1–15, SAS 17–19, and SAS 24–27, and SAS to which they refer, as well as the Introduction to the SAS. The application of other SAS is not mandatory, but may be applied voluntarily for internal reporting.
- 2 **While recognizing the importance of ensuring consistency of the national accounting standards with IFRS, they should nevertheless be developed as standalone simplified standards suitable for non-PIEs.** SAS contain many references to full IFRS which results in a complex set of accounting standards. This may also leave room for interpretation in some cases; for example paragraph 1.60 of *SAS 1 Property Plant and Equipment* states “the accounting treatment of sale and leaseback transaction shall be in

¹⁵¹ Article 54 (9) of Companies Act states that the SASs shall transpose the content of Directive 78/660/EEC and Directive 83/349/EEC and their concept shall not be contrary to International Financial Reporting Standards.

¹⁵² The ROSC team did not analyze in details these standards, except SAS 33 as there are no international benchmarks for such accounting standards; IFRS or IFRS for SMEs are following an approach based on specialized activities or elements of financial statements and not on types of entities/industries. The Slovenian standard-setter may consider a similar approach in accounting standards development in medium-to-long-term perspective.

accordance with IAS 17.58–17.63¹⁵³, inclusive”; it does not however refer to specific disclosure requirements for sale and leaseback transactions which are included in paragraph 65 of *IAS 17 Leases*. This may create an ambiguity and room for interpretation as to whether entities should disclose the same items as required by *IAS 17 Leases* or disclosures should be provided based on general requirements of *SAS 24 Formats of balance sheet for external business reporting*¹⁵⁴. There is also an issue of complexity, with standards cross referencing to other standards - for example the Introduction to SAS - Consolidation of Accounting Data in Financial Statements (13) states: “When a parent or its subsidiary is an investor in jointly controlled entities, the investment in jointly controlled entities shall be accounted for in consolidated financial statements on the basis of either proportionate consolidation or equity method. In doing so, the entity shall apply the provisions of IAS 31.30–31.45B¹⁵⁵”. The *IAS 31 Interests in joint ventures* articles mentioned contains references to *IAS 27 Consolidated and Separate Financial Statements*, *IAS 28 Investments in associates*, *IAS 39 Financial instruments: recognition and measurement*, *IFRS 5 Non-current assets held for sale and discontinued operations*, and *IFRS 3 Business Combinations*. Disclosure requirements for SME business combinations also seem more complex than those of Section 19 of the IFRS for SMEs, as Slovenian entities need to make all disclosures as required by *IFRS 3 Business Combinations*¹⁵⁶.

- 3 **In addition to the complexity, including references to IFRS (which are frequently updated) make it necessary to update SAS as references become outdated.** For instance, specific features of evaluating individual economic categories in consolidated financial statements are discussed in a separate section of each SAS while general description of the consolidation process is provided by the *section 13 Consolidation of Accounting Data in Financial Statements* of the Introduction to SAS. In addition, the Section 13 requires that if some issues related to consolidation are not covered by this Section, provisions of *IAS 27 Consolidated and Separate Financial Statements* and *IFRS 3 Business Combinations* shall directly apply. At the same time, according to the EU endorsement status report as at 23 December 2013¹⁵⁷, the following IFRS changes were recently endorsed: *IFRS 10 Consolidated Financial Statements*, *IFRS 11 Joint Arrangements*, *IFRS 12 Disclosures of Interests in Other Entities*, the amended *IAS 27 Separate Financial Statements*, the amended *IAS 28 Investments in Associates and Joint Ventures*, and the consequential amendments. These require implementation, at the latest,

¹⁵³ Page 146 - [http://eur-](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2008R1126:20130331:EN:PDF)

[lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2008R1126:20130331:EN:PDF](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2008R1126:20130331:EN:PDF)

¹⁵⁴ SAS 24 Formats of balance sheet for external business reporting, paragraph 24.12

¹⁵⁵ Page 279 - [http://eur-](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2008R1126:20130331:EN:PDF)

[lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2008R1126:20130331:EN:PDF](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2008R1126:20130331:EN:PDF)

¹⁵⁶ Introduction to SASs – Business combinations (10).

¹⁵⁷

[http://www.efrag.org/WebSites/UploadFolder/1/CMS/Files/Endorsement%20status%20report/EFrag%20Endorsement%20Status%20Report%20%2023%20December%202013\(1\).pdf](http://www.efrag.org/WebSites/UploadFolder/1/CMS/Files/Endorsement%20status%20report/EFrag%20Endorsement%20Status%20Report%20%2023%20December%202013(1).pdf)

from the beginning of the first financial year starting on or after 1 January 2014. References related to consolidation included in SAS therefore need to be updated¹⁵⁸.

- 4 **The hierarchy of accounting policies for cases that are not specifically covered by SAS is not clearly defined in SAS or any other legislation.** The hierarchy can currently be only indirectly defined on the basis of the Article 54 of Companies act (General accounting rules) which states that *companies shall administer books of account and prepare yearend accounts in accordance with this Act and the SAS or IFRSs, unless otherwise provided by the law*. The Introduction to SAS prescribes that accounting policies shall be changed if it is required by the SAS and Institute's Positions on or Interpretations of the Standards. SAS would benefit from a clear hierarchy to help preparers and auditors properly apply professional judgments when it is needed. The hierarchy should also prescribe the role of positions and interpretations, as well as whether reference to IFRS is permitted¹⁵⁹. For instance, according to IFRS for SMEs¹⁶⁰ management uses its judgment in developing and applying an accounting policy for a specific transaction which is not addressed by the standard; in doing so management is required to consider the applicability of the following sources in descending order: (i) the requirements and guidance in IFRS for SMEs dealing with similar and related issues; (ii) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses and the pervasive principles in Section 2 of the standard and (iii) requirements and guidance in full IFRSs dealing with similar and related issues (this is optional).
- 5 **There are a significant number of non-profit organizations in Slovenia. In response to demand for specific accounting guidance they have a special accounting standard.** An association is an independent and non-profit entity established in accordance with the provisions of the Associations Act. In 2012, there were 21,622 associations with total revenues of EUR 547 million. The activity of the association must be public and it cannot distribute profits among members¹⁶¹. Accounting and financial reporting requirements for the associations and their federations are prescribed by SAS 33 Accounting Solutions in Associations and Disability Organization's. The annual report of an association includes: (i) balance sheet; (ii) income statement; (iii) notes to the financial statements; and (iv) report on the operations of the association. The annual financial statements of associations whose revenues or expenses in the previous financial year exceeded EUR 1 million must be audited; there are approximately 60 associations that satisfy these criteria. The audit report needs to include an explanatory paragraph¹⁶² confirming that: (i) the report on the operations is consistent with the financial statements; and (ii) all expenditure was in support of the association's activities and no funds were distributed

¹⁵⁸ ROSC team was informed that working group, nominated by SIA Expert Council is currently working on this issue.

¹⁵⁹ A project „Setting up a hierarchy of accounting rules” was initiated by SIA and will address this issue (http://www.si-revizija.si/racunovodje/index.php#Delo_sekcije).

¹⁶⁰ IFRS for SMEs, paragraphs 10.4 – 10.6

¹⁶¹ Excess of revenue over expenses for all activities and other sources.

¹⁶² Article 27 of the Associations Act.

among members. Audited financial statements and audit report must be submitted to AJPES within eight months of the year end (by August 31)¹⁶³. SAS 33 states that accounting treatment of the association's assets and liabilities is in accordance with general SAS from 1 to 19; but an association is not obligated to follow subsequent measurement rules for assets and liabilities¹⁶⁴ and the impact could be that their financial statements are based on historical cost rather than on fair values. Accounting shall be kept in accordance with the double-entry bookkeeping system, adapted to an association's needs, but small associations are allowed to use a simple accounting system if at least two of the criteria prescribed by SAS 33 in paragraph 33.10 are met.¹⁶⁵

Transposition of the accounting aquis

6 **Even though the Companies Act¹⁶⁶ requires that the SAS shall transpose the content of Directives 78/660/EEC on annual accounts and 83/349/EEC on consolidated accounts (also known as Fourth and Seventh Council Directives), some areas are not transposed or are transposed in a way that contradicts the directives.** The following discrepancies were identified by the ROSC team:

- Some of SAS' provisions related to intangible assets as prescribed by Article 12 (11)¹⁶⁷ of the Directive are not compliant or are not transposed. According to SAS 2 Intangible Assets and Long-term Deferred Costs goodwill with indefinite useful life shall not be amortized, while both the Fourth and Seventh Council Directives, as well as the new Accounting Directive (2013/34/EU) require that where the useful life cannot be reliably estimated, it shall be written off within a maximum period set by the MS (within 5 years under the Fourth Council Directive, but no shorter than five years and no longer than 10 years under the new Accounting Directive). While SAS 2 allows recognition of development costs as intangible assets as permitted by the Directive, the requirement that no distribution of profits take place unless the amount of the reserves available for distribution and profits brought forward is at least equal to that of the costs not written off is not transposed into the domestic legislation;
- It appears that the Companies Act¹⁶⁸ requires disclosures of information concerning acquisitions of own shares in Notes to financial statements rather than in the Business Report, as required by the Article 19 (2) (c)¹⁶⁹ of the Directive, while the derogation¹⁷⁰ is applicable only in respect of small entities. This may not be

¹⁶³ Article 29 of the Associations Act.

¹⁶⁴ Paragraph 33.6 of the SAS 33 and Article 26 of the Associations Act.

¹⁶⁵ (i) the average number of full-time employees on the last day of the previous accounting period shall not exceed 2; (ii) the annual revenue of the preceding accounting period shall not exceed EUR 30,000,00; and (iii) average value of assets at the beginning of the accounting period does not exceed EUR 50,000.00

¹⁶⁶ Article 54 (9).

¹⁶⁷ See Articles 34 and 37 (1) of Directive 78/660/EEC.

¹⁶⁸ Article 69 (1) (5).

¹⁶⁹ See Article 46 (2) (d) of Directive 78/660/EEC.

¹⁷⁰ Article 19 (3) of the Directive 2013/34/EU.

considered a major non-compliance issue, because the Companies Act considers both notes to financial statements and business report to be part of the annual report; however the authorities may wish to reconsider this specific provision.

- 7 **Taking into account the advantages of the flexibility of the repealed so-called Fourth and Seventh Council Directives¹⁷¹, Slovenia imposes simplified accounting and reporting requirements on small enterprises and sole proprietorships, which generally meet the identified needs of users of those entities' financial statements.** The provisions of the Companies Act and other regulations, relating to small companies applies also to micro companies unless otherwise regulated by the specific law. However, the thresholds as currently defined by the Companies Act and based on which entities are classified as micro, small, medium-sized and large would need to be amended and brought in line with new requirements¹⁷². As a result the number of Slovenian entities, subject to exemptions and simplified requirements for SMEs will increase significantly. Currently small and, when applicable, medium-sized companies are subject to less demanding disclosure requirements set forth in the Companies Act and/or in SAS, for instance: (i) small and medium-sized entities are allowed to submit abridged balance sheets; (ii) small and medium-sized entities are allowed to draw up abridged profit and loss accounts, subject of prescribed limits; and (iii) small companies whose securities are not traded on a regulated market are exempted from preparation of the business report. In addition, entities not subject to auditing are not required to disclose information and data required by various SAS; they must only satisfy the disclosure requirements in compliance with the Companies Act and some SAS. The competent Slovenian authorities would need to consider implementation of additional simplifications and exemptions provided by the Directive 2013/34/EU for micro entities and small entities and groups. These refer to various exemptions for micro entities, provided by Article 36 of Directive 2013/34/EU, such as exemption from the obligation to present 'Prepayments and accrued income' and 'Accruals and deferred income'; and permission to draw up only an abridged profit and loss account showing separately at least the prescribed items, where applicable.
- 8 **The legislation in Slovenia does not take full advantage of exemptions for micro-entities permitted by the EU accounting directives.** Although some of the exemptions for micro entities, allowed by Article 1a of the Fourth Council Directive or by Article 36¹⁷³ of the new Accounting Directive are already transposed into domestic legislation (such as permission to prepare abridged balance sheets), the requirements associated with these exemptions are not yet transposed. These requirements become compulsory once exemptions are transposed and do not, for example, allow alternative measurement basis for fair value (Section 7a of the Fourth Council Directive or Article 36 (3) of the new

¹⁷¹ The Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings repealed Council Directives 78/660/EEC and 83/349/EEC.

¹⁷² Article 53 states that Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by 20 July 2015.

¹⁷³ Assessment of article 36 was based on the assumption that the size of thresholds for classification of micro entities will be amended. Currently, the thresholds defined by the Companies Act for micro entities are exceeding this Directive's requirements.

Accounting Directive). Pursuant to article 55 (7) of the Companies Act¹⁷⁴ while micro entities are allowed to draw up an abridged balance sheet¹⁷⁵ and exempted from the obligation to prepare the business report¹⁷⁶, and while the provisions of Article 8 of the new Accounting Directive “Alternative measurement basis of fair value” are transposed among various SAS, there are no legal provisions that such entities are not permitted to apply the provisions of the SAS which are in line with article 8 of the Directive. Domestic legislation should be amended in order to clearly state that, in respect of micro entities, annual financial statements drawn up in accordance with transposed exemptions based on the Directive’s Article 36, paragraphs 1, 2 and 3, shall be regarded as giving the true and fair view, and consequently disapplication¹⁷⁷ shall not apply to such financial statements¹⁷⁸.

SAS as compared with IFRS for SMEs¹⁷⁹ - high level overview

- 9 **A list of all SAS is presented in Annex 3.**
- 10 **Generally, the concepts and principles from SAS are comparable with those described in Section 2 Concepts and Pervasive Principles of the IFRS for SMEs and no major contradictions or areas of incompatibility were identified.** Some of principles which are not directly described by SAS could be interpreted as being included in the „true and fair view” concept.
- 11 **To a large extent, the financial statements presentation as prescribed by SAS’ formats is comparable with the Sections 3 to 7 of the IFRS for SMEs.** The detailed structure of the financial statements as prescribed by SAS 24 Formats of balance sheet for external business reporting, SAS 25 Formats of income statement for external business reporting, SAS 26 Formats of cash flow statement for external business reporting and SAS 27 Formats of statement of changes in equity for external business reporting is comparable with IFRS for SMEs minimum requirements.

¹⁷⁴ Art. 55 (Micro, small, medium-sized and large companies) of the CA. (7) The provisions of this Act and other regulations relating to small companies shall also apply to micro companies unless otherwise regulated by this act and other rules.

¹⁷⁵ Companies Act, Article 65 (3) and Article 66 (4).

¹⁷⁶ Companies Act, Article 60 (2).

¹⁷⁷ Accounting Directive, Article 4(4) and respectively Companies Act, Article 61 (3).

¹⁷⁸ According to the provisions of article 53 of the Directive member states shall bring into force the laws, regulations and administrative provisions necessary to comply by 20 July 2015.

¹⁷⁹ IFRS for SMEs is a simplified set of standards developed by the IASB and designed for entities that have no public accountability. It is based on full IFRS, but simplified in two aspects: (i) valuation and measurement – the standard uses simplified approaches and those that are less costly; and (ii) reduced disclosure requirements. The standard is also supported by illustrative financial statements and disclosure checklist. In addition, the IFRS Foundation dedicates significant resources for disseminating and implementing the standard; for example a detailed set of training material is developed and publicly accessible on IASB website in many languages. The standard also aims to be static with revisions only once every three years.

12 **As SAS incorporate many key principles and concepts from full IFRS, which are also used as a reference for IFRS for SMEs, SAS are to a large extent comparable with provisions of IFRS for SMEs¹⁸⁰.** However, the following main differences between SAS and IFRS for SMEs were identified by the ROSC team:

- i. **The scope of application of SAS is not fully compatible with IFRS for SMEs.** According to *Section 1 Small and Medium-sized Entities*, the IFRS for SMEs is intended for use by entities that do not have public accountability; SAS may be used by Slovenian listed entities for preparing their individual financial statements¹⁸¹, except banks and insurance companies which are required to use IFRS for their individual financial statements¹⁸² (in accordance with EC Regulation No 1606/2002 only consolidated financial statements of listed companies have to be prepared on IFRS basis).
- ii. **It appears that Slovenian entities are not required to disclose the amount of significant cash and cash equivalent balances held by the entity that are not available for use, as required by paragraph 7.21 of the IFRS for SMEs.**
- iii. **SAS do not contain a general requirement to disclose information about judgments and to cross-reference information in the notes with related item in financial statements.** There seems to be no systemic approach (a general requirement) to disclose management judgments made in the process of applying the entity's significant accounting policies that have the most significant effect on the amounts recognized in the financial statements, as required by IFRS for SMEs paragraph 8.6. Although according to *SAS 6 Investment Property*¹⁸³, management needs to apply judgment to determine whether a property qualifies as investment property, no disclosures are required in that respect. In addition, SAS and/or Companies Act do not require entities to cross-reference each item in the financial statements to related information in the notes, as prescribed by paragraph 8.3 of the IFRS for SMEs.
- iv. **Although financial instruments area is complex by its nature, the standards setter may wish to analyze in detail the approach taken in IFRS for SMEs and streamline this area in SAS.** Currently accounting treatments of financial instruments in SAS are fragmented and included in various SAS, such as *SAS 3 Investments*, *SAS 5 Receivables*, *SAS 9 Long-Term Liabilities* and *SAS 11 Current Liabilities*. In some cases SAS refer to full IFRS for accounting treatment of financial instruments¹⁸⁴. Under IFRS for SMEs financial instruments are covered in two sections - Basic Financial Instruments and Other Financial Instruments Issues (which are more complex). Entities are allowed to apply the recognition and measurement provisions of IAS 39 *Financial Instruments: recognition and*

¹⁸⁰ The ROSC team used a tool similar of Transposition Table and undertook a detailed analysis to what extent the provisions of SASs are comparable with IFRS for SMEs.

¹⁸¹ Companies Act, articles 54 (1) and 54 (10).

¹⁸² Companies Act, article 54 (11), Banking Act, article 203; Insurance Act, article 155.

¹⁸³ SAS 6 Investment Property, paragraph 6.3.

¹⁸⁴ SAS 3 Investments, paragraph 3.29.

measurement plus disclosure requirements of IFRS for SMEs (this is the only reference to full IFRS that is part of IFRS for SMEs). Recent changes to full IFRS in this area could also be considered when revising SAS requirements in dealing with financial instruments.

- v. **Accounting treatment of measurement of inventories in SAS 4 Inventories is different from IFRS for SMEs.** The following main differences were identified: (a) *SAS 4 Inventories* allows that under justified circumstances some inventories may be measured either at contracted full cost, at one extreme, or at variable production costs not including purchasing overheads, at the other extreme¹⁸⁵. IFRS for SMEs¹⁸⁶ requires that an entity shall include in the cost of inventories all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition; (b) *SAS 4 Inventories* requires inventories to be measured at the lower of initial cost and net realizable value, but it does not appear to explicitly require reversal of impairment when initial conditions no longer exist, as required by IFRS for SMEs¹⁸⁷.
- vi. **SAS requirements for accounting of investments in associates and joint ventures are different to the provisions of IFRS for SMEs.** IFRS for SMEs allows accounting for associates (joint ventures) in consolidated financial statements and in the financial statements of an investor that is not a parent but that has an investment (venturer's interest) in one or more associates (joint ventures), by choosing between the cost, equity or fair value models¹⁸⁸. According to the provisions of SAS, in consolidated financial statements investments in associates are accounted by applying the equity method¹⁸⁹. While investment in jointly controlled entities may be accounted for on the basis of either proportionate consolidation¹⁹⁰ or equity method (in doing so, the entity shall apply the provisions of IAS 31.30–31.45B¹⁹¹). In separate financial statements investments in associates and in jointly controlled entities are accounted at acquisition price or its fair value, following the provisions of *SAS 3 Investments*.¹⁹²
- vii. **Measurement after recognition of investment property is treated differently in SAS and IFRS for SMES.** *SAS 6 Investment Property* allows entities to choose either the cost or fair value model. It requires the cost model to be applied when the fair value of an investment property can no longer be reliably measured¹⁹³. IFRS for SMEs requires fair value to be applied for all investment property whose fair

¹⁸⁵ SAS 4 Inventories, paragraph 4.13.

¹⁸⁶ IFRS for SMEs, paragraph 13.5.

¹⁸⁷ IFRS for SMEs, paragraphs 13.19 and 27.2–27.4.

¹⁸⁸ IFRS for SMEs, paragraphs 14.4 and 15.9.

¹⁸⁹ Introduction to SASs - Consolidation of Accounting Data in Financial Statements (13).

¹⁹⁰ Proportional consolidation is not allowed in IFRS for SMEs.

¹⁹¹ The standards setter may wish to revise these references, as according to the EU endorsement status report as at 23 December 2013 companies shall apply IFRS 11 Joint Arrangements and the consequential amendments, at the latest, as from the commencement date of its first financial year starting on or after 1 January 2014.

¹⁹² SAS 3 Investments, paragraphs 3.52 and 3.17.

¹⁹³ SAS 6 Investment property, paragraphs 6.10-6.14.

value can be measured reliably without undue cost or effort, otherwise the cost model is to be applied and in that case the assets are not considered investment property any longer and become part of property, plant, and equipment accounted for in accordance with section 17 of IFRS for SMEs¹⁹⁴. As a consequence, the approach for transfers to, or from, investment property accounts in *SAS 6 Investment Property* and IFRS for SMEs is different.

- viii. **The approaches on measurement after initial recognition of the property, plant and equipment in SAS and IFRS for SMEs are different.** While IFRSs for SMEs allows only a cost-depreciation-impairment model¹⁹⁵, *SAS 1 Property, Plant and Equipment* allows entities to choose either the cost-depreciation-impairment model or revaluation model¹⁹⁶. In addition, it was noted that *SAS 1 Property, Plant and Equipment* contains provisions for recognition of small tools¹⁹⁷; such items are not recognized in accordance with IFRS for SMEs or full IFRS.
- ix. **Accounting treatment of intangible assets at initial recognition, and measurement after initial recognition, in SAS differ substantially in some cases to IFRS for SMEs.** Currently, IFRS for SMEs prohibits recognition of internally generated intangible assets and requires entities to recognize expenditure incurred internally on an intangible item, including all expenditure for both research and development activities as an expense (this is a simplification as compared to full IFRS)¹⁹⁸. *SAS 2 Intangible Assets and Long-Term Deferred Costs* allows recognition of internally generated intangible assets (except for internally generated brands, colophons, mastheads, publishing titles, customer lists, items similar in substance and internally generated goodwill¹⁹⁹) and provides conditions when development costs may be recognized as intangible assets²⁰⁰. For measurement after initial recognition IFRSs for SMEs allows only a cost-depreciation-impairment model²⁰¹, including for goodwill²⁰² while *SAS 2 Intangible Assets and Long-Term Deferred Costs* allows entities to choose either the cost-depreciation-impairment model or revaluation model²⁰³ for intangible assets while goodwill and intangible assets with indefinite useful lives shall not be amortized, but rather impaired²⁰⁴. Moreover, IFRS for SMEs requires that all intangible assets shall be considered to have a finite useful life (it is presumed to be ten years an entity is unable to make a

¹⁹⁴ IFRS for SMES, paragraph 16.7.

¹⁹⁵ IFRS for SMES, paragraph 17.5.

¹⁹⁶ *SAS 1 Property, Plant and Equipment*, paragraph 1.24.

¹⁹⁷ 1.47. An item of property, plant and equipment whose individual acquisition price as per supplier's invoice does not exceed 500 euro may be carried and recognized as a group of small tools. Items of small tools whose individual acquisition price as per supplier's invoice does not exceed 500 euro may be classified as materials.

¹⁹⁸ IFRS for SMEs, paragraphs 18.4 and 18.14.

¹⁹⁹ *SAS 2 Intangible Assets and Long-Term Deferred Costs*, paragraphs 2.14 and 2.15.

²⁰⁰ *SAS 2 Intangible Assets and Long-Term Deferred Costs*, paragraph 2.13.

²⁰¹ IFRS for SMES, paragraph 18.18.

²⁰² IFRS for SMEs, paragraph 19.23.

²⁰³ *SAS 2 Intangible Assets and Long-Term Deferred Costs*, paragraph 2.28.

²⁰⁴ *SAS 2 Intangible Assets and Long-Term Deferred Costs*, paragraph 2.26.

reliable estimate)²⁰⁵. *SAS 2 Intangible Assets and Long-Term Deferred Costs* permits that an intangible asset whose individual value does not exceed 500 euro be recognized as cost of the period in which it is incurred²⁰⁶; there are no such provisions in IFRS or IFRS for SMEs.

- x. **Accounting treatment of use of provisions is different in SAS and IFRS for SMEs.** While paragraph 21.10 of the IFRS for SMEs requires that only those expenditures for which the provision was originally recognized can be charged against a provision, it appears that *SAS 10 Provisions and long-term accrued costs and deferred revenue* allows in justifiable cases, to use them for equivalent items²⁰⁷.
- xi. **The provisions for classification of an instrument as liability or equity are not included in SAS.** It appears that financial instruments that meet the definition of a liability and need to be classified as equity according to IFRS for SMEs²⁰⁸ because they represent the residual interest in the net assets of the entity may have different treatment in SAS. For instance, according to *SAS 8 Equity*, preference shares are part of share capital²⁰⁹, while paragraph 22.5 of IFRS for SMEs provides preference shares as an example of instruments that are classified as liabilities rather than equity.
- xii. **There are some differences in accounting and disclosures for government grants between SAS and IFRS for SMEs.** While IFRS for SMEs requires entities to measure grants at the fair value of the asset received or receivable²¹⁰, SAS allows measurement either at cost or fair value²¹¹.
- xiii. **The recognition criteria for borrowing costs in SAS follow the full IFRS approach and not a simplified approach included in IFRS for SMEs.** IFRS for SMEs requires recognition of all borrowing costs as an expense in profit or loss in the period in which they are incurred²¹² (this is a simplification compared to full IFRS), various SAS allow capitalization of borrowing costs²¹³.

²⁰⁵ IFRS for SMEs, paragraphs 18.19-18.20.

²⁰⁶ *SAS 2 Intangible Assets and Long-Term Deferred Costs*, paragraph 2.49.

²⁰⁷ 10.10. Provisions should only be used for expenditures for which the provision was originally recognized; in justifiable cases, however, they may also be used for equivalent items. Such a case is the use of provisions made and charged against operating expenses for warranties given at the sale of products or provision of services.

²⁰⁸ IFRS for SMEs, paragraphs 22.3 and 22.5.

²⁰⁹ 8.36. This Standard uses some terms which need to be explained in order to define the key concepts. g) Preference shares are part of share capital. Their owners are usually not entitled to participate in the management of the entity. If the entity has generated sufficient net profit, dividends on preference shares are paid at a specified percentage or amount.

²¹⁰ Paragraph 25.5.

²¹¹ *SAS 1 Property, Plant and Equipment*. 1.13. [...] An item of property, plant and equipment acquired by way of a government grant or a donation is carried at cost, or at fair value when the cost is not known; *SAS 2 Intangible assets and long-term deferred costs*. 2.18. [...] An intangible asset acquired by way of a government grant or a donation shall on acquisition be recognized at cost or, if this is not known, at fair value increased by any directly attributable cost of preparing the asset for its intended use.

²¹² IFRS for SMEs, paragraph 25.2.

²¹³ For example: *SAS 1 Property, Plant and Equipment*. 1.10. [...] The cost of the asset also comprises the borrowing costs related to the acquisition of the item of property, plant and equipment to bring the asset to

- xiv. **Some aspects of accounting for revenues arising from construction contracts in which the entity is the contractor are treated differently in SAS and IFRS for SMEs.** IFRS for SMEs explicitly requires²¹⁴ an entity to immediately recognize as an expense any costs whose recovery is not probable, SAS do not include such provisions in respect of construction contracts.

its working condition; SAS 2 Intangible assets and long-term deferred costs. 2.17. An intangible asset that qualifies for recognition shall on initial recognition be measured at cost. [...] The cost also includes the borrowing costs incurred until the intangible asset has been created.

²¹⁴ IFRS for SMEs, paragraph 23.24.

Annex 3: List of Slovenian Accounting Standards²¹⁵

- SAS 1 – Property, Plant and Equipment
- SAS 2 – Intangible Assets and Long-term Deferred Costs
- SAS 3 – Investments
- SAS 4 – Inventories
- SAS 5 – Receivables
- SAS 6 – Investment Property
- SAS 7 – Cash
- SAS 8 – Equity
- SAS 9 – Long-Term Liabilities
- SAS 10 – Provisions and Long-Term Accrued Costs and Deferred Revenue
- SAS 11 – Current Liabilities
- SAS 12 – Short-Term Accruals and Deferrals
- SAS 13 – Depreciation and Amortization Charges
- SAS 14 – Costs of Materials and Services
- SAS 15 – Labor and Employee Benefit Costs
- SAS 16 – Cost Classification by Types, Centers and Units
- SAS 17 – Expenses
- SAS 18 – Revenue
- SAS 19 – Types of Profit or Loss and of Net Cash Inflow or Outflow
- SAS 20 – Budgeting and Budgets
- SAS 21 – Bookkeeping Documents
- SAS 22 – Books of Account
- SAS 23 – Accounts Processing and Statements of Accounts
- SAS 24 – Formats of Balance Sheet for External Business Reporting
- SAS 25 – Formats of Income Statement for External Business Reporting
- SAS 26 – Formats of Cash Flow Statement for External Business Reporting
- SAS 27 – Formats of Statement of Changes in Equity for External Business Reporting
- SAS 28 – Accounting Supervision and Supervision of Accounting
- SAS 29 – Accounting Analyses
- SAS 30 – Accounting Reporting
- SAS 33 – Accounting Solutions in Associations and Disability Organizations
- SAS 34 – Accounting Solutions in Co-operatives
- SAS 35 – Accounting Monitoring of Public Utility Services
- SAS 36 – Accounting Solutions in Non-Profit Organizations – Private-Law Entities
- SAS 37 – Accounting Solutions in Entities Subject to Bankruptcy or Liquidation Procedure
- SAS 38 – Accounting Solutions in Mutual Funds
- SAS 39 – Accounting Solutions in Small Sole Proprietorships
- SAS 40 – Accounting Solutions in Social Enterprises

²¹⁵ <http://www.si-revizija.si/publikacije/index.php>

Annex 4: Status of implementation of the 2004 A&A ROSC policy recommendations

2004 ROSC recommendation	Status of implementation
<p>1. Significant changes to the statutory framework, especially self-regulation of the audit profession, and its implementation are needed. More specifically:</p> <p>a. Increase public oversight of accounting standard setting and the audit profession</p>	<p>Partially implemented. The Agency for Public Oversight of Auditing (APOA) was established and is responsible for public oversight of auditing. The accounting standard setting process by SIA has not changed significantly since 2004. Although the standard setting process includes a period of exposure for public comments, it does not involve all relevant stakeholders such as regulators (for example Ministries of Economy and Finance who ultimately authorizes the issue of SAS) and the business community (actual and potential users of financial information such as investors, bankers, financial analysts).</p>
<p>b. Although not currently required by the EU, Slovenia should extend mandatory application of IFRS to all public interest entities</p>	<p>Partially implemented. This recommendation has not been implemented since some listed companies (not listed on the Prime Market) have the option to use either IFRS or SAS for individual financial statements. Although the accounting requirements in the SAS are less rigorous than IFRS, the listed companies use IFRS for their consolidated accounts in line with EU requirements. So the needs in terms of quality and quantity of financial information by users of financial statements are partially met.</p>
<p>c. Increase the accountability of preparers of financial statements</p>	<p>Implemented. According to the Companies Act, management and “control bodies” (i.e., supervisory board, in a two-tier system, or board of directors, in a one-tier system) are now responsible for ensuring that annual reports are drawn up and published in accordance with applicable statutes and standards.</p>
<p>d. Ensure shareholders approve consolidated financial statements based on the opinion of the supervisory board</p>	<p>Partially implemented. Board members have the right in law and in practice to approve financial statements. However, shareholders are not generally tasked with approving financial statements. The AGM does so only if the control bodies fail to approve the financial statements; if this task is delegated to the AGM by management or the control bodies; or if the AGM is secured the right to approve financial statements in the company’s bylaws (the</p>

2004 ROSC recommendation	Status of implementation
	latter applies only to companies with a one-tier board system).
e. Enhance audit regulation to strengthen audit quality	Implemented. The Auditing Act includes safeguards for the dismissal of auditors. The minimum level of professional indemnity insurance for auditors as required by Auditing Act ²¹⁶ despite having no particular empirical basis appears both readily available on the market and sufficient to cover the level of actual claims which to-date have been negligible given the practicality of pursuing claims. The Auditing Act requires that both the APOA and SIA review the ownership and quality assurance arrangements of audit firms. Audit fees chargeable to the clients appear fully liberalized and deregulated and are also required to be disclosed separately from fees auditors receive from other services.
f. Enhance the authority of regulators over audit firms	Partially implemented. Although there is some regulation of the work of auditors, the priority for regulators over the past few years and for the immediate future is dealing with the banking crisis rather than focusing on the oversight of audit firms. Changes to the legal framework in regulation are currently being discussed, but lawmakers and regulators are concerned about disruption these could cause. However, there is a clearly a role for financial sector regulators to play regarding their contribution to the oversight of auditors in general and perhaps in collaboration or by coordinating their efforts with APOA which is directly responsible for audit oversight.
g. Enhance financial transparency requirements	Implemented. This recommendation was fully implemented in the law for disclosure requirements of listed companies.

²¹⁶ The minimum level of professional indemnity insurance cover required by the Auditing Act is the higher of: (i) the highest fee for an individual auditing services contract multiplied by 15; and (ii) the sum of all fees for auditing services contracts multiplied by 2.5.

2004 ROSC recommendation	Status of implementation
<p>2. The Securities Market Agency should enhance its monitoring and enforcement arrangements in line with the requirements of Recital 16 in the EU Regulation 1606/2002 on IFRS application. More specifically:</p> <ul style="list-style-type: none"> a. Securities Market Agency's monitoring objectives b. Coordination at the European level c. Definition of enforcement d. Necessary powers e. Issuers and documents f. Methods of enforcement g. Actions h. Reporting 	<p><i>Partially implemented.</i> This recommendation was only partially implemented by the Securities Market Agency (ATVP). Although they have the legal power to enforce and monitor IFRS application, it is limited for reasons including a lack of resources and absence of IFRS expertise. ATVP is fully aware of this issue and would like to enhance monitoring and enforcement of IFRS application.</p>
<p>3. Enhance academic education, as well as training</p>	<p><i>Implemented.</i> Although some of the details of the 2004 recommendation have not been implemented, academic education curricula at university level has been updated to include subjects relevant to accountancy qualification in line with IES, including IFRS and ISA.</p>
<p>4. Enhance professional education, as well as training</p>	<p><i>Partially implemented.</i> As discussed in paragraph 74, the government, regulators, professional bodies and education providers should work together to decide on appropriate target educational standards and qualifications suitable for Slovenia's large pool of people working in accounting. In addition, the IFRS training programme for financial sector regulators is available but would benefit from more systematic approach. The regulators are fully aware of this and have tried to compensate by recruiting professional accountants or ex-auditors but their numbers are limited in each regulator. IFRS training programmes should be improved by each regulator to ensure proper IFRS monitoring and enforcement.</p>

Annex 5: The feasibility of incorporating the Agency for Public Oversight of Auditing into another regulator

- 1 This annex addresses the feasibility of incorporating the Slovenian public audit oversight body (POB) and the Agency for Public Oversight of Auditing (APOA) into a single regulatory body. It considers international standards and trends, factors that may influence the decision and the particular circumstances of Slovenia.

A. International standards

- 2 There is no specific acknowledged authority on the relative merits of a fully independent public audit oversight body or integrating those responsibilities into that of a super regulator. The International Forum of Independent Audit Regulators (IFIAR) has certain core principles but does not explicitly favor any one approach or institutional framework for how the principles should be put into practice. IFIAR's focus is very much on ensuring that audit regulation is independent of the profession rather than on the relationship between the audit regulator and other regulators. Similarly, the EU's Statutory Audit Directive emphasizes the need for the audit regulator to be independent of the profession but offers no view on other aspects of its institutional setup.

B. International trends

- 3 Given that public audit oversight and Public Oversight Boards (POBs) are only a comparatively recent innovation, most national regulators will only have experience of one or other framework whose design may be more attributable to happenstance. As such regulators are unable directly to compare the advantages and disadvantages of various frameworks. The public oversight function in the United Kingdom's Financial Reporting Council, for example, has always been independent whilst the public oversight function in the Netherlands has always been part of that country's securities regulator, the Authority for Financial Markets, and in Norway – part of country's integrated regulator, the Financial Supervisory Authority. The French audit oversight body, the H3C, was created in 2003 as a high-level independent public authority with direct links to the Minister of Justice and has a working relationship with the combined banking and insurance regulator. Smaller EU countries also have a mix of approaches: Hungary's POS is part of government; Bulgaria's is independent; Malta's is part of government; Lithuania's is independent; and Greece's is independent.
- 4 Sometimes the lines are blurred; POBs can be relatively independent within government, or be independent but closely linked to a sponsoring government body or regulator. There are no clear differences within IFIAR between the 'categories' of audit regulators or any obvious impact on approaches to audit inspection and regulation. Those audit regulators that are also securities regulators are members of International Organization of Securities Commissions (IOSCO), the international organization of securities regulators, which addresses audit issues as a non-core activity.
- 5 The different approaches were highlighted in recent EU legislative reform debate when the EC proposed that the European Securities and Markets Authority (ESMA) be given oversight

over audit regulation. The fewer EU member states who address audit oversight within their securities regulators supported the proposition while others opposed it.

C. Factors to consider

- 13 There can be some advantages, notably scale, to having the audit regulator as part of a wider functioning body such as government or a larger regulator. There can be advantages too in an independent audit regulator. Significant factors, including how they apply to Slovenia, are shown in the table below:

Factor	Considerations	Slovenia
State Budget	Where a POB is dependent on a stagnant, declining or insufficient State Budget and is prohibited from raising additional revenues to enable it properly to perform its obligations, it might be better instead to form the POB as an entity that is not dependent on financing from the State Budget.	The APOA is a government agency funded by the State Budget and prohibited from raising revenues other than those from fines imposed on audit firms. Other regulators such as the BS, Insurance Supervision Agency (AZN), and the Securities Market Agency (ATVP) can raise revenues from the regulated entities and as such are not constrained by the State Budget.
Raising revenues	If the POB is considering raising revenues by charging fees directly from public interest entities ²¹⁷ and if other regulators already levy fees on PIEs, it might make matters easier if PIEs were levied a single charge by one regulator. This does not necessarily mean that regulators should merge but it would make things easier from an administrative perspective if they did.	The APOA does not currently raise revenues directly from PIEs but this report recommends considering such a revenue-raising model.

²¹⁷ Public interest entity (PIE) is not a term specifically defined in Slovenian legislation. In other EU jurisdictions, PIEs comprise listed companies, banks, insurance companies as well as other companies that the government regards as significant, for example in terms of their contribution to the economy. Throughout this report, except where noted, the term PIE in Slovenian context is used to refer to listed companies, banks and insurance companies.

Factor	Considerations	Slovenia
Influence	In countries where there is comparatively little appreciation of the value of a POB and all that it stands for, and where there is a much greater appreciation of other regulators, it might make sense at least in the short-term to establish the POB as part of another regulator.	Slovenia appears to have very little demand for high quality general purpose financial statements. Parliament does not seem to engage much on financial reporting and auditing issues. Also, public oversight institution is relatively new and central banks and supervisors are well resourced institutions whose role is well understood and respected; this is typical for many jurisdictions.
Pay scales	Countries where civil service pay scales would be insufficient to attract appropriately qualified and experienced staff to a POB might consider establishing their POB outside the civil service.	The APOA's civil service pay scale is relatively low and therefore it is difficult to attract and retain qualified staff.
Regulators' accounting capacity	Countries with a relatively small pool of accountants with significant experience of IFRS and derivative financial reporting standards might benefit from combining the POB with other regulators who need and would benefit from such experience as they review their regulated entities' financial statements.	Slovenia has a population of only 2.06 million. Slovenian regulators uniformly lack appropriate capacity to understand and hold their regulated entities to account for their application of IFRS and Slovenian Accounting Standards (SAS).
Regulators' audit capacity	Countries with a relatively small pool of experienced audit professionals might benefit from combining the POB with other regulators who need and would benefit from such experience in their interactions with audit firms.	Slovenia has a population of only 2.06 million. Slovenian regulators have limited capacity and legislative powers to hold their regulated entities' auditors to account for their application of International Standards on Auditing (ISA).
Infrastructure	Separate institutions and regulators require comparatively greater resources in terms of time and funds to establish and maintain infrastructure. Combining regulators may reduce overhead costs.	The APOA comprises only five permanent staff so is likely to marginally save overhead costs if it was to merge with another regulator.

Factor	Considerations	Slovenia
Number of PIEs	Countries with a relatively small number of PIEs might be better served by fewer regulators given that POBs tend to review the audits of individual PIEs on a three-year cycle and other regulators tend regularly to review PIEs' financial statements.	Slovenia has no formal definition of PIEs. However, there are only 104 banks, insurance companies and listed entities.
Number auditors of PIEs	Countries with a relatively small number of auditors of PIEs might be better served by fewer regulators particularly as other regulators tend to meet regularly with PIEs' auditors to discuss general industry issues as well as approaches to specific accounting and auditing concerns.	The large international audit networks dominate the Slovenian audit market for PIEs.
Regulation of listed entities.	Countries with lots of regulation aimed solely at listed companies are likely to have a close relationship between the countries' POB and securities regulator e.g. the US PCAOB has a close relationship with the SEC.	The securities market is relatively small and plays a limited role in the Slovenian economy.
Appetite of other regulators	If other regulators are not keen on the idea of a super regulator or are likely to regard an integrated POB as a distraction, burden or irrelevance, the POB may be better kept separate. An independent body has a much clearer institutional focus on audit oversight and the governance arrangements are often clearer.	Merging all financial sector regulators into one institution (and also possibly including in it the APOA) in the near future could distract from the reforms that the BS is implementing in response to the banking crisis.

D. Conclusion

- 14 There is no right answer. Country specifics determine the optimal design. POBs are situated variously in government, within wider-remit regulators or are independent. In smaller countries such as Slovenia, they may also either be part of government or independent but with close links to the sponsoring government department, especially in the start-up phase. There is no single model from a specific jurisdiction that has been shown to be better than another. They all have their specific merits and demerits and there is always room for improvements to be made to the audit supervisory model in order to adapt to the growing role for audit regulators and audit regulation.

- 15 In Slovenia, given relatively little demand for general purpose financial statements, given also the low capacity to understand and enforce IFRS and derivative financial reporting standards as well as ISA, and given the low and declining budget of the APOA, the ROSC team suggests that serious consideration should be given to folding the APOA into an integrated super regulator with the securities market regulator, the ATVP, the banking regulator, the BS, and the insurance regulator, the AZN.



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