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and Codes on Accounting and Auditing

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Serbia

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List of Common Abbreviations

A&A	Accounting and Auditing
ABR	Agency for Business Register
ACCA	Association of Chartered Certified Accountants
AGM	Annual General Meeting
CFRR	Centre for Financial Reporting Reform
CA	Certified Accountant
COE	Chief Executive Officer
CPA	Certified Public Accountant
CPD	Continuing Professional Development
CPF	Country Partnership Framework
EU	European Union
FEA	Federation of European Accountants
GDP	Gross Domestic Product
GNI	Gross National Income
IAASB	International Auditing and Assurance Standards Board
IAS	International Accounting Standards
ID	Investigation and Discipline
IES	International Education Standard
IESBA	International Ethics Standards Board for Accountants
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IPSAS	International Public Sector Accounting Standards
ISA	International Standards on Auditing
ISQC	International Standards on Quality Control
KPI	Key Performance Indicators
LLC	Limited Liability Companies
MDA	Management Discussion and Analysis
MoE	Ministry of Economy
MoF	Ministry of Finance
MTP	Multilateral Trading Platform
NAC	National Accounting Commission
NBS	National Bank of Serbia
NPL	Non-Performing Loan
PIE	Public Interest Entity
POB	Public Oversight Board
QA	Quality Assurance
QC	Quality Control
ROSC	Reports on the Observance and Standards of Codes
SAAA	Serbian Association of Accountants and Auditors
SAI	State Audit Institution
SEC	Securities Exchange Commission
SME	Small and Medium Sized Entity
SMO	Statement of Membership Obligation
SOB	State-Owned Bank
SOE	State-Owned Enterprise

Currency: New Serbian Dinar (RSD)
1 EUR = 120 RSD (as of 8 September 2015)

Preface

This Report on Observance of Standards and Codes in Accounting and Auditing (A & A ROSC) provides an assessment of accounting, financial reporting and auditing requirements and practices within the enterprise and financial sectors of Serbia and sets forth areas of consideration with a view to improving the country’s institutional environment for corporate financial reporting. To assess Serbia’s compliance with standards and codes, this Report uses international benchmarks of good practice, including International Financial Reporting Standards (IFRS), International Standards on Auditing (ISA), the Statements of Membership Obligations (SMO) of the International Federation of Accountants (IFAC), and—because Serbia is seeking accession to the European Union—relevant provisions of the EU *acquis communautaire* (“the *acquis*”) governing financial reporting. 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 2005.

Reports on the Observance of Standards and Codes (ROSC) Accounting and Auditing (A&A) assess accounting and auditing practices in participating countries. They form part of a joint initiative implemented by the World Bank and the International Monetary Fund to review the quality of implementation of twelve internationally recognized core standards (the ROSC Program). These standards and their related codes are relevant to economic stability and private and financial sector development. The program was developed at the end of the 1990s, in the wake of financial crises that affected many countries in several regions of the world. Since its inception in early 2000, the ROSC A&A program has concluded evaluations of the A&A environment in more than one hundred countries around the world. ROSC A&A reports have been issued for all countries of the Europe and Central Asia Region, except Russia.

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Executive Summary

Need for updated assessment of accounting and auditing in Serbia

Serbia has launched an ambitious series of structural reforms to promote growth and competitiveness in its economy. The country's development priorities include improvements in governance, institutional capacity, and the quality of regulation affecting the business climate as well as the reform, privatization, or phase-out of numerous remaining state-owned enterprises (SOEs). Developing a reliable system of corporate financial reporting is important to the success of Serbia's reform agenda and future prosperity.

Improvements in corporate financial reporting are important for the success of Serbia's economic reforms.

Credible information from financial statements can help investors and lenders identify viable opportunities to offer capital and credit and make it easier for good businesses to obtain funding. It can expose risks of business illiquidity and insolvency to protect creditors and enable timely reallocation of resources to better uses. It can promote financial discipline in enterprises by faithfully revealing their financial condition and performance. It can help assure adequate identification and management of risk by

financial institutions and their regulators, to reduce the danger of financial crises. It can help create a level playing field in the economy by exposing remaining subsidies or preferences to commercial enterprises that remain state owned or supported. And it can assist in effective tax collection.

For all of these reasons, improvements in corporate financial reporting could substantially enhance Serbia's business climate, help reduce its budget deficit, and add momentum to its drive toward a dynamic and prosperous economy. In addition, as a candidate for accession to the European Union, Serbia must conform its framework for corporate financial reporting with the EU *acquis*.

This Updated ROSC A&A report for Serbia seeks to provide timely information to support Serbia's reforms. The first report for Serbia was published in 2005. This Report gauges Serbia's current status and progress in creating a reliable system of corporate financial reporting and identifies challenges still to be addressed.

Significant progress since the original ROSC

Since the 2005 ROSC, Serbia has made progress in developing its legal framework, standards, and institutions to foster reliable and efficient financial reporting. Perhaps most significantly, Serbia has reduced the burden and complexity of reporting obligations for smaller enterprises by adopting IFRS for SMEs and other simplified reporting rules and limiting the reach of the statutory audit requirement. In addition, Serbia has improved its institutional infrastructure by, for example, creating a Chamber of Authorized Auditors and implementing quality control inspections for audits. The table below summarizes the primary recommendations in the 2005 ROSC and developments in Serbia since then.

2005 ROSC Recommendation	Developments since 2005
Statutory Framework	
Serbia should amend its laws and regulations in a manner more consistent with the EU <i>acquis communautaire</i>	In 2013, Serbia enacted new Accounting and Audit Laws, which were largely compliant with the <i>acquis</i> as it existed at the time. The new law included less burdensome reporting standards for micro, small, and medium-size enterprises.
Statutory audit requirement	
Serbia should exempt a number of limited liability companies from the statutory audit requirement so that only the large limited liability companies would be required to be audited.	The statutory audit threshold has been adjusted to exempt smaller companies that may not greatly benefit from an audit and may not realistically be able to pay for it
Filing of Annual Financial Statements	
Serbia should create a business registry to accept filings of legal entity and consolidated financial statements, together with the auditor’s report (where applicable), and to make these documents readily publicly available.	The business registry began operations in 2005 and has developed into an efficient repository allowing ready access to corporate financial statements, with recent statements for those companies required to submit their financial statements available instantly and free of charge through the internet.
Dismissal of statutory auditors	
Serbia should regulate dismissal of statutory auditors to assure that it is done only for good cause, to help preserve auditor independence.	Serbian law now generally prohibits dismissal of statutory auditors during an engagement term and allows dismissal only for a justified reason.
Serbia should enhance its institutional framework governing financial reporting and auditing by creating a Chamber of Auditors to regulate external auditors; implementing quality assurance monitoring of auditors to assess their compliance with auditing, independence, and ethical standards; and creating a public oversight board, governed by a majority of non-practitioners, to oversee the Chamber and quality assurance system.	A Chamber of Authorized Auditors has been created, and the Chamber has implemented an audit quality assurance program for statutory auditors, hired well-qualified inspectors, and performed two cycles of inspections. A public oversight board, consisting of a majority of non-practitioners, has been created to supervise the Chamber and the quality assurance system.
Monitoring and Enforcement: Preparers	
Regulators in Serbia should play an active role at least in the enforcement of accounting standards	This recommendation has been implemented in the banking sector, but not elsewhere. However, as discussed below, fiscal realities

2005 ROSC Recommendation	Developments since 2005
in the general-purpose financial statements of public interest entities (“PIEs”).	may prevent full implementation of this recommendation for some time.

More improvements needed

Despite this progress, much remains to be done. Two new Directives have been promulgated by the EU requiring further legislative changes if Serbia is to conform. For example, under the 2014 EU Directive and Regulation governing statutory audit, membership of the Public Oversight Board for auditors will have to be fully independent of the profession, and the POB will have to assume direct responsibility for quality assurance and discipline for auditors of PIEs, rather than delegating these functions to the Chamber. In addition, reporting requirements can and should be further simplified. For example, the current requirement to apply IFRS for SMEs is burdensome and unrealistic for small companies. Similarly, Serbia may wish to consider whether the requirement to apply full IFRS for all “large” companies sweeps too broadly, and whether a narrower requirement might render compliance more realistic and cost-effective while still providing adequate information to users of their financial statements.

Even more importantly, despite legal and institutional improvements, the quality of corporate financial reporting has likely deteriorated in recent years as economic pressures lingering from the 2008-2009 financial crisis have induced businesses to cut costs on accounting and auditing, with commensurate impact on quality. Factors contributing to poor-quality reporting and possible measures to address them are discussed below.

Cash-strapped companies have cut their spending on accounting and auditing, with commensurate impact on quality.

Challenges for preparers of financial statements

The quality of internal accounting personnel in Serbian enterprises varies considerably. Many businesses do have conscientious and adequately qualified internal accountants, but resources devoted to the accounting function are generally inadequate and, except in a few marquee companies with foreign investors or other differentiating factors, the quality of internal controls generally appear to be insufficient to assure reliable accounting and financial reporting. In SOEs, the quality of internal controls is widely recognized as especially poor, thus increasing the risk of waste, fraud, and continuing losses to the State.

Smaller enterprises managed by their owners sometimes manipulate accounting accruals or otherwise produce biased reporting to satisfy lender criteria, reduce taxes, or further other goals inconsistent with reliable reporting. Many small and medium-sized businesses entirely outsource their accounting function, often to providers of doubtful competence and quality. In general, businesses appear to focus on incurring the least possible cost for their accounting function, rather than assuring the quality and reliability of their accounting and financial reporting, because they perceive little benefit from financial reporting other than legal compliance. Overall, the quality of accounting and financial reports is unsatisfactory.

Challenges for effective external audit

Lingering effects from the financial crisis of 2008-2009 have seriously damaged the market for audit services in Serbia. Cash-strapped businesses, seeking to reduce costs wherever possible, have driven audit fees so low that they are often inadequate to support an audit performed consistent with professional standards. Given the extraordinarily low level of audit fees in many instances, it is likely that some auditors are “selling audit reports” rather than audit services—that is, providing audit reports to create the appearance of compliance with the law mandating statutory audit, while performing little or no actual auditing.

Many auditors may be compromising quality to offer lower fees.

In addition, it appears that many auditors rely solely on substantive tests of account details in their work, with little or no assessment of internal controls in their audit risk assessments, perhaps due to lack of training. Without an assessment of internal controls, auditors are less able to identify companies that are not auditable, perform efficient and effective audit procedures, or provide meaningful suggestions in their management letters to improve corporate internal controls.

Some Serbian SOEs are required to appoint their external auditor through a public tender process, with low audit fees the main criterion for selection, and with little regard for auditor competence, experience, or commitment of sufficient work to perform an adequate audit. Even SOEs not subject to public tender rules commonly select auditors based almost solely on their low fees. Typically, appointment of auditors for SOEs occurs late in the financial reporting process, potentially leaving inadequate time for an effective audit. Both of these factors have compromised audit quality for SOEs.

Challenges in education and professional training

Accounting education needs more focus on practical application of IFRS and other standards.

Many financial reporting professionals have not yet fully absorbed and learned to apply the modern accounting and auditing standards that Serbia has adopted. Current university curricula could be improved to better assure adequate preparation of accounting students in IFRS, particularly at the undergraduate level. Teaching materials sometimes inadequately address issues of practical application. Moreover, as is the case in many countries, there is inadequate cooperation and linkage between university educators and professional accounting organizations or major accounting firms to assure that university education adequately prepares students to enter the accounting and auditing professions.

Aspects of professional education, particularly the training and examination process for accountants seeking certification as statutory auditors, are also poorly developed. Based on the widespread lack of assessment of internal controls in audit risk assessment and planning, it appears that professional education for auditors may also need more focus on internal controls.

Challenges in monitoring and enforcement

Key monitoring and enforcement mechanisms to assure reliable financial reporting were recently established and require further development. For example, Serbia relies heavily on quality assurance inspections of auditors to assure reliable financial reporting, because other incentives and mechanisms are weak or non-existent. The Chamber of Authorized Auditors has hired and deployed a well-qualified staff of inspectors, so there is a good foundation to push for improvements in financial reporting through enhanced audit rigor. But the Chamber has not yet attempted inspections of audits for financial institutions or other complex audits, based on a reasonable strategy in the early years of the program of focusing on developing their methodology and capacity initially through review of simpler audit engagements.

Serbia's audit quality inspectors are well-qualified, but need to increase capacity for risk-based review and review of specialized audits.

Until the quality assurance function develops the capacity and tools for adequate inspection of audits of financial institutions and other more challenging audits, the risk of inadequate auditing of these critical institutions remains unaddressed. In addition, the quality assurance program has not yet developed methodology or capacity to select audits for review based on their relative risks. Finally, given the poor state of internal controls at Serbian companies, quality assurance inspectors should test the auditor's assessment of internal controls in their audit risk assessments and planning, as well as the adequacy of their communications about control deficiencies with management and others charged with corporate governance.

The disciplinary process for auditors needs to be bolstered.

Further, the disciplinary function for external auditors is insufficiently developed to assure compliance with professional auditing, independence, and ethics standards. Neither the Chamber nor the public oversight board has a dedicated committee or well-developed procedures for handling auditor disciplinary cases. Development of a meaningful disciplinary function may be particularly important as a countervailing pressure, when auditors are being pushed by their clients to minimize audit fees so drastically that they may be tempted to issue audit reports without complying with professional standards.

This Report is mindful that proposals to improve corporate financial reporting must take into account Serbia's tight fiscal condition. For example, for some time it may not be possible to fully implement the recommendation in the 2005 ROSC for financial regulators to develop mechanisms for monitoring and enforcement of compliance with accounting standards in general purpose financial statements for all PIEs. With respect to banks, the NBS very recently moved to add staff knowledgeable in IFRS to its Bank Supervision Department. Developing this expertise and embedding it in the supervisory process will take time. For financial statements of other kinds of companies, monitoring might be somewhat enhanced through training of tax inspectors in IFRS and other governing standards, which could at least help them identify some of the most egregious departures from reporting standards. However, the external audit and quality assurance for auditors are likely to remain the primary means for fostering reliable reporting for some time to come.

Perception and use of corporate financial reporting

Generally, economic decision-makers in Serbia lack confidence in the reliability of financial statements or capacity to understand and use the information they provide (or both). Banks require audited financial statements to extend some varieties of loans and credit in order to satisfy regulations of the National Bank of Serbia, but they appear to make little use of the financial information provided. Lending and credit decisions hinge

Financial reporting in Serbia is not widely understood, trusted, or used in economic decision-making.

far more on collateral. The equity market is very small and thinly traded and has not created substantial demand for reliable corporate financial reporting. Foreign investors apparently do more often review reported financial information for companies in which they may take a stake, but generally view reported information as of doubtful reliability. Continuing privatization of SOEs may help create more demand for reliable financial reporting.

Actual use of information from financial statements by economic decisions-makers would create an incentive for companies and their auditors to cultivate a reputation for reliability, so that companies could obtain loans, credit, equity investment, and other beneficial arrangements on favorable terms. Currently, use of information from financial statements is generally too meager to create an incentive for businesses to invest in high-quality and reliable accounting and auditing. Indeed, financial reporting in Serbia receives so little attention that, for example, SOEs that received qualified or adverse audit opinions have in some instances paid dividends based on reported profits, even though the accounting adjustments required for an unqualified opinion would have eliminated those profits entirely.

Areas for consideration

The following table summarizes this Report's key recommended areas for possible further reform and improvement in Serbia:

Area for possible reform	Possible measures
Statutory Framework for Corporate Financial Reporting	<p>Further amendments consistent with newer EU law, including:</p> <ul style="list-style-type: none"> • Reconsideration of requirement for small companies to apply IFRS for SMEs and possibly of the requirement for all large companies to apply full IFRS • Full independence of public oversight board (POB) members (exclusion of practitioners from Board) • Direct POB responsibility for audit quality assurance and auditor discipline
University accountancy education	<ul style="list-style-type: none"> • Better incorporation of IFRS into undergraduate curriculum • More focus on practical application • Better linkage between university and profession in establishing curriculum
Professional accountancy	<ul style="list-style-type: none"> • Improve training and exam process for statutory auditors

Area for possible reform	Possible measures
education	<ul style="list-style-type: none"> • Increase focus on auditor assessment and communication of deficiencies in internal controls
Monitoring and Enforcement	<ul style="list-style-type: none"> • Develop capacity of QA inspections to review specialized audits, including financial institutions • Develop risk-based selection process for audit QA review • Incorporate more review of auditor assessment and communication of internal control deficiencies in inspection • Develop dedicated committees and procedures for auditor discipline in both the Chamber and the POB • Develop IFRS capacity of supervisory personnel in the national bank and securities regulator • Train tax inspectors in IFRS/ IFRS for SMEs to provide some limited help in identifying gross noncompliance
SOE sector	<ul style="list-style-type: none"> • Reform tender process for auditors to assure adequate consideration of audit quality in addition to price • Require all SOEs to consider auditor quality in selection • Require earlier auditor engagement in reporting process • Develop capacity for understanding and use of financial reporting, including audit opinions, among regulators • Assure additional regulatory scrutiny when an SOE receives a modified audit opinion
Perceptions and Use of Financial Reporting	<ul style="list-style-type: none"> • Promote outreach to lenders, creditors, investors, and the public about the value and uses of corporate financial reporting

I. Introduction

A. Country Background

1. **Serbia has an educated but aging population.** Serbia is a landlocked country in the Western Balkans, at the crossroads between Central and Southeastern Europe, and one of six former Republics of the Socialist Federal Republic of Yugoslavia. According to 2011 census data, about 98% of the Serbian population is literate, and 16.2% of inhabitants have higher education. Serbia has among the ten oldest populations in the world, with an average age of 42.2 years. About 20% of the population are over the age of 65. In recent years, Serbia has been experiencing a serious “brain drain,” with an estimated outflow of about 32,000 people a year, who are on average younger and better educated than the general population.¹ Thus, Serbia’s economic future and capacity to care for its aging population depends in part on its ability to create better opportunities for younger and more educated citizens to stay home.

B. Economic Context

Business Climate

2. **Serbia’s transition to a successful market economy is incomplete.** With a population of about 7.2 million, Serbia is by a significant margin the largest of the former Yugoslav Republics, but its economic output lags in both absolute and per capita terms behind former Republics Croatia and Slovenia, both of which have become members of the European Union. Serbia began later than other former socialist countries in Eastern Europe in seeking to build a market-based economy, beginning only in 2001, after a decade of war and political turbulence.
3. **Growth was strong but then stalled.** From 2001 through 2008, Serbia experienced continual annual growth in its GDP, ranging from about 2.5% to about 9.3%, for an average of about 5%. The country was then hard hit by the financial crisis, suffering four years of contraction or anemic growth before recovering to a 2.5% growth rate in 2013. Then, in 2014, the country experienced devastating floods and registered a decline in GDP of about 1.8% for the year. The National Bank of Serbia currently forecasts that GDP is likely to grow very modestly (about 0.5%) in 2015 because of austerity measures and consequent contraction of consumption.²
4. **Serbia is currently classified as an upper middle-income country, but faces significant challenges to maintain and improve competitiveness and living standards.** As of 2013, Serbia had a GDP of US \$42.52 billion and Gross National Income (GNI) per capita of US \$ 5,730. The ratio of formally employed workers to retirees is about one to one. As of 2013 unemployment is over 20%, and only 47 % of Serbia’s working age population is formally employed. Almost 20% of the working age population, and as much as third of those actively

¹ <http://inserbia.info/today/2014/12/brain-drain-32000-people-leave-serbia-each-year/>

² http://www.nbs.rs/export/sites/default/internet/english/18/18_3/presentation_invest.pdf

employed, work in the public sector, including in the large sector of State-Owned Enterprises (SOEs), many of which are bloated and inefficient.³

5. **Serbia's recent efforts to manage its fiscal budget deficit have been stymied by subsidies to SOEs.** According to Serbia's Business Registry, as of July 2015, there are 118,564 registered companies and 215,468 sole proprietors in Serbia. According to the Country Partnership Framework for Serbia for 2016-2020 ("CPF"), over 1,000 companies remain in state hands. The 140 companies in restructuring alone cost Serbia up to Euro 1 billion in direct and indirect subsidies over the last five years.⁴ The companies in the portfolio of Serbia's Privatization Agency generated total losses of EUR 690 million in 2013, or over 2 percent of GDP.
6. **The business climate in Serbia needs improvement, but some recent trends do not appear favorable.** In 2015, Serbia ranks 91st of 189 countries in the ease of doing business, a decline from 77th in 2014. For comparison, Croatia and Slovenia—other former Yugoslav Republics that have since become part of the European Union—rank 65th and 51st, respectively, for 2015. Serbia has also seen some recent deterioration in Transparency International's Corruption Perceptions Index, ranking 78th out of 175 countries for 2014, down from 72nd out of 177 countries for 2013. Croatia and Slovenia ranked 61st and 39th, respectively, for 2014.

C. Financial System

7. **As of the date of the report, there are 30 banks registered in Serbia, with the banking sector dominated by foreign banks.** The most recent financial indicators from September 30 2014 (29 banks analyzed) show that total assets of the banking sector amounted to EUR 24.9 billion (using the market rate of 118.8509 RSD to the Euro on that date), while total equity amounted to EUR 5.2 billion. The five largest banks (one of them state owned) held more than half of total assets and revenue of the banking sector, with the percentage floating around 75% for the ten largest banks. Indicators show that the banking sector remains competitively fragmented, without excessive concentration of capital. Twenty out of 29 banks analyzed registered profit at the end of third quarter of 2014, with the total result of the banking sector reflecting EUR 181 million in profit. The level of non-performing loans (NPLs) is estimated to be at 23% and remains the key issue and area for improvement in the banking sector.
8. **There are 27 insurance companies, most of them in foreign ownership.** The insurance sector is registering growth and as of September 30 2014, total assets of the sector amount to EUR 1.43 billion and total equity of EUR 293 million. According to the National Bank of Serbia (NBS), key development areas for insurance companies include strengthening corporate governance, risk management and transparency.
9. **Other financial institutions and their respective segments are relatively small compared to banks and insurance companies.** This is due partly to the fact that some sectors and financial services are still in their early years of development, such as voluntary pension funds and financial leasing. As of September 30 2014, there were 16 leasing companies with

³ See http://ec.europa.eu/enlargement/pdf/key_documents/2014/20140108-serbia-progress-report_en.pdf

⁴ See <http://pubdocs.worldbank.org/pubdocs/publicdoc/2015/6/912241435066773233/Serbia-CPF.pdf>.

total assets of EUR 556 million. There were four pension funds management companies and six investment funds management companies, mostly managing one to two funds each. Investment in state debt instruments makes up 90% of the assets of pension funds. Apart from general lack of capital and unfavorable economic climate, the level of operations and potential for growth, in particular for investment funds, are negatively influenced by undeveloped capital market.

10. **Serbia's capital markets are shallow and increasingly thinly traded.** The regulated markets of the Belgrade Stock Exchange include the prime listing, standard listing and open markets. Companies that do not fulfil requirements for prime or standard listing trade on the open market. Those companies that cannot meet rules of the stock exchange for the regulated market, trade on the multilateral trading platform (MTP) market. The market is shallow, and there are only 4 companies each in quotation on the prime listing and the standard listing, with around 50 on the open market. Total turnover registered in 2014 amounted to EUR 173 million, down from EUR 267 million EUR and EUR 219 million in 2013 and 2012, respectively. Market capitalization at the end of 2014 was about EUR 6.7 billion.
11. **The National Bank of Serbia (NBS - the Central Bank), and Securities Exchange Commission (SEC) are principal regulators of financial institutions.** The NBS regulates and supervises banks, insurance companies, pension funds and pension funds management companies and leasing houses. The Securities Exchange Commission (SEC) oversees investment funds and investment funds management companies, broker-dealer houses and stock exchanges. The Ministry of Finance regulates and supervises factoring companies.

D. SOE Sector

12. **SOEs still control a substantial portion of the Serbian economy.** In Serbia, as of year-end 2014, there were more than 1,000 state-owned enterprises (SOEs), with total assets of about EUR 34.2 billion, combined turnover of EUR 8.8 billion, and more than 250,000 employees.⁵ The largest SOEs operate in the energy, transportation, construction, and telecommunication sectors. The state controls SOEs either through direct majority ownership or through effective management control. In terms of shareholding and management control, the SOEs could be classified into four major groups:⁶
 - SOEs under control of the Privatization Agency (more than 500 as of October 2015,⁷ expected to be privatized or put into bankruptcy or other resolution by year end 2015, when the Privatization Agency will be reorganized)
 - Large public SOEs performing services of general interest and operating in regulated markets, for example, EPS (the electrical utility), the Road Company, Srbijagas, and the Postal Service. There are around 10 SOEs in this group.
 - Large SOEs operating in competitive markets, for example, Telekom Serbia, Air Serbia, Ski Resorts, and the Steel Company. There are around 40 SOEs in this group.
 - Local public companies owned by cities or municipalities, mainly utility companies (about 650 SOEs).

⁵ <https://www.imf.org/external/pubs/ft/scr/2015/cr1550.pdf>

⁶ <http://www.fren.org.rs/sites/default/files/qm/L2.pdf>

⁷ http://www.b92.net/eng/news/business.php?yyyy=2015&mm=10&dd=13&nav_id=95704

13. **SOEs have generated large losses and aggravated Serbia's budget deficit.** As of July 2014, it was estimated that SOEs generate annual losses amounting to EUR 1 billion (around 3.5% of total GDP).⁸ Poor performance of SOEs creates inefficiency in the economy and contributes to Serbia's budget deficit in various ways, including:
- direct increases in government expenses through subsidies and activated guarantees;
 - direct reduction of government revenues through unpaid taxes and contributions;
 - direct increases in the public debt through the state guarantees given for loans of SOEs; and
 - indirect increases in the budget deficit and public debt through that State's assumption of future pension obligations without current contributions by SOEs, long-term arrears between SOEs, and soft budget constraints tolerating non-payment by SOEs.
14. **SOEs have diverse ownership structures.** Serbia has SOEs owned by the central government and sub-national governments. A complete list of all the enterprises in which the state holds a majority or minority ownership interest does not exist.
15. **SOEs are major employers.** As of mid 2014, the 250,000 employees of SOEs comprised more than 15% of the formally employed workforce. Most of the employees were still concentrated in a relatively small number of enterprises. Almost two-thirds are employed in public enterprises (large and local public enterprises) and in the three major state-owned enterprises (Telekom, Rail Company, Steel Company). In the 33 largest state public enterprises there were over 63,000 employees in total.⁹
16. **Reforms of SOEs are incomplete.** The Program of Public Sector Reform Measures from 2013 outlined measures for improving operations of SOEs, resolving issues of SOEs in restructuring (by mid 2014) and ceasing issuing guarantees for Srbijagas.¹⁰ However, implementation of these measures is incomplete and has not yet yielded the expected benefits in reducing losses and increasing efficiency.
17. **Performance of SOEs is not fully transparent.** SOEs do make audited annual financial statements public. However, the transparency of SOE performance is otherwise limited, in particular with respect to key performance indicators (KPIs), management reporting and financial results. The reporting on KPIs is entirely constrained to annual business plans (budgets), which are not publicly available. Public disclosure of analyses of achieved results and deviations from budgets are inadequate for meaningful assessment of SOE performance.
18. **Governance of SOEs is generally weak.** Regardless of the legal form of SOEs, they virtually all have weak corporate governance and financial reporting structures. SOEs are under strong political influence, typically directed at increasing employment and keeping output prices at a relatively low level to protect "social" categories.¹¹ However, there are many SOEs that could still be categorized as potentially good targets for the privatization (for example, Telekom, Galenika, and Ski Resorts).

⁸ http://www.fiskalnisavet.rs/doc/eng/analysis_of_state-owned_enterprises-fiscal_aspect.pdf

⁹ http://www.fiskalnisavet.rs/doc/eng/analysis_of_state-owned_enterprises-fiscal_aspect.pdf

¹⁰ http://www.fiskalnisavet.rs/doc/eng/analysis_of_state-owned_enterprises-fiscal_aspect.pdf

¹¹ <http://www.fren.org.rs/sites/default/files/qm/L2.pdf>

E. SME Sector

19. **The vast majority of legal entities in Serbia are micro, small and medium companies.** These companies represent 99.8% of all registered companies in Serbia. The total number of SMEs is 283,386 (although only about 150,000 legal entities in Serbia are required to apply the Accounting Law). These companies account for almost 71% of total employment and generate 54% of value added in Serbia. SMEs are mostly active in the sales (wholesale and retail) and manufacturing sectors. The great majority of SMEs are micro entities, of which there are about 270,000, representing 96% of the total companies in the country. Micro entities account for 43% of employment in Serbia. In contrast, about 488 companies are classified as large enterprise, about 0.2% of total companies.¹²
20. **Access to finance is a key constraint to growth for SMEs.** According to the World Bank's 2015 Systematic Country Diagnostic for Serbia,¹³ SMEs perceive access to finance (including long-term finance) and corruption as key constraints to growth, along with political instability, taxes, and tax administration. Citing the joint World Bank/EBRD Business Environment and Enterprise Performance Survey (BEEPS) for Serbia, the SCD noted that SMEs have been hit heavily by tightened bank credit standards and a lack of willingness to lend. The share of firms obtaining bank financing dropped from 29 percent in 2008 to 15 percent in 2013, and the share using trade credit from suppliers went up from 7 to 18 percent. Asked about the major constraint to obtaining a loan, 34 percent cited unfavorable interest rates, followed by 5 percent that cited complex application procedures. The share of SME loans in total business was 21.4 percent in 2007 and only 21.2 percent in 2012. Long-term loans account for most lending to SMEs, having gone up from 64.5 percent in 2007 to 72 percent in 2012. Nevertheless, the amount of loans, collateral requirements, and maturities remains unfavorable. Banks are reluctant to expand credit to the economy for fear of weaker economic performance, difficulties in recovering losses by selling collateral, and inability to collect receivables.

F. Linkage of this Assessment to Serbia's Development Agenda

21. **Serbia needs to improve its regulatory environment and competitiveness.** According to the CPF, to achieve broad based and sustainable growth, Serbia will need to promote higher investment, increase productivity, and improve external competitiveness. The CPF has noted, among other things, that (1) corporate financial reporting in Serbia has improved but still lags EU practices; (2) Serbia needs to improve governance, institutional capacity, and the quality of regulation affecting the business climate; and (3) Serbia has a substantial number of inefficient and often insolvent state owned or socially owned enterprises that still need to be reformed, privatized, or phased out, because subsidies to these SOEs are hampering Serbia's efforts to reduce fiscal budget deficits and inhibiting development of an open and competitive economy with a level playing field attractive for foreign and domestic private investment.
22. **This assessment can help inform improvements in regulation of financial reporting.** With respect to the constraints on growth identified in the CPF, this Report will help identify

¹² http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/countries-sheets/2014/serbia_en.pdf

¹³ <http://pubdocs.worldbank.org/pubdocs/publicdoc/2015/11/63111446462343770/Serbia-SCD-web.pdf>

areas to strengthen capacity in relevant institutions responsible for overseeing corporate financial reporting. Further, the Report will note challenges and areas for improvement to help Serbia conform to the *acquis* and develop regulations that improve the quality of financial reporting with due regard to avoiding unnecessary costs for business and the public fisc.

23. **The supply of reliable information from financial statements is important to Serbia's economic success.** Credible information from financial statements can help investors and lenders identify viable opportunities to offer capital and credit and make it easier for good businesses to obtain funding.¹⁴ It can expose risks of business illiquidity and insolvency to protect creditors and enable timely reallocation of resources to higher uses.¹⁵ It can promote financial discipline in enterprises, whether publicly or privately owned, by faithfully revealing their financial condition and performance.¹⁶ It can help assure adequate identification and management of risk by financial institutions and their regulators, to bolster financial stability and reduce the danger of financial crises.¹⁷ It can help create a level playing field in the economy by exposing remaining subsidies or preferences to commercial enterprises that remain state owned or supported.¹⁸ And it can assist in fair and effective tax collection.¹⁹
24. **Improved regulation of financial reporting will improve the business climate.** Improved regulation will promote transparency and sound corporate governance, making it easier, less costly, and less risky for foreign and domestic investors to finance growing businesses. Further, better regulation of financial reporting and better quality reporting will enhance trust in reported financial information, eventually leading to an environment where lenders are willing to provide financing based on reported cash flows, income, and financial condition rather than on collateral, which would substantially increase access to finance. Such developments could help address problems with access to finance, which are a key constraint to growth, particularly for SMEs. Moreover, simplification of financial reporting requirements and reduction of reporting burdens for businesses that are not public interest entities—a process that has already begun in Serbia, but could be further enhanced—will help reduce costs and improve competitiveness for Serbian businesses. Finally, better regulation and use of financial reporting and other financial information from SOEs would help support Serbia's efforts to privatize some of its SOEs on favorable terms and restructure and reform others. Thus, this Report should provide important information to assist in the reform process.

¹⁴ E.g., <https://www.kellogg.northwestern.edu/accounting/papers/Verdi.pdf>

¹⁵ E.g., <http://www.jimsjournal.org/14%20%20David%20S.%20Y.pdf>

¹⁶ E.g., <http://www.conferenz.co.nz/content/whitepapers/2011/financial-disciplines.pdf>

¹⁷ E.g., <http://www.bis.org/speeches/sp020227.htm>

¹⁸ E.g., <http://www.wsj.com/articles/u-s-airlines-claim-to-document-subsidies-at-gulf-rivals-1429573165>

¹⁹ E.g., http://www.oecd.org/ctp/tax-global/Principles_for_international_engagement_May2013.pdf

II. Institutional Framework

A. Statutory Framework

General Corporate Sector Accounting

25. **The Law on Companies (2011) regulates business activities in Serbia.** It recognizes four types of companies: general partnerships, limited partnerships, limited liability companies and joint stock companies. Most companies in Serbia are incorporated as limited liability companies.
- Limited liability companies have shares that are not publicly tradable and minimum share capital of EUR .83 (RSD 100).²⁰ The company may have a single-tier or a two-tier structure. In a single-tier system, in addition to an annual general meeting (AGM, or assembly), the company has at least one director. In the two-tier system, companies must also form a Supervisory Board comprising non-executive directors.²¹ The financial statements and auditors' reports must be approved and are adopted by the AGM.²²
 - Joint stock companies have shares which may be publicly traded and minimum share capital of EUR 25,000 (RSD 3,000,000).²³ The company may also have a single-tier or a two-tier system. As in an LLC, the financial statements and the auditors' reports must be approved and are adopted by the AGM.²⁴

Serbia has made significant improvements in its statutory framework governing company accounting since the last ROSC in 2005. Serbia's Law on Accounting came into force in July of 2013. The new law requires application of IFRS for large entities, listed companies, banks, insurance companies and other financial institutions regulated by the NBS, regardless of their size, as well as for parent legal entities preparing consolidated financial statements. The new law prescribes a choice for medium-sized entities whether to apply either IFRS or IFRS for SMEs,²⁵ requires IFRS for SMEs for small enterprises, and allows micro-sized entities to choose whether to implement IFRS for SMEs or a more simplified reporting regime based on the Rulebook on financial reporting for micro-enterprises.²⁶ Serbian law previously required full IFRS for all large and medium-sized reporting entities, and the new law is a substantial improvement, imposing less burdensome requirements on medium-sized entities and rendering compliance more achievable and realistic. However, as discussed below, there is still room for further simplification of financial reporting

²⁰ Law on Companies (2011) – Article 145

²¹ Law on Companies (2011) – Article 198

²² Law on Companies (2011) – Article 216

²³ Law on Companies (2011) – Article 293

²⁴ Law on Companies (2011) – Article 367

²⁵ IFRS for SMEs are international financial reporting standards adjusted to suit the needs of small and medium sized entities, first introduced in 2009. IFRS for SMEs are significantly simplified compared to full IFRS through simplified accounting policies, absence of topics that are not applicable for SMEs (for example, earnings per share, periodical or segmental reporting) and reduced disclosure requirements. Nevertheless, IFRS for SMEs are sophisticated modern standards for accrual accounting.

²⁶ Full IFRS, as well as IFRS for SMEs must be implemented following their translation, adoption by the Ministry of Finance, publication in the Official Gazette of the Republic of Serbia.

requirements. Classification of companies as large, medium, small, or micro is summarized in Table 1. Table 1: Classification of Companies under the Accounting Law

(EU requirements, when different, in parentheses below)

Criteria*	Average no. of employees	Net turnover	Balance sheet total
Micro	Up to 10	Up to 700,000 EUR	Up to 350,000 EUR
Small	10 – 50	up to 8,800,000 EUR (up to 12,000,000 EUR**)	up to 4,400,000 EUR (up to 6,000,000 EUR**)
Medium	50-250	Up to 35,000,000 EUR (up to 40,000,000 EUR)	Up to 17,500,000 EUR (up to 20,000,000 EUR)
Large	Over 250	Over 35,000,000 EUR (over 40,000,000 EUR)	Over 17,500,000 EUR (over 20,000,000 EUR)

*Companies may not exceed two of the three criteria

** The Accounting Directives sets a maximum net turnover and balance sheet total of 8 million and 4 million, respectively, for small companies. However, it allows Member States the option to increase these thresholds to the maximums noted in the table above.

*** Eu Directive 2013/34/EU states that where, on its balance sheet date, an undertaking or a group exceeds or ceases to exceed the limits of two of the three classification criteria set, that fact shall affect the application of classification only if it occurs in two consecutive financial years. The Accounting Law of Serbia is not in line with this requirement as it states that classification is performed each year, on the day of the financial statements' preparation, and that classification will be applied during the year.

26. **The Law on Accounting also substantially harmonized Serbian law on corporate accounting with the EU *acquis* as it existed until June 2013.** However, almost simultaneously with Serbia's completion of its Law on Accounting, the EU substantially amended the *acquis* as it relates to annual financial statements, consolidated financial statements and related reports. The above classification of companies under Serbia's Accounting Law varies somewhat from the 2013 Accounting Directive (for example, the *acquis* uses balance sheet total and net turnover thresholds of \leq EUR 20,000,000 and \leq 40,000,000, respectively, for medium-sized companies; and \geq 20,000,000 and \geq 40,000,000, respectively, for large companies). Serbia could therefore decrease the number of large companies subject to full IFRS reporting, and increase the number of medium-sized companies with the option to apply IFRS for SMEs, by raising its thresholds.

27. **Serbia has introduced the concept of a public interest entity; however, it is arguably too broad.**²⁷ Under the Law on Auditing, public interest entities are defined as: (i) all large entities (per Table 1 above); (ii) financial institutions; (iii) listed companies; and (iv) any

²⁷ Article 2 of the EU Accounting Directive defines public interest entities as listed entities, credit institutions, insurance companies, and other entities 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.

entities which the Government proclaims to be of public interest. While the EU allows Member States to determine entities to be PIEs because of their size, when Serbia amends its Law on Accounting to conform its classification of companies fully with the *acquis*, it may wish to consider whether the requirement to apply full IFRS for all “large” companies sweeps too broadly, and whether a narrower requirement might render compliance more realistic and cost-effective while still providing comparable and adequate information to users of their financial statements.

28. **Most accounting requirements are contained in the Law on Accounting and related Rulebooks (By-Laws).** The Law on Accounting is based on the EU Fourth and Seventh Company Law Directives—which have been superseded by the new EU Accounting Directive²⁸—and sets forth basic accounting, financial reporting and bookkeeping rules that must be followed by all companies. In addition, companies must comply with Rulebooks issued by the Ministry of Finance, which prescribe the layouts for financial statements, charts of accounts, and reporting rules for statistical purposes. These rulebooks are not entirely aligned with IFRS.²⁹ Table 1 lists the rulebooks that companies must apply.

Table 2: Rulebooks to the Law on Accounting

Rulebook	
All Companies	
1	Rulebook on the layout of Chart of accounts and the content of accounts included in the layout of Chart of accounts for companies, cooperatives and entrepreneurs
2	Rulebook on the content and layout of financial statement forms for companies, cooperatives and entrepreneurs
3	Rulebook on the content and form of the Statistical report for companies, cooperatives and entrepreneurs
4	Rulebook on the manner and deadlines for conducting of inventory and alignment of book-keeping statement with actual state
5	Rulebook on the manner and conditions of financial statements publication and keeping the Register of financial statements
Micro Companies	
6	Rulebook on the manner of recognition, valuation, presentation and disclosure of the positions in financial statements for micro legal entities and other legal entities

29. **All companies except micro-entities prepare annual financial statements comprising a balance sheet, income statement, statement of other comprehensive income, statement of changes in equity, statement on cash flow, and notes to financial statements.**³⁰ This is not in line with the *acquis*, which prohibits requiring more than a balance sheet, profit and

²⁸ Directive 2013/34/EU, referenced in this report as “the Accounting Directive.”

²⁹ For example, financial statements must be prepared in a format prescribed by the Ministry of Finance that does not comply with IAS 1 (revised) and some items that do not meet the definition of asset or liability under IFRS are reported on the face of the balance sheet rather than off-balance sheet.

³⁰ Law on Accounting (2013) –Article 2 (refers to statement on other results rather than OCI, but meaning appears to be the same).

loss account, and notes for small and micro-entities.³¹ The complete set of financial statements, together with the audit report (when required), must be submitted electronically to the Agency for Business Register within six months after the balance sheet date (micro-enterprises had the temporary option to submit in paper form, ending with their 2014 financial statements).³² Large companies are also required to prepare an “annual report on operations” (equivalent to a management report), whose contents are in compliance with EU requirements regarding management reports. The only difference is that in Serbia, both small and medium companies are exempted from preparing a management report, whereas in the EU, only small companies are exempted.³³

30. **Micro-enterprises are exempted from a number of requirements, including from the need to prepare certain financial reports, which sensibly and appropriately reduces their reporting burdens.** The financial statements of micro-enterprises consist of only a balance sheet and income statement. These must be prepared in accordance with the Rulebook on financial reporting for micro-enterprises.
31. **The parent company of a group of companies is required to prepare consolidated annual financial statements; groups comprised solely of small companies are in some cases exempted from this requirement.** Parent companies must prepare consolidated annual financial statements comprising a consolidated balance sheet, consolidated income statement, consolidated statement of other comprehensive income,³⁴ consolidated statement of changes in equity, consolidated statement of cash flow, and notes. Consolidated financial statements must be submitted electronically, together with the auditors’ report, to the Business Registry within seven months of the balance sheet date. There is no legal requirement for micro, small and medium-sized entities to prepare a consolidated management report. A parent legal entity may decide to prepare, as one report, its annual and consolidated management report, provided it contains information significant for the group as a whole. If the individual subsidiaries’ total assets and annual revenues are less than half the thresholds of that of small companies, the parent company is not required to prepare consolidated financial statements.³⁵ This exemption is not in line with the *acquis*, which requires small groups to be exempted from the consolidation requirement, and permits medium groups to be exempted. The thresholds for determining which groups are to be exempted are defined in the *acquis* at the group level, not at the subsidiary level.³⁶
32. **Companies are also required to submit financial statements to the Agency for Business Register for statistical purposes.** Companies must submit preliminary financial statements for statistical purposes by the end of February,³⁷ comprising a balance sheet, income statement and a statistical report; they also have the option to file their final financial statements at that time, and many do. There is debate among stakeholders on the quality and usefulness of the statistical reports, which are not made publicly available on an individual company basis, but provide the data for aggregate statistics. There is no mechanism to assure

³¹ New Accounting Directive – Article 4, paragraph 1.

³² Law on Accounting (2013) – Article 33

³³ Law on Accounting (2013) – Article 29 stipulates the requirements for the annual report on operations.

³⁴ The Serbian law translated this as “consolidated statement on other results.”

³⁵ Law on Accounting (2013) – Article 27

³⁶ New Accounting Directive – Paragraph 33 sets forth the exemptions for small and medium groups. Article 3, paragraph 5 defines the thresholds for small groups; Article 3, paragraph 6, for medium groups.

³⁷ Law on Accounting (2013) – Article 35

consistency between the preliminary financial statements filed for statistical purposes and the final financial statements that may be filed later.

Audit and Internal Control Requirements

33. **The 2013 Law on Auditing requires medium and large companies, as well as companies whose operating revenues exceed 4.400.000 EUR in equivalent in dinars, to undergo an annual financial statement audit.** This new law has considerably reduced the scope of the statutory audit requirement, exempting many smaller companies that may not greatly benefit from an audit and may not realistically be able to pay for a genuine audit.³⁸
34. **Independent auditors are appointed by the AGM, no later than 30 September for the current year.**³⁹ There is mandatory audit partner rotation every seven years, with a two-year cooling off period.⁴⁰ International Standards on Auditing (ISA), as translated and published in the Official Gazette, are required for all statutory audits. The Chamber of Authorized Auditors, a professional body, is legally vested with the task of quality control over the work of statutory audit firms and application of the standards.
35. **Listed companies, financial institutions, and SOEs are required to form an audit committee; however, only banks have consistently implemented this requirement.**^{41,42} The EU Directive requires the majority of the audit committee members to be independent of the entity; however there is no such requirement in local legislation. Serbian law requires SOEs to appoint at least one certified internal auditor to perform the internal audit function.⁴³ According to provisions of the Company Law, the audit committee prepares, proposes and monitors the implementation of accounting and risk management policies; proposes persons in charge for internal audit; supervises internal audit; reviews the application of accounting standards; and gives an opinion on the external auditor appointment and on the draft audit contract. The internal control function checks compliance with relevant laws, regulations and company bylaws; supervises implementation of accounting policies; reviews implementation of risk management policies; monitors compliance with a corporate governance code; and assesses corporate policies and processes.
36. **The legal and institutional framework governing SOEs is quite fragmented.** Broadly speaking, central-government SOEs fall into one of three groups:
- i. *Enterprises that fulfill a public policy objective* (e.g., electricity, gas, railways, post) are established in accordance with the Law on Public Enterprises and are under the purview of the Directorate for Control and Supervision of Public Enterprises of the Ministry of Economy. If the PE Law is silent about an issue, SOEs must comply with the Companies Law. All such

³⁸ Under the previous law, a company was subject to the statutory audit requirement if it met at least two of three criteria: (1) > EUR 2.5 million in net turnover, (2) total balance sheet > Euro 1 million, and (3) > 50 employees. The new law provides a considerably higher floors for turnover and balance sheet total, per table 1.

³⁹ Law on Auditing (2013) – Article 24

⁴⁰ Law on Auditing (2013) – Article 40

⁴¹ Law on Auditing (2011) – Articles 43 and 44

⁴² Company Law (2011) – Articles 411, 451, 452

⁴³ Law on Budget System, Article 82

SOEs (currently 37 as of the end of field work for this Report) are wholly-owned by the government.

- ii. **Commercial enterprises** (e.g., telecommunications, airports, airline) that generally operate in a competitive market are established under the Companies Law, as a joint stock company or limited liability company. They are to report to their respective line ministry, although they do not seem to do so in practice. Commercial SOEs may be wholly or partially owned by the government.
- iii. **Enterprises in the process of being sold or wound down** are under the purview of the Privatization Agency. This process is expected to be completed by the end of 2015.

37. **The financial reporting standards that are to be applied by an SOE depends on its size, based on the same thresholds for private companies.** For the most part, SOEs are required to apply the Law on Accounting and Law on Auditing. Thus, as in the private sector, large SOEs are required to apply IFRS; smaller SOEs apply IFRS for SMEs. Likewise, medium and large SOEs are required to undergo an annual financial statement audit, as well as any SOE subject to the Law on Public Enterprises. In addition, the Ministry of Economy requires SOEs to report the following on a quarterly basis: balance sheets, income statements and statements on cash flows, as well as key performance indicators (KPIs) for the largest SOEs operating in the energy sector.⁴⁴ SOEs subject to the Law on Public Enterprises must publish their annual financial statements and auditor's report on their website. SOEs subject to the Companies Law are required to publish their annual financial statements and auditor's report through the Agency for Business Register.
38. **SOEs governed by the Public Enterprise Law have a distinct corporate structure.**⁴⁵ The governing bodies are the Supervisory Board and the CEO.⁴⁶ A Management Board is optional for SOEs; the government may opt to form one and, in such cases, this must be reflected in the SOEs' by-laws. The CEO is appointed through a competitive hiring procedure.
39. **SOEs governed under the PE Law must establish an audit committee.**⁴⁷ According to the Law on Public Enterprises, the audit committee should have three members appointed by the Supervisory Board. The PE Law does not set forth independence requirements for audit committee members. In addition, if an SOE is established as a public joint-stock company—but not as a private JSC—under the on Companies Law, they must form an audit committee.
40. **According to the Rulebook on criteria and standards for the establishment and functioning of the financial system and controls in public sector, SOEs are obliged to have in place internal control processes and procedures.** Although these procedures are formally followed and required reports are prepared on annual basis, the effectiveness of these procedures is questionable, since there is no adequate testing and assessment mechanism for internal controls. The Supervisory Board is responsible for establishing and monitoring the internal controls, according to both the Law on Public Enterprises and the

⁴⁴ Law on Public Enterprises – Article 52

⁴⁵ Law on Public Enterprises – Article 11

⁴⁶ In Serbia, the CEO is referred to as the Management Board is called the Executive Board.

⁴⁷ Law on Public Enterprises – Article 43

Law on Companies. However, in practice, SOEs' internal controls are sometimes overridden by company management.

41. **SOEs established under the Law on Public Enterprises must select auditors through public tender, which in practice encourages sacrifice of audit quality for lower fees.** The audit committee of SOEs governed by the law on Public Enterprises is responsible for drafting the request for proposals, conducting the tender procedure, and selecting the external auditor.⁴⁸ The method for selecting the auditor, while not strictly required by law, in practice tends to be through lowest price, which forces prospective auditors to aggressively compete on fees in order to win clients. Even SOEs that are not subject to public tender requirements commonly focus almost solely on securing low fees in auditor selection. In some cases, SOEs with revenues in the range of several hundred million euros pay auditors' fees in the range of several thousand euros. Audit quality for many if not most SOEs is therefore doubtful; and as with general companies, there are no follow up procedures in law or in practice to be taken when SOEs receive modified audit opinions. Indeed, during this assessment, the team learned of instances in which SOEs that had received modified audit opinions paid dividends based on the companies' reported financial results, when adjustments consistent with the opinions expressed in the audit opinions would have rendered dividends impermissible.
42. **SOEs submit the annual business plans (budgets) to the Ministry of Economy for review and approval.**⁴⁹ Business plans are required to be submitted to the government by December 1 for the following year. The annual business plans are required to be published on the SOE website.

Special Accounting, Auditing, and Governance Requirements for Financial Sector

43. **The Law on Accounting (July 2013) and Law on Auditing (July 2013) specifically regulate financial reporting and auditing of financial institutions.** The Law on Accounting classifies all financial institutions as large irrespective of their size, thus making application of IFRS mandatory for financial institutions. All financial institutions are also subject to mandatory statutory audit, as are all large companies under the Law on Auditing.
44. **Sector specific regulation prescribes additional reporting and auditing requirements for financial institutions, which are largely complied with.** The Law on Banks and Law on Insurance are the primary legislation that regulates banks and insurance companies. Respective legislative acts define operations of other financial institutions⁵⁰. Through accompanying by-laws, the regulators prescribe additional prudential requirements for in-year and annual reporting and external audit.
45. **The NBS and the SEC prescribe the form of financial statements and Chart of Accounts for each of the financial institutions, different to the one used for the non-financial sectors.** Following the adoption of the Law on Accounting in 2013 and in line with its

⁴⁸ Law on Public Enterprises – Article 44

⁴⁹ Requirements relating to the business plans of SOEs are set forth in Articles 50-56 of the Law on Public Enterprises; publication requirements, including for business plans, are set forth in Article 62.

⁵⁰ Law on voluntary pension funds and pension plans, Law on financial leasing, Law on investment funds, Law on capital market.

provisions, forms of financial statements and a chart of accounts have been adopted through by-laws and apply to 2014 financial statements.

46. **Banks are required to apply IFRS as of the application date stipulated by the IASB and the standard even if not yet translated into Serbian.** Such requirement is part of the most recent amendments to the Law on Banks (2015) and its objective is to assure that financial reporting for banks is aligned with the most recent updates to IFRS, even if the respective standard or revision of a standard has not been translated and officially published in Serbia. Banks prepare interim un-audited financial statements for each calendar quarter, and submit certain financial indicators to the NBS monthly. Banks are required to deliver to the NBS their audited annual financial statements within 120 days after the end of the calendar year for separate financial statements, and within 150 days for consolidated financial statements.
47. **In addition to expressing an opinion on financial statements, the auditor is expected to provide an assessment of the system of internal controls, internal audit function and risk management within audited banks.** The auditor should provide a management letter accompanying the audit report to the NBS. The Law on Banks prescribes more stringent rules with regard to rotation of auditors, and requires change of the auditor for banks after a maximum of five years. The NBS plans to try to help assure and bolster the quality of audits by requesting the auditors to provide the audit plan for each engagement of financial audit of a bank to the NBS for review. During the year of this assessment, the NBS moved to add staff knowledgeable in IFRS to its Bank Supervision Department. Developing this expertise and embedding it in the supervisory process will take time. The NBS also has a right to request a special purpose audit⁵¹ of a bank if needed.
48. **Insurance companies are also subject to additional reporting and auditing requirements.** Similarly to banks, insurance companies are obliged to deliver annual audited financial statements to the NBS at the latest by April 30 of the current year for the previous year. They prepare interim un-audited financial statements for each calendar quarter, while certain financial indicators are submitted to the NBS monthly. Mandatory rotation of auditors is after five years, and as with banks, in addition to expressing an opinion on financial statements, the auditor should provide assessment of the system of internal controls, internal audit, accounting function and organizational and technical capacity within audited insurance companies. The auditor provides the management letter accompanying the audit report to the NBS.
49. **Additional reporting and auditing requirements have been imposed by regulators for other financial institutions as well.** The NBS and SEC impose other specific requirements on leasing companies, pension funds and pension funds management companies, investment funds and investment funds management companies and broker-dealer houses. They must prepare interim financial statements, mostly on a quarterly basis with some information provided monthly. Management companies prepare separate financial statements for the company and for each fund they manage. In most cases, financial audits of those institutions extend their scope to provide assessment of the system of internal controls and other systems within those organizations.

⁵¹ Law on Banks, article 63 and Decision on conditions and manner of conducting supervision of banks and special audit of banks.

50. **Listing on Belgrade Stock Exchange includes some requirements related to the quality of financial reporting, but those do not appear stringent.** There are only a few conditions for inclusion and trading for prime listing and standard listing and they largely consist of financial reporting requirements, albeit those do not seem to be stringent. In order for a company to be included in the prime listing, it needs to have an unmodified (clean) audit opinion on its financial statements and register a net profit. The requirements for inclusion on the standard listing are an unmodified (clean) *or* qualified modified audit opinion on financial statements. In subsequent periods, to continue trading and listing, in addition to a requirement regarding the level of capital, companies are obliged to have an unmodified (clean) *or* qualified modified audit opinion for both prime and standard listing. Thus, there does not appear to be any barrier to a company continuing to trade even if it repeatedly receives qualified audit opinions and does not correct its reporting.
51. **The Securities Commission prescribes additional financial reporting and auditing requirements for listed companies.** Listed companies⁵² are required to submit annual audited financial statements to the SEC by April 30. Annual financial statements need to be accompanied by a corporate governance overview⁵³. Listed companies also must prepare and publish condensed semi-annual and quarterly financial statements; quarterly reporting applies only for companies included in prime or standard listing, while semi-annual reporting applies for all on the regulated market. The requirement to prepare quarterly reports is not in line with the *acquis*, which requires only annual and semi-annual reporting.⁵⁴ There is mandatory rotation of auditors after five years. The audit opinion needs to provide assessment of internal controls, internal audit and risk management, in addition to an opinion on financial statements.

Gaps in Serbia's Legal Framework for Accounting and Auditing

52. **Serbia will need to further amend its laws to conform to the *acquis*.** As an EU accession country, Serbia has until year end 2018 to transpose the requirements of the 2013 EU Accounting Directive and the 2014 EU Statutory Audit Directive. This Report does not purport to offer an exhaustive listing of all elements of Serbian law in the area of accounting and auditing that may need to be amended to comply with the *acquis*. However, some key gaps to be addressed are:
- i. the audit quality assurance system must be fully independent of the profession and introduce a risk-based system for monitoring;
 - ii. the audit oversight body must be legally vested with the power and obligation to establish an effective quality assurance review system and disciplinary system for auditors of PIEs, and its membership must be fully independent (that is, entirely excluding practitioners from decision-making);

⁵² Law on capital market defines public entities as companies fulfilling one of the following: (i) it has performed successfully an IPO in line with a prospect approved by the SEC or (ii) it is trading on regulated or MTP market of the stock exchange.

⁵³ Law on Accounting, article 29

⁵⁴ Directive 2013/50/EU, amending the Transparency Directive (2004/109/EC) – through this amendment, the EU abolished the requirement for publishing quarterly financial information. A quarterly reporting requirement is allowed only if, following an impact assessment, it is found that more frequent reporting does not lead to an excessive focus on short-term results and performance, and does not discourage small and medium companies from listing.

- iii. Serbian law⁵⁵ needs to include more detailed requirements for reporting on corporate governance, in line with the Accounting Directive ;
- iv. reporting requirements regarding payments to the government need to be added to the Law on Accounting;
- v. Local legislation does not envisage additional disclosure requirements for medium, large and public interest entities, as required by the EU Accounting Directive;
- vi. Serbian law does not require small and medium enterprises to prepare an annual report on operations, while the *acquis* allows such an exemption only for small enterprises;
- vii. The exemption for groups comprising only some small companies from consolidation requirements is not in line with the *acquis*, which sets thresholds for the group as a whole;
- viii. Financial reporting requirements for micro-entities exceed those of the *acquis*, and Serbia may wish to consider simplifying them even further;⁵⁶
- ix. Independence requirements for audit committee members need to be harmonized with the *acquis*;
- x. Quarterly reporting for listed companies is not in line with the *acquis*.

B. Publication and Accessibility of Financial Statements

53. **The Agency of the Business Registry makes financial statements publicly available and easily accessible for all companies registered in Serbia.** All companies are required to submit their annual and consolidated financial statements to the Agency. Financial statements are published on the Agency's webpage within 60 days after receiving them. Users are able to access the financial statements of all companies from the 2014 financial statements onwards, on the Agency's website, free of charge. For these companies, the full set of the financial statements are publicly available on the Agency's website, including the balance sheet, income statement, statement of cash flow, statement on change of equity, statistical annex and notes to the financial statements. The official, paper version, of financial statements can be purchased from the Agency for a fee (ranging from 600 RSD to 2000 RSD (approximately 5 to 17 euros) This is above the fees charged by EU Member States (in which access is free or a symbolic fee of EUR1-2 is charged), and may not conform with the *acquis*, which prohibits fees that exceed administrative costs.⁵⁷ For these companies, general data and an extract from the balance sheet and income statements are available free of charge. As part of the assessment for this report, accessibility of financial statements on the website was tested and found to be reliable and user-friendly.

C. Professional Bodies

Audit Profession

54. **The Chamber of Authorized Auditors enjoys statutory recognition, and the Chamber's membership is mandatory for licensed auditors and all audit firms.** The Chamber was

⁵⁵ Company Law, article 368

⁵⁶ For example, some requirements regarding reporting for depreciation may be more exacting than necessary and realistic for compliance by micro-entities, such as annual testing or assessment of the depreciation period, depreciation method, residual value, and economic life of depreciable assets.

⁵⁷ Publication Directive (2009/101/EC) sets forth that the fee charged for financial statements should not exceed the administrative costs of obtaining them.

established in 2006 by the Law on Accounting and Auditing, following a recommendation for its creation in the 2005 ROSC. The new Audit Law (2013) has given the Chamber expanded regulatory powers, particularly in regards to quality assurance and the promulgation of auditing standards adopted by the government. The Chamber became an IFAC associate member in November 2014; it is not a member of the Federation of European Accountants (FEE).

55. **About 60 audit firms are registered with the Chamber to perform statutory audits.** The pool of audit firms requiring regulation and quality oversight is thus a more manageable size than in some other countries in the region. For example Croatia, considerably smaller than Serbia in population, has 235 registered audit firms.
56. **The Audit Law gives the Chamber the mandate to operate the statutory audit function and enforce its requirements.** Under requirements of the Law, the Chamber, among other things:
- a. Prepares the program of qualifying examination for a certified auditor, organizes qualifying examinations for certified auditors and issues certificates to statutory auditors;
 - b. Prepares a continuing professional education program and organizes continuing professional education of licensed certified auditors;
 - c. Maintains the Registers of licensed certified auditors, audit firms and independent auditors, imposed measures, and members of the Chamber;
 - d. Determines fees for: membership in the Chamber, registration with the registers maintained by the Chamber, examinations organized by the Chamber, issuing excerpts from registers, certificates from records maintained by the Chamber, and other fees specified by general instruments of the Chamber;
 - e. Determines the amount of the special contributions for quality assurance review of audit firms, independent auditors and licensed certified auditors;
 - f. Prepares an annual quality assurance plan of audit firms, independent auditors and licensed certified auditors;
 - g. Prepares a methodology of quality assurance of audits performed and quality control of audit firms, independent auditors and licensed certified auditors;
 - h. Carries out quality assurance reviews of audit firms, independent auditors and licensed certified auditors.
57. **The Chamber's governance structure is established by the Audit Law (2013).** It consists of the Assembly, the Council, the Supervisory Board, Secretariat, Secretary General, and various Committees to manage specific tasks.
- **The Assembly** is the key governing body of the Chamber, with the president appointed from the ranks of members of the Assembly for a term of 4 years with maximum one reappointment available.
 - **The Council** is the executive body of the Chamber; it has 7 members (six elected by the Assembly and one nominated by the Ministry of Finance)
 - **The Supervisory Board** is the controlling body of the Chamber; it has 5 members appointed by the Assembly.
58. **The Chamber currently maintains three Committees.**
- **The Ethics Committee** manages ethical behavior of the profession and ensures that Code of Ethics is observed. It has 5 members.

- **The Quality Control Committee** manages quality assurance system. It establishes an annual plan for QA reviews and monitors its implementation, considers reports on completed reviews, and proposes measures to eliminate the irregularities identified in the reviews. It has 5 members.
 - **The Commission for Examination, Training and Continuous Professional Development** is responsible for overall governance and supervision of the development and delivery of the professional examination, the training activities and the CPD activities of the Chamber. It has 5 members. Professional and administrative activities within the Chamber are performed by the Secretariat. The Secretary General manages and organizes the day to day business of the Chamber. The Secretary General is appointed by the Council.
59. **The Chamber does not have a Disciplinary Committee, but it has initiated a system for investigating and disciplining acts of misconduct.** This process is managed by the Ethics Committee of the Chamber and includes the involvement of the Chamber Secretariat and Governing Council. In accordance with the Audit Law, the Chamber shall inform the Ministry of Finance and the Public Oversight Board of any disciplinary proceedings taken against members of the Chamber. If, during the disciplinary procedures, evidence appears that a criminal offence was committed, the Chamber is required to notify the competent juridical bodies of all the facts known to it. The disciplinary process relies heavily on the QA process as the Ethics Committee does not have the capacity to conduct investigations.
60. **The Chamber should strengthen its investigation and disciplinary function.** The tasks formally assigned to the Ethics Committee do not clearly include investigation and discipline. The tasks of the Committee should be more clearly defined with regards to investigation and discipline and there should be clarification of the adjudication and appeals process. The Chamber should have a separate body or a panel responsible for conducting investigations and another separate body or a panel responsible for the adjudicative process.
61. **The Chamber does not have authority to issue, renew and revoke audit licenses, as that responsibility was delegated to the Ministry of Finance by the Audit Law (2013).** The Chamber had authority to issues licenses for the provision of statutory audits; however the new Law transferred this responsibility to the Ministry. The Chamber is still responsible for keeping the respective registers.
62. **The Audit Law prescribes minimum competency requirements for membership of the audit profession.** These requirements are in line with both the EU acquis, as well as with IFAC's statements of membership obligations (including SMO 2 and SMO 4). Candidates must hold:
- University degree
 - Three years practical experience in auditing
 - All professional certification exams administered by the Chamber
 - No conviction of crimes which make the candidates unworthy of performing audit
63. **The Chamber recognizes standard EU mutual recognition arrangements.** Holders of audit license from another EU state are required to take an aptitude test that ensures knowledge of Serbian company law and tax law.

64. **The Audit Law restricted the right to audit financial statements to Chamber’s members only.** The Audit Law requires that only members of the Chamber can provide audit services and an auditor can only provide legally specified non-audit services in addition to performing audits.

Table 3: Chamber’s Compliance with IFAC SMOs

SMO	Status
SMO 1 – Quality Assurance (QA)	The Audit Law (2013) gives the responsibility to the Chamber for the quality assurance reviews. The Chamber has conducted an initial pilot round of inspections and its first regular round of inspections. However, the Chamber intentionally avoided review of audits for regulated entities (such as financial institutions) in these first cycles of inspections in order to focus initially on establishing and improving their basic inspections process.
SMO 2 – International Education Standards: The Chamber needs to update its professional accounting education program for consistency with IES.	The Chamber has set up a system to ensure that its education, examination and CPD requirements fulfill the SMO 2 and relevant national and EU requirements, but the system needs to be reviewed and improved. Rather than formal teaching, the Chamber offers consultations prior to exams, which is not an adequate substitute. The Chamber also needs to define assessment strategy clearly to assure proper testing of specific needed skills.
SMO 3 – International Auditing and Assurance (IAASB) pronouncements:	The Audit Law (2013) requires the use of ISAs. The Chamber is responsible for supporting the implementation of ISAs through education and training activities.
SMO 4 – International Ethics Standards Board for Accountants (IESBA) Code of Ethics:	The Audit Law (2013) requires auditors to comply with the requirements of the Code of Ethics issued by the IESBA. The Law requires the Chamber to adopt the Code and monitor the implementation. The Chamber establishes ethical requirements for its members and the most recent version of the IESBA Code was adopted in 2012 without modifications.
SMO 5 – International Public Sector Accounting Standards (IPSAS):	The Serbian Government has not yet adopted IPSAS, however the Government anticipates the adoption of IPSAS. The Chamber promotes IPSAS through their CPD courses and other educational activities.
SMO 6 – Investigation and Discipline:	The Chamber needs to review and improve its I&D system by further defining the investigation and disciplinary process, ensuring that a dedicated body is appointed for conducting the investigation process, and another separate body appointed for the disciplinary adjudication process, as well as clarifying the adjudication and appeals processes.

SMO	Status
SMO 7 – International Financial Reporting Standards.	The Serbian Government is responsible for setting accounting standards and the Law on Accounting (2013) requires application of IFRSs and IFRSs for SMEs. The Chamber supports the implementation of IFRSs and other standards through the development and delivery of CPD, the design and execution of examinations, and other related activities.

Serbian Association of Accountants and Auditors (SAAA)

65. **SAAA is a voluntary membership organization for both accountants and auditors in Serbia.** It was founded in 1955 and has been a full member of IFAC since 1997 and a member of FEE (the Federation of European Accountants) since 2013.
66. **Some tension between professional bodies.** Following the establishment of the Chamber of Authorized Auditors and restriction of audit services to members of the Chamber, there has at times been a strained relationship between the two organizations, but there appear to have been recent efforts between these two organizations to achieve better cooperation.
67. **Membership composition of SAAA is as follows:**

Certified Accountants/Certified Public Accountants	1925
Accounting Technician	2013
Students	3274
Accounting firms	612

68. **A key role of the SAAA has been in providing translation in Serbian language for IFRS, IFRS for SMEs, ISA, IPSAS, and the Code of Ethics.** However, based on the agreement signed between the Ministry of Finance and the IFRS Foundation in 2013, the translation of IFRS has become the responsibility of the Ministry of Finance.
69. **The key standards and codes for audit quality are the ISAs, ISQC1 (governing quality control within audit firms) and the Code of Ethics for Professional Accountants, all readily available in English.** Responsibility for the translation of these standards has been delegated in Serbia by IFAC to the SAAA. The latest officially published ISA translation was issued in 2010. The SAAA has also translated the ISAs edition from 2013 and made available for a fee (currently about Euro 150). The date of publishing for this translation in the Official Gazette has not yet been decided as this needs to be agreed between the MoF and SAAA.

Table 4: SAAA’s compliance with IFAC SMO

SMO	Status
SMO 1 Quality Assurance	The Audit law gives the responsibility of QA to the Chamber of Authorized Auditors. SAAA maintains a voluntary system of QA for its membership. SAAA is involved in a project to additionally improve its system of

SMO	Status
	quality assurance in collaboration with the Institute of Chartered Accountants of England and Wales.
SMO 2 International Education Standards for Professional Accountants and Auditors	The SAAA education program and final assessment are based on the Association of Chartered Certified Accountants (ACCA) program. SAAA works to maintain and update the program to ensure its compliance with IESs.
SMO 3 International Standards and other Pronouncements issued by the IAASB	SAAA has established an ongoing process for the translation of the IAASB pronouncements, having translated and published the 2005, 2006, 2009 and 2010, 2013 Handbook. SAAA translates the standards in accordance with the IFAC translation policy, raises its members' awareness about the requirements and organizes seminars and other training.
SMO 4 IESBA Code of Ethics for Professional Accountants	Serbia has utilized direct adoption and SAAA has translated and published the 2012 Code of Ethics.
SMO 5 International Public Sector Accounting Standards and Other Pronouncements issued by the IPSASB	The SAAA is the body responsible for the official translation of IPSASs into Serbian language and follows the IFAC translation policy to accomplish this. The SAAA has translated the IPSAS 2013 Handbook (as well as the 2004, 2007 and 2011 Handbooks) and provides courses and training.
SMO 6 Investigation and Discipline	SAAA has implemented mechanisms for investigating and disciplining its members for misconduct and failure to meet the rules. SAAA maintains a three tiered system (Investigation Committee, Disciplinary Committee and Appeals Committee); however, it does rely upon the Serbian legal system in certain cases.
SMO 7 – International Financial Reporting Standards.	The Serbian Government is responsible for setting accounting standards and the Law on Accounting (2013) requires application of IFRSs and IFRSs for SMEs. SAAA was responsible for the translation of IFRS and IFRS for SMEs and the latest IFRS translation published by the SAAA is the 2009 edition.

D. Professional Education and Training

Education at the University Level

University of Belgrade, Faculty of Economics

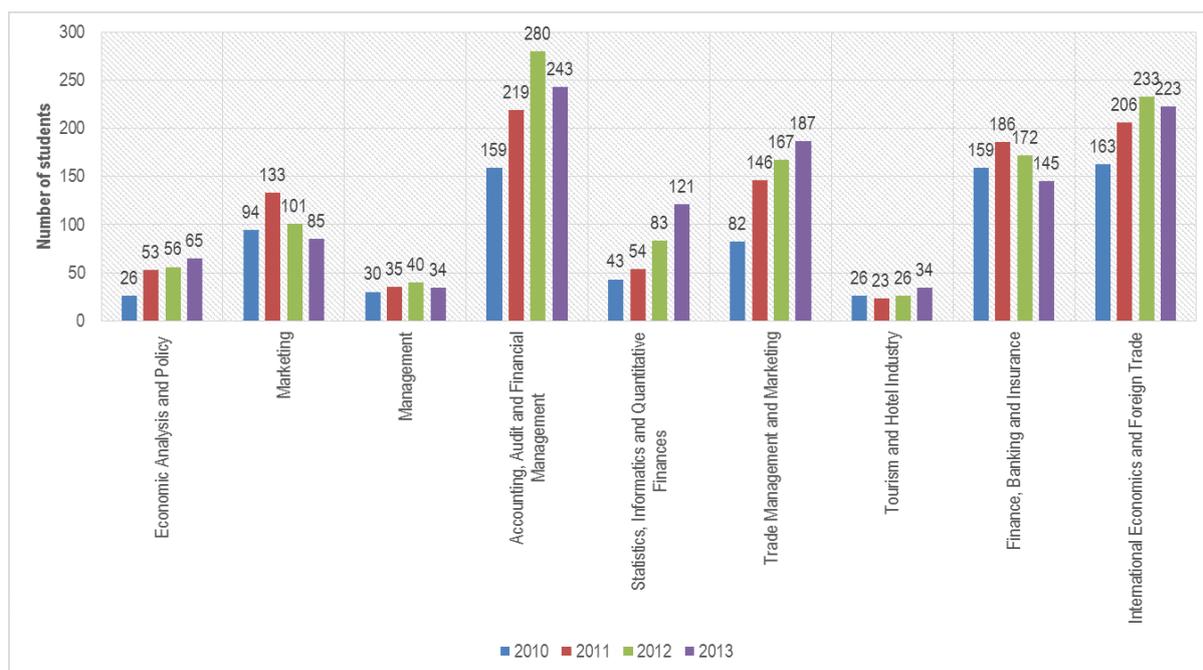
70. **In September 2003, Serbia joined the Bologna Process and committed itself to the process of higher education reform.** In 2004 the reform and implementation of the principles of Bologna Declaration started at the University of Belgrade and at the Faculty of

Economics.⁵⁸ One of the basic postulates of the Bologna Declaration is a three-level system of higher education, which has been accepted by the Faculty of Economics in Belgrade. A three-level study system, currently accepted at the Faculty of Economics, consists of: 4-year-long undergraduate academic studies, 1-year-long master academic studies and PhD studies which last for three years.

71. **The Faculty of Economics in Belgrade offers the Bachelor's Degree in economics within which an accounting-related specialization.** The first four semesters of the study program are common for all students. In the fifth semester, the program branches into nine modules, one of which is Accounting, Audit and Financial Management.
72. **There are some weaknesses in the university accounting curriculum, especially related to international accounting and auditing standards.** The University of Belgrade, Faculty of Economics only provides in-depth teaching of IFRS and ISAs in their masters programs, and thus significant numbers of those with bachelor degrees have little or no formal education on these topics. The general opinion is that some of the professors at the University of Belgrade possess a high knowledge of IFRS; however there are an insufficient number of skilled lecturers and some teaching materials are unsatisfactory. IFRS for SMEs is covered at the bachelor level, in the fifth semester, as the majority of businesses in Serbia are SMEs. In addition to revising the curriculum, there is a need to provide resources to effectively teach it.
73. **The general perception of the University of Belgrade, Faculty of Economics is fair, and that level of quality is higher than in the programs offered by private universities.** The feedback from partners in audit firms during the ROSC interviews suggested that while the university provides theoretical knowledge, the practical skills imparted are lacking and in need of improvement.
74. **The number of students studying accounting and auditing in undergraduate degrees is increasing, indicating a strong demand for accountancy education.** In 2010, the number of students in accounting and auditing programs at the University of Belgrade was 159, which grew to 280 in 2012. There was a slight drop in numbers in 2013, with the 243 students. Compared with the other modules, the accounting and auditing program has the largest number of students. The statistics are illustrated in the Figure 1 below.

⁵⁸ This Report's assessment of accounting education at the university level focuses on the University of Belgrade because resource constraints did not permit a full assessment of the entire university sector, and the University of Belgrade is both the largest provider of accounting graduates in the country and by widespread perception the highest quality. Thus, deficiencies found in the University of Belgrade program may likely exist also in other programs perceived as weaker.

Figure 1: Students studying trends⁵⁹



75. **There is a need to link the education system at the university level to the professional audit training program.** At present, the links between university education and professional training programs are not clear and appear to be weak. The key parties should work together to revise the university curriculum to better support progression from the university sector to the professional training program.

Education and Examination at the Professional Level

Chamber of Authorized Auditors

76. **The criteria set out in the Audit Law (2013) for the approval of statutory auditors conforms to the Eight EU Company Law Directive and with the new Audit Directive.** Article 6 of the Law (2013) defines the minimum requirements for future registered auditors. The Law sets out that the certificate issued to the certified auditor by the Ministry of Finance may be obtained by a person who:
- Passed examination for the title of certified auditor
 - Has a university degree
 - Has at least three years of practical experience in auditing, with at least two years under supervision of licensed certified auditor
 - Has no ban on issuing of new license, in case that the license has been withdrawn
 - Has no criminal conviction
77. **The Chamber offers examination through a two level system as defined by the Article 2 of the Program for taking of examinations to acquire the title of professional Certified Auditor; however, neither the Chamber nor any other institution offers any sort of preparatory training for candidates who wish to take the professional examination. The**

⁵⁹ Source: Student records database, Faculty of Economics, University of Belgrade

test of theoretical knowledge included in the examination is prescribed by the Audit Law (2013) and is in line with the requirements of the Audit Directive. The examination is organized as a two level system, but there is no prescribed order of taking the examination. However, there are no courses or materials to assist candidates in preparing for the examination. It is important to provide such training and preparatory materials, either through the Chamber or an agreement with the University or other third party, accredited by the Chamber to this end. The following table lists the courses that individuals must complete for a title of Certified Auditor.

Table 5: Courses that individuals must complete for a title of Certified Auditor.

Level 1		Level 2	
1	Theory and principles of accounting	1	Law for certified auditors
2	Financial reporting framework and IFRS	2	Tax systems
3	Financial analysis	3	Business information systems
4	Managerial Accounting	4	Microeconomics, general and financial economics
5	Risk management and internal control	5	Financial mathematics and statistics
6	Audit theory	6	Financial management of undertakings
7	Audit methodology		

78. **The coverage of Ethics and Independence is required both by the Audit Law (2013) and Audit Directive.** The Chamber does include Ethics and Independence under the Audit Theory course, but needs to ensure that it is covered sufficiently in the examination.
79. **The Program for taking of examinations details subjects and the content of the subjects.** There are no learning outcomes prescribed for the exams as required by International Education Standards 2, 3 & 4 (all covering Initial Professional Development, focusing respectively on: Technical competence; Professional skills; and Professional values, ethics, and attitudes). IES were recently amended and these standards became effective in July 2015. As a result, in order to conform with the revised standards, the Chamber should identify the subject specific skills that a student will gain as a result of the professional training program. The levels of each part of the professional training must be identified to show the level of teaching and learning and the assessment instruments.

The Serbian Association of Accountants and Auditors

80. **The Accounting Law (2013) does not regulate the accounting profession and does not include any educational requirements for accountants.** The qualification of the SAAA is not recognized under the Accounting Law. However, SAAA developed and operates a professional accountancy education program, which contributes to the development of the accountancy profession in Serbia.
81. **The SAAA has its own professional syllabus and examination core program is defined at three levels:** (i) Accountant, (ii) Certified Accountant (CA) and (iii) Certified Public

Accountant (CPA). The following table lists the courses that individuals must complete for each particular stage.

Table 6: SAAA syllabus

Accountant		Certified Accountant		Certified Public Accountant	
1	Recording Financial Transactions	1	Preparing Financial Statements	1	Audit and Assurance Services
2	Information for Management Control	2	Financial Information for Management	2	Performance management
3	Preparing Financial Statements	3	Managing People	3	Strategic Business Planning and Development
4	Cost Accounting	4	Information Systems	4	Complex Corporate Reporting
5	Audit procedures	5	Corporate and Business Law	5	Strategic Financial Management
6	Tax System	6	Tax System		
7	Managing People and Systems	7	Financial Management and Control		
8	Financial Statements Compilation	8	Financial Reporting		
9	Planning, Control and Performance Management	9	Audit and Internal Review		

*Qualification as a Certified Accountant is a necessary condition for acquiring the Certified Public Accountant certification.

82. **SAAA syllabus is based on the ACCA professional syllabus.** Periodical reviews and comparison with ACCA are performed and the syllabus is updated. The most recent updates were done in February 2015.
83. **SAAA recognizes ACCA and CPA qualifications after tax and law examination.** SAAA also has standing arrangements with a number of PAOs from the region for recognition of qualifications.
84. **Number of students taking SAAA examinations and average age of qualification, as of December 31 2014:**

Table 7: Number of SAAA Exam Takers and Average Age of Qualification

Category	Number	Average Age at Qualification
Accountant	853	24
Certified Accountant	2341	28
Certified Public Accountant	80	34

85. **Candidates need at least three years of practical experience in accounting which can be obtained before, alongside or after a program of study.** Practical experience is verified by both employer and mentor/supervisor. SAAA monitors practical training.
86. **Available resources in Serbia should be coordinated and marshalled for a strong and sustainable professional education and training system.** The Chamber may wish to consider giving some recognition to the exams of the SAAA, if satisfied with their scope and rigor. SAAA qualification as well as their assessment methods should be reviewed and appropriate exemptions for SAAA students awarded. This would allow members of the SAAA to become certified auditors after taking additional Chamber exams. A cooperative and collaborative relationship between the Chamber and the SAAA could help promote continuing improvements in the accounting and auditing professions in Serbia.

Continuing Professional Development

87. **Licensed certified auditors are required to maintain their competence through participation in the Continuing Professional Development Program (CPD).** The structure, content, and organization of the CPD program is managed by the Chamber of Authorized Auditors. The Audit Law (2013) specifies that in addition to the Chamber, the following institutions can offer CPD, with prior approval of Public Oversight Board: academic institutions, professional bodies, audit firms as well as other legal entities that possess adequate technical, organizational and administrative capacities.
88. **The Chamber offers CPD through various forms of professional and educational activities.** This is achieved by organizing symposia, workshops, panels and roundtables in accordance with the Chamber's annual program. The approval for the CPD program organized by the Chamber must be given by the Ministry of Finance. The Chamber uses methodology for identifying topics via a questionnaire to members on important topics they would wish to see covered in CPD events.
89. **The minimum for licensed certified auditors is 120 hours of CPD in the period of three years.** Recognized CPD units include attending or giving training programs, publishing research, and reading professional literature. Sixty hours of the required CPD must be earned through attendance at workshops or seminars, and the remaining 60 hours the licensed certified auditor can earn individually through activities such as attending international symposiums or reading professional literature. These requirements appear consistent with international standards of good practice.
90. **The Accounting Law is silent on the CPD requirements for accountants.** However, CPD is mandatory for SAAA members. The SAAA applies combined input and output based approach. Under the input based element, all SAAA members are required to complete at least 120 hours of relevant professional development activity in each rolling three year period, of which 60 hours is structured. Out of 120 hours, at least 20 hours must be completed in each year. Under the output- based element, SAAA members must demonstrate the development and maintenance of appropriate professional competence by providing verified evidence. Again, these requirements appear consistent with international good practices.

91. **The Chamber has established a process to monitor whether the licensed certified auditors meet the CPD requirement.** At the end of each training/workshop certificates are issued confirming attendance and number of hours. In the case of individual work, written statements confirming the work completed and number of hours spent must be submitted to the Chamber. The Chamber reserves the right to require additional information relating to the evidence submitted.
92. **If an auditor has not met the CPD requirement for the three successive years, the Ministry of Finance will not renew the license.** However, there is a weak link within the Audit Law (2013), in that if an auditor does not meet the CPD requirements, he could wait for his license to expire and then simply apply for a new audit license and get one even without fulfilling the CPD requirements. This loophole in the law should be addressed through new legislation.

E. Monitoring and Enforcement of Accounting and Auditing Standards

General Corporate Sector

Monitoring and enforcement by the Ministry of Finance

93. **Serbia does not perform direct regulatory review of the quality and reliability of individual corporate financial statements, and may not be able to do so in the foreseeable future.** Neither the Ministry of Finance, nor the Securities Commission, nor any other public body currently has the capacity or resources to monitor the quality of general corporate financial statements. Although tax inspectors may review corporate financial statements, they do so with a view of assuring compliance with tax law rather than conformance to IFRS or other governing accounting standards. In addition, in general, tax inspectors have a poor understanding of IFRS. Given current budgetary realities in Serbia, it may not be realistic to expect that the country could in the foreseeable future implement a regular program of regulatory review of corporate financial statements, along the lines of the work performed, for example, in the U.S. by the Division of Corporation Finance of the Securities and Exchange Commission. Serbia might be able to provide some limited additional capacity for identifying egregious departures from accounting standards by training tax inspectors in IFRS and IFRS for SMEs, but given the different focus of tax inspections, the effects are not likely to be substantial.
94. **Serbia has established a National Accounting Commission to identify emerging issues of general concern, but the body does not have the capacity to perform a regulatory monitoring function for individual financial statements.** The Commission was established by the 2006 Accounting and Audit Law and continues to operate in accordance with the 2013 Accounting Law. The main purpose of the National Commission is to serve as an advisory body to the Ministry of Finance. Its main tasks are to:
- Monitor the application process of IAS, IFRS and IFRS for SMES
 - Provide opinions to the Ministry of Finance regarding translation of those standards
 - Provide solutions for potential problems that may occur in the process of application of those standards in practice, and

- Monitor the application process of EU Directives relating to accounting and propose adequate solutions for national legislation.

95. **The Commission includes stakeholder representatives.** The members of the National Commission for Accounting are representatives of the National Bank of Serbia, Securities Exchange Commission, Tax Administration, Ministry of Finance and the accounting professional body (SAAA). There is no representative from academia, even though until recently they had their own representatives. The Ministry may wish to consider including representation from academia on the Commission in the future.
96. **The Commission’s work should be more transparent and publicized.** The MoF has emphasized the importance of the National Commission and stated that the Commission provides to the Ministry independent, significant and constructive expertise. However, during the ROSC interviews, some other stakeholders were not aware of the Commissions’ existence. The MoF should consider making the work of the Commission more transparent and publicized. As one measure, the Commission’s half-year and annual reports should be published on the Ministry’s web site.

Monitoring and enforcement through civil and criminal litigation

97. **The threat of civil litigation and criminal prosecution provide very weak incentive for reliable financial reporting.** Although investors or others who suffer losses because of faulty financial reporting or deficient auditing in theory may seek redress in civil lawsuits, such suits appear to be extremely rare, indeed virtually unheard of, perhaps because of concerns about the capacity and reliability of the court system. Knowledgeable stakeholders agree that the threat of civil suit provides very weak incentive for conformance with IFRS and other reporting requirements. Similarly, criminal prosecution is in theory possible for falsification of corporate financial reporting and knowing acquiescence by auditors, but appears to be essentially unknown as a stand-alone basis for criminal prosecution.⁶⁰ Account falsification charges might be brought as part of a broader case for embezzlement or misappropriation, but are seldom or ever brought on their own. Moreover, there is no prosecutorial body with specialized experience in financial reporting issues, and prosecutors and other law-enforcement officials with more generalized responsibilities likely have insufficient expertise to handle matters involving application of IFRS. Thus, the system for enforcing financial reporting rules may not conform to the *acquis*, which requires penalties to be effective, proportionate, and dissuasive.⁶¹

Monitoring and enforcement through the external audit and audit quality inspections

98. **The external audit, and quality assurance and discipline for external auditors, appear to be the primary mechanism for assuring conformity of financial reporting with**

⁶⁰ An accountant or auditor can be sanctioned in accordance with the Criminal Code of the Republic of Serbia (“Official Gazette of the Republic of Serbia”, No. 85/05, 88/05, 107/05, 72/09, 111/09 и 121/12), if he or she “fabricates documents with false contents, false balance, estimates or through interventions or concealing of facts, falsely represents the status or movement of assets and business results, thereby misleading management authorities of the company or another legal person when taking decisions relative to management, or places the company or other legal person in a more favorable position when obtaining funds or other benefits that otherwise they would not be entitled...”

⁶¹ Article 51 of the new Accounting Directive.

governing accounting standards. The lack of direct regulatory monitoring and enforcement for preparers of financial statements leaves external auditors with an outsized role in Serbia in assuring reliable reporting and conformity to IFRS and other governing rules and standards. Thus, the quality of external auditing—and of quality assurance for auditors—are particularly critical for the reliability of financial reporting in Serbia.

99. **Serbian law vests the Chamber with the authority and obligation to perform quality assurance for audit firms.** Under the 2013 Audit Law, the Chamber must review reports and other data that audit firm and independent auditor are obligated to submit and perform quality control of works of audit firms and independent auditors that encompasses:
- Review of the internal quality control system of the audit firm and independent auditor (checking existence and content of QC manual/procedures, whether they comport with ISQC1 requirements, as well as application in practice);
 - Control to assess whether the licensed authorized auditor, independent auditor and audit firm comply with the independence requirements with respect to the legal entity, subject of audit;
 - Control to establish whether they are performing audits in compliance with the International Standards on Auditing;
 - Assessment of quality in respect of the resources engaged for individual audit engagement (composition of audit team and number of work hours spent);
 - Review of contractual audit fees and respective calculation; and
 - Quality control of work performed by licensed authorized auditor (review of quality of the individual audit engagement performed at least for one legal entity-subject of audit).
100. **The Chamber must perform audit quality control (QC) of audit firms and independent auditors at a minimum once every six years (or once every three years for auditors of PIEs).** QC may be performed more frequently, especially in the case of audit firms or independent auditors that were the subject of measures ordered by Ministry of Finance based on the Chamber’s findings arising from regularly performed QC. The Public Oversight Board may propose to the Ministry of Finance to issue an order to the Chamber for extraordinary quality control of an audit firm if the NBS or the Securities Commission provide notification that there is reasonable doubt that the audit firm does not perform in accordance with the Auditing Law and ISAs.
101. **Serbia has made a promising beginning in audit quality assurance.** The Chamber has implemented a program of audit quality inspections in response to the power and obligations vested by the 2013 Audit Law. Especially in comparison to programs in other countries in the region, Serbia’s system of audit quality control shows great promise. The Chamber has been able to raise sufficient funds to hire well-qualified staff. The inspections team is currently composed of two inspectors who each have more than eight years of audit experience with “Big Four” firms. One of the inspectors has significant experience working in the internal quality control function of a “Big Four” firm. The inspectors are guided by a written methodology that includes references to governing audit and quality assurance standards. The inspectors report to Quality Control Committee of the Chamber, which at the time of this assessment included members who were well-qualified as current practitioners in audit, but of course were not independent of the profession. As of this assessment, the quality control inspectors have completed one cycle of “pilot” inspections and one round of regular inspections.

102. **The quality assurance program needs better capacity to identify, assess, and respond to risk.** The quality control inspectors performed their first two cycles of inspections without any written guidance or methodology for selecting which audit engagements to review for the auditors under inspection, and did not attempt to select audits for review based on risk. Indeed, in the first two cycles, the inspectors did not review any audits of regulated entities such as financial institutions, even though they could present substantial risk. Officials from the Chamber acknowledged that selections of audits for review should be risk-based, and should be guided by a written methodology, but explained that the Chamber determined that the inspectors and the program should accumulate some experience through several cycles of inspections before attempting to develop and implement a methodology for risk-based selections. This is a reasonable strategy for a fledgling program, but underscores that substantial risks of deficient auditing may go unaddressed until the quality assurance-team develops and implements a risk-based selection process, which should occur as soon as possible. A well-developed process should be able to help identify elevated risks for both particular audited companies and particular audit areas (such as revenue recognition, valuation of assets, and so forth). The risk identification methodology should be regularly updated and informed by analysis of evolving economic and market conditions, changes in governing accounting standards, and other factors that may increase the risk of faulty reporting and audit failure.
103. **The quality assurance program needs better capacity to review specialized audits, such as for financial institutions.** As of the time of this assessment, the staff quality control inspectors at the Chamber were well-qualified in general corporate auditing but did not have significant experience in auditing of financial institutions or with other specialized audits. It may be uneconomical for the Chamber to attempt to hire full-time staff with specific background in the variety of audits for which specialized knowledge and experience may be critical for adequate review, such as audits for banks, insurance companies, companies in extractive industries, pharmaceuticals companies, software companies, and others.
104. **An alternative may be to develop a pool of specialized experts, who may be current practitioners as long as they and their firms have no connection to the audit they will review, to assist in particular inspections of specialized audits.** Adequate procedures would have to be developed to assure that conflicts of interest are avoided. Further, funding could be an issue. However, during this assessment, representatives of all “Big Four” firms as well as other international network firms who were interviewed expressed a willingness to support additional fees as members of the Chamber to assure that the Chamber will have adequate funding to handle review of specialized audits. In addition to finding appropriately experienced personnel to assist in reviews of specialized audits, the Chamber will need to develop written guidance and methodology for these reviews, most critically for reviews of audits of financial institutions.
105. **The quality assurance program needs better enforcement backing.** In the end, a quality assurance system cannot be effective unless the regulated entities know that there can be serious consequences for failure to cooperate with inspections, failure to address inspections comments seeking improvements, or failures to perform adequate auditing or breaches of auditor integrity that are so egregious that the regular inspections process is insufficient to protect the public. The structures, resources, and legal authority for auditor discipline in

Serbia are currently inadequate, particularly in light of the outsized role that auditing plays in assuring reliable financial reporting.

106. **The Chamber should make structural changes to handle investigations and discipline.** While ideally, investigations into possible auditor misconduct would be entirely separated from the inspections function, as a matter of resources, the Chamber may need to have its inspectors also investigate the facts for potential disciplinary proceedings, at least in the short and medium term. However, the Chamber should consider developing a specialized committee or clearly vesting an existing committee with responsibility for considering and adjudicating disciplinary charges against auditor. That committee should be separate and should operate independently from the committee responsible for investigating and recommending disciplinary charges, to assure the appearance and the reality of fairness and objectivity in assessing the evidence, determining responsibility, and gauging appropriate penalties where appropriate.
107. **The law provides for sanctions against auditors for deficiencies.** The Ministry of Finance can impose fines for violations of the 2013 Audit Law. Under current law, for deficiencies found through the Chamber's quality assurance reviews, depending on the nature of the violation, the Ministry of Finance on the proposal of the POB may issue an Order (by Decree) requiring:
- elimination of irregularities (for certain violations);
 - improvements of the internal (firm's) audit quality control system;
 - improvements of the internal oversight procedures for handling confidential data
 - other measures necessary for compliance with Auditing Law, the International Standards on Auditing, and other audit profession rules.
 - withdrawal of license for performing audit services
108. **Sanctions law should allow flexibility.** The law should allow for flexible sanctions such as requirements to obtain particular additional professional education, requirement for review of the auditor's work by another qualified auditor over some time period, limitations on the auditor's practice (such as restrictions from auditing financial institutions, or restrictions from soliciting new clients for some time period), and other measures, with power to suspend or bar the auditor if these measures or conditions are not satisfied. Flexible authority to fashion sanctions or remedial measures can substantially enhance the regulatory body's ability to improve audit quality.
109. **Both quality assurance and enforcement need to be more independent of the profession, at least for PIE auditors.** Under the 2014 EU Audit Directive and Regulation⁶², the audit oversight authority may not delegate the quality assurance and disciplinary functions for auditors of PIEs to a professional body; that authority must rest with the independent oversight authority. In addition to the need to conform to this requirement of the *acquis*, more independence for these functions is needed to bolster the appearance and reality of a rigorous and reliable system. The public is likely to perceive that practicing auditors may not have sufficiently strong incentive to call out their fellow practitioners for audit deficiencies in the inspections process, due to both professional solidarity and deference and to the concern that the practitioner's own conduct might have been deficient in similar ways.

⁶² Regulation 537/2014/EU, referenced in this Report as "the Audit Regulation."

110. **Some measures are already in place to promote independence of the Chamber's inspections staff, but more are needed.** Currently, decisions regarding hiring, firing, and compensation of the Chamber's quality control inspectors are subject to review by the Public Oversight Board, a majority of whose members must be independent from the profession. Furthermore, inspections reports and disciplinary decisions of the Chamber are subject to review by the POB. Thus, the quality control function at the Chamber has a significant degree of independence from the profession. However, in keeping with the requirements of the *acquis*, and to assure the public of full independence, the quality assurance and disciplinary functions will eventually need to be transferred to the POB, at least with respect to auditors of PIEs. A significant concern that should be considered is whether compensation for inspectors would be more restricted at the POB due to civil service or other requirements, and whether the POB could pay inspectors adequately to attract the kind of well-qualified and experienced former practitioners who currently serve as inspectors for the Chamber. Ideally, depending on their willingness and record of good performance, one or both of the same inspectors might eventually be transferred to the POB.
111. **The Public Oversight Board should be vested with more legal power, more funding, and full independence from the profession.** Currently, the Public Oversight Board has the power to oversee the functions of the Chamber, but does not perform inspections, disciplinary activities, or other such activities itself. To comply with the *acquis*, the POB will need to be adequately funded and authorized to conduct these activities, at least with response to auditors of PIEs. In addition, under the 2013 Audit Law, a majority of the Board must be made up of non-practitioners, and currently the POB includes members who are currently audit practitioners. To comply with the 2014 Audit Directive and Regulation, the composition of the Board, and the law governing composition, will have to be changed to include only non-practitioners.

Financial Sector

112. **The NBS has a dedicated department for bank supervision.** There are around 100 employees in NBS's Bank Supervision Department, which is also in charge of supervising leasing companies. The department for supervision of insurance companies, which also covers pension funds and pension funds management companies, has 56 people on staff. According to the NBS, in cases of banks that lost their licenses over the previous several years, there were no cases of such sanctions being linked to financial reporting weaknesses, but rather in most cases they related to the capital adequacy requirement.
113. **The NBS performs both off-site and on-site supervision of banks and non-bank financial institutions, and supervision includes assessment of financial reporting and auditing.** According to both the Department for Bank Supervision and Department for Supervision of Insurance Companies, after annual financial statements and audit reports of banks and insurance companies are collected, analysis of financial statements and audit findings represent an important part of off-site review and one of the factors in determining annual plans for on-site supervision, which are risk-based. It is the NBS's objective to perform on-site supervision of each bank at least once every three years, but the NBS has experienced capacity constraints, and this objective has not been achieved. There is no rule for frequency of on-site supervision for insurance companies, and it depends on assessment of risks. However, in the past, the usual frequency in practice was to perform on-site supervision every three to four years.

114. **A small, specialized group within NBS will actively interact with external auditors.** As of the time of interviews for this assessment, the group consisted of a supervisor and three new employees expected to begin work immediately. The group is to meet with banks and their auditors both before and after the financial statements and audit reports are issued. The group will perform functions including obtaining the audit plans and audit risk analyses and commenting on them where appropriate; obtaining and analyzing the audit reports and management letters once they are available; and asking follow-up questions where needed to clarify issues. Developing this expertise and embedding it in the supervisory process will take time.
115. **The general perception is that the quality of financial reporting of financial institutions, in particular banks, is on average better than in other sectors, but the risk is higher and may not be fully addressed.** The apparently better general quality of reporting for banks in comparison to other sectors is likely a result of (i) more stringent requirements imposed on those institutions by their regulators, in the areas of reporting, auditing, internal controls, internal audit and corporate governance in general and (ii) regular supervision performed by the NBS. However, it cannot be concluded with confidence that the general quality of reporting and auditing for financial institutions is adequate in light of the elevated risk these institutions present to stakeholders and the general public. Concerns arose when a partly state-owned bank went into receivership in late 2011 after receiving an unmodified audit opinion on financial statements that reported positive financial performance and sufficient equity. Although charges were never brought, and this Report does not purport to find or allocate fault, these events have left lingering concern about the quality of reporting and auditing for banks, and the NBS has increased its capacity to monitor auditing of financial institutions in response.
116. **The great majority of audit opinions on financial statements of banks for 2013 were unmodified (clean).** This also largely applies to non-bank financial institutions, and contrasts with other sectors of the economy, where the percentage of modified audit opinions appears to be substantially higher. The audited financial statements are in general submitted to regulators within prescribed deadlines.
117. **The National Bank of Serbia through its Department for Bank Supervision provides a list of audit firms acceptable to audit financial statements of banks, which currently includes six audit firms.** Audit firms can request to be considered for inclusion on the list. Nevertheless, while there are specified criteria which a firm should meet in order to be included on the list⁶³, it appears to be a mostly formal process and there is no methodology for a more thorough capacity assessment of a firm, nor does the NBS have capacity to perform such an assessment.
118. **The Department for Supervision of Insurance Companies does not provide a list of acceptable audit firms to audit financial statements of insurance companies, but rather pre-approves the auditor selected by the insurance company.** There are no established criteria how adequacy and capacity of audit firms are assessed in that process, but the NBS asserts that basic information on capacity is reviewed and a proposed audit firm would be rejected if it had an insufficient number of employees or inadequate experience—

⁶³ Decision on external audit of banks (Official Gazette 18/2015)

circumstances that so far have not arisen, according to Department for Supervision of insurance companies.

119. **The NBS does not have the capacity to perform quality-control reviews of auditors and relies on the Chamber to do so.** Staff of the NBS made clear that they use and rely upon the audit reports provided for financial institutions, but do not have the capacity to perform quality assurance on audit firms, and rely upon the Chamber's quality assurance program. However, as previously discussed, the Chamber does not yet have adequate capacity to review specialized audits, including those for financial institutions, and has excluded those audits from its reviews in its first two inspections cycles. Further, the Chamber currently has no methodology to guide inspections of audits for financial institutions, in addition to the lack of staff experienced in this area. Once the Chamber begins reviews of audits for financial institutions, it is likely to take some time for its team to become proficient in performing such reviews and to develop and adapt adequate methodology. Thus, audits of financial institutions present a significant risk that has not yet been adequately addressed by Serbia's systems of monitoring and enforcement.
120. **The Securities Commission monitors compliance with legislation by the public entities, as well as financial institutions for which it is the regulator.** The Law on Capital Markets delegates supervisory functions to the SEC. In performing this role, the SEC is entitled to require from public entities any information and documentation it deems needed. It is authorized to apply measures and sanctions in case of non-compliance or irregularities, including exclusion from listing or open market. Equally, the SEC supervises investment funds, broker-dealer companies and stock-exchange and imposes measures and sanctions in cases of non-compliance with applicable regulation.
121. **The Securities Commission prescribes a list of acceptable audit firms for public entities, but criteria for inclusion does not appear to be sufficiently strict to add value.** There are 14 firms eligible to audit all participants (listing, open market and MTP), 11 firms accepted as auditors of public entities included in open market and MTP, and 10 more approved for auditing of companies on MTP only. There is no established methodology for capacity assessment of audit firms included in the list. The list applies to audit of investment funds as well. Furthermore, representatives of the Securities Commission acknowledged that they do not have the capacity to monitor or assess the quality of corporate financial reporting and auditing.

SOE Sector

122. **SOEs submit their annual business plans (budgets) to the Ministry of Economy for review and approval.** The ultimate approval of the annual budgets is granted by the government. Although the government (Ministry of Economy and ministries relevant for the industry in which SOE operates) is responsible for monitoring the submission of business plans and financial statements of SOEs, the monitoring is mainly focused on whether SOEs follow formal financial guidelines and principles, not on the quality of budgeting, reporting and management process. The SOEs also submit quarterly reports on the realization of their business plans to the Ministries of the Economy, Labor, and the relevant line ministries.⁶⁴

⁶⁴ Article 52 of the Public Enterprise Law.

The Public Enterprise Law does not require a review of the quality of financial reporting of SOEs, their proper application of IFRS, or the quality of audits. As a result, it appears that no government body performs an analysis of the financial statements and auditors' reports. Furthermore, there appears to be no follow-up on issues raised by external auditors in their audit reports of SOE financial statements. Thus, if the auditor's opinion is qualified or some disclosures are improper, there appear to be no follow up procedures or consequences for management.

123. **The Ministry of Economy is charged with performing KPIs analysis.** However, there appear to be no consequences if SOEs underscore on certain KPIs. The MoE appears to focus mostly on its formal legal obligations in terms of monitoring function (see Appendix) and has limited staff, resources, and capacity to perform actual analysis. The main focus of the MoE's analysis appears to be the yearly results and profit distribution of SOEs.
124. **The highest level of monitoring takes place during annual budget drafting.** At that time, the MoE and other relevant ministries perform deeper analysis of certain positions and ask for corrections, before final approval. In later stages, the controlling focus is whether actual is in line with budget in terms of costs. There is a lack of real performance analysis and revenue analysis. Usually instances of exceeding budget constraints are pre-approved or resulted from some extraordinary event, therefore follow up and potential sanctions are rare. Overall, there appears to be a need for some body within the government to be provided with the authority, capacity, and responsibility to perform more detailed and substantive monitoring of financial statements of SOEs.
125. **State owned banks (SOBs) are monitored by the Ministry of Finance.** The role of the Ministry of Finance in monitoring SOBs is similar to the role of the Ministry of Economy in monitoring SOEs. A new risk analysis unit within the MoF has some duties for SOE oversight.
126. **Regardless of the legal form of SOEs, they virtually all have a weak corporate governance and financial reporting structure.** SOEs are under strong political influence associated with the decision making process in order to increase employment and keep output prices at a relatively low level to protect "social" categories.
127. **According to the governing Rulebook, SOEs are obliged to have in place the internal control processes and procedures.** Although these procedures are formally followed and the required reports are prepared on annual basis, the effectiveness of these procedures is questionable, since there is typically no adequate testing and controlling mechanism for internal controls. The Supervisory Board is responsible for establishing and monitoring the internal controls, according to both the Law on Public Enterprises and the Law on Companies. Independence of the internal control or internal audit functions is also questionable, although there are formal rules and procedures. It is not common for a breach of internal controls to be identified and addressed with any meaningful consequences. One example when follow-up does occur is with cost control mechanisms and cases when costs exceed budget level without authorization.
128. **In addition, the quality of financial reporting in SOEs is lower than in private companies.** SOEs are subject to the Law on Accounting like any other legal entities and must

apply IFRS or IFRS for SMEs depending on their size. Although each SOE has its specific characteristics, there are some recurring issues in SOE financial reporting. For example:

- poor methodology and calculations of transfer pricing impacts the measurement and recording of intercompany transactions
- deficient valuation and impairment of fixed assets and inventories
- questionable classifications of assets (under construction vs. in-use)
- biased and inconsistent provisions and penalty interest calculation on outstanding and overdue trade receivables
- insufficient or inadequately supported provisions for contingencies and management estimates
- low quality of specific disclosures related to business and financial risks
- low quality of auditing driven in part by low audit fees

129. **The monitoring of accounting and financial reporting should be enhanced to promote better quality reporting by SOEs.** Monitoring should be improved through scrutinizing financial reporting and internal controls in SOEs by the Ministry of Economy. SOEs would receive feedback on which measures to take in order to correct and improve internal controls. Currently, there appear to be no consequences in cases where the internal controls fail or there are occasional breaches of procedures. Although there are still many SOEs that could be categorized as potentially good targets for the privatization, numerous SOEs remain under the state majority shareholding. Therefore, increasing their operational efficiency and implementation of adequate financial reporting, monitoring and enforcement should be a priority.
130. **Consider consolidation of SOE financial statements at the state level.** This could improve the quality of the financial reporting at SOEs. There would be a requirement that accounting standards are uniform and consistent across SOEs in order to enable consolidation. This could resolve some inconsistency and issues regarding classifications, valuations and provisions. Also, the state would have a global overview on SOE performances and follow up actions could be better managed.

F. Role of Women

131. **While no information specific to accounting programs is available on a gender-disaggregated basis, more women enroll in university than men.** Serbia, similar to other countries in the Western Balkans, inherited only moderate gender imbalances in human capital endowment. This trend has continued since the transition, and enrollment rates are similar between girls and boys, and more women enroll in tertiary education overall. Gender-disaggregated data for students enrolled in the Accounting Faculty of the University of Belgrade were not available; females represent just over one-third of all professors.
132. **Women participate at lower rates in the labor market and earn lower wages than men in the private sector, when taken as a whole.** The female employment rate of 34 percent in Serbia trails that of men. Women are also underrepresented in the business world and in politics, with men comprising 71 percent of company owners and holding over 80 percent of ministerial positions in government. As a rule, women with a lower level of educational attainment are more likely to be unemployed. Interestingly, however, this trend is reversed at higher levels: university-educated women have higher employment rates than men, and

women with a master's degree are employed at a rate 21 percent higher than men. Higher paid women and more educated women see minimal gender wage gaps. Among low-skill occupations, women earn wages more than 20 percent below male wages. The exception is the public sector, where women do not face significant wage gaps.

133. **When considering the financial services industry specifically,—including accounting and auditing—women are in a more equitable position.** The majority of authorized auditors registered with the Chamber are women: 57 percent. There are no data on the number of audit firms owned by women or the number of female partners in audit firms. However, the ROSC team held informal discussions with female audit partners of international network firms, who believe that women in the financial services industry tend to enter the profession at relatively equal rates, or higher rates, than men. They also mentioned that career progression in the audit profession also tends to be equitable, and policies relating to work-life balance issues—including maternity leave—were adequate and have allowed them to progress in their careers while also raising a family. The exception is when it comes to business development, where women are seen to be at a significant disadvantage, since business relationships and deals tend to be developed in environments that are not women-friendly (late night meetings at bars, invitations to attend soccer matches, etc.). However, this seems to be changing as well; some clients—particularly international ones—often have women in senior management positions and they, too, do not feel comfortable closing deals in male-dominated environments. Thus, the comparative advantage that men currently have when it comes to business development seems to be declining slowly over time, at least when it comes to the international audit firms that serve foreign clients.

III. Accounting Standards as designed and practiced

A. Standards Gap

134. **The lack of continuously available up-to-date translations creates a gap in accounting standards prescribed by the Law on Accounting.** In the past, the usual frequency of publishing translations of IFRS (which was in application for all legal entities under the old Law on Accounting and Auditing) was every several years, which resulted in a time lag and gap between IFRS as published by the IASB and translated versions applied in Serbia. This created problems in defining the accounting framework for preparers of financial statements, but also for auditors in expressing their opinion on financial statements. Eventually as a response, preparers and auditors defined the accounting framework as “legislation and regulation prescribed in Serbia,” thus rightly abandoning assertions that financial statements were prepared in accordance with IFRS, as actual standards applied departed from full IFRS as published by the IASB.
135. **The most recent Serbian translation of IFRS refers to the 2013 version of the standards (published in 2014 in Serbia); a sustainable mechanism for translation does not exist at present.**⁶⁵ Therefore, the latest official translation includes the conceptual framework and IFRS 10, 11, 12 and 13. IFRS for SMEs has been translated and published in 2013⁶⁶. Both

⁶⁵ Official Gazette 35/14

⁶⁶ Official Gazette 117/2013

translations are applicable starting with 2014 financial statements. The Rulebook⁶⁷ on financial reporting of micro and other legal entities was published in 2013 and amended in 2014. However, Serbia needs to develop a sustainable mechanism to fund and assure performance of timely translations in the future. The latest published translated version of IFRS for SMEs is 2009.

B. Compliance Gap

136. **There are some cross-cutting weaknesses in application of financial reporting standards.** Based on discussions with the auditors with regard to the main issues in financial reporting identified with their auditees and review of a limited number of audit reports, it appears that deficiencies in implementation of financial reporting standards persist throughout sectors and different sizes of companies. This primarily relates to experiences with financial statements up to 2013, therefore to challenges in application of IFRS as those were in application for practically all entities up to the new legislation in 2013. Similarly, translation of IFRS numbers 10-13 was published in 2014, and that is the beginning year of application for those standards. Recurring issues are described in the table below.

Table 8: Recurring Issues in Application of Accounting Standards

Issue	Nature of the Problem	Relevant Standards
Unrecorded liabilities	Frequently obligations of an entity with probable outflow and for which reliable estimates can be made, are not recognized as provisions, therefore resulting in understatement of liabilities and overstatement of reported results.	IAS 37: Provisions, Contingent Liabilities and Contingent Assets
Overvalued inventory	Valuation of inventories represents an issue in many cases, reflecting inappropriate application of the measurement rule requiring reporting at lower of cost or net realizable value, in particular related to determining net realizable value. This results in most cases in overstating assets and results of the entity.	IAS 2 – Inventories
Receivables heavily in arrears and overvalued	Carrying value of receivables includes in many cases debt which is over 180 days or in some cases 360 days old. This results in overstating assets and results. Provisions and write-off of bad and doubtful debt is defined by entity’s internal accounting policies and procedures, however those often appear either too flexible or not applied in practice. The accounting treatment of bad and doubtful debt is in many cases manipulated to achieve targeted net results, for either tax or other purposes.	IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors”, “IAS 39 – Financial Instruments: Recognition and Measurement” and superseding “IFRS 9 – Financial Instruments

⁶⁷ Rulebook on recognition, valuation, presentation and disclosures in separate financial statements of micro and other legal entities (Official Gazette 118/2013 and 95/2014)

Issue	Nature of the Problem	Relevant Standards
Impairment of assets	Entities only in rare cases assess indications for impairment of assets at the end of reporting period, or act upon any such indication in determining the asset's recoverable amount. This results in overstatement of assets and results.	IAS 36 – Impairment of Assets
Unrecorded obligations for employee benefits	Accounting and disclosure of employee benefits, defined as consideration given by the entity for services rendered by employees or for termination of employment, is not always in line with requirements. This in most cases understates liabilities or overstates result.	IAS 19 – Employee Benefits
Deferred tax assets and liabilities	There are frequently issues with measurement and recognition of deferred tax assets and deferred tax liabilities.	IAS 12 – Income Taxes

137. **A review of 20 sample financial statements performed during this assessment revealed additional recurring issues.** However, the conclusions should be considered 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, and the reviewer could not access the underlying accounting records to test reported figures. More information about the methodology and results of the review of 20 sample financial statements is provided in Appendix 4. Nevertheless, the review identified some common deficiencies in financial statements:

- Consistent with the information from interviews with auditors, some companies faced issues with the adequate valuation and impairment of fixed assets, inadequate or unrecorded provisions for contingencies (in many cases related to ongoing litigation), various accounting classifications rules, deferred taxation implementation and disclosures.
- In a few instances companies had not reconciled their receivables and liabilities with third parties.
- Some companies faced a going concern issue without adequate assessment or disclosure.
- There were different disclosures on which Law on Accounting was applied. In some cases, companies disclosed the application of the new Law on Accounting and provisions immediately entered into force. In others, companies disclosed the basis as the previous Law on Accounting and Audit. Although there are no significant and material differences from an accounting perspective between those two approaches, there could potentially be an issue of legal treatment of their financial statements.

138. **Lack of resources and capacity in the internal accounting function, bias, and poor internal controls are likely root causes of many recurring accounting deficiencies.** The quality of internal accounting personnel in Serbian enterprises varies considerably. Many businesses do have conscientious and adequately qualified internal accountants, but resources devoted to the accounting function are generally inadequate and, except in a few marquee companies with foreign investors or other differentiating factors, the quality of internal controls generally appear to be insufficient to assure reliable accounting and financial

reporting. In SOEs, the quality of internal controls is widely recognized as especially poor, thus increasing the risk of waste, fraud, and continuing losses to the State. Smaller enterprises that are dominated by an owner/manager sometime manipulate accounting accruals or otherwise produce biased reporting to satisfy lender criteria, reduce taxes, or further other goals inconsistent with reliable reporting. Many small and medium-sized businesses entirely outsource their accounting function, often to providers of doubtful competence and quality.

139. **Some members of the accounting profession have expressed concern that the new reporting framework creates compliance issues.** Some preparers of financial statements expressed the view that a decade of application of IFRS yielded some results in improvements in quality of financial reporting, and that the shift to IFRS for SMEs, although the latter is a simplified version of IFRS, could cause problems such as reclassifying certain positions properly and simply conforming to a somewhat different set of requirements. Another potential complication mentioned was with consolidation, for example in cases where a parent company is classified as large and a daughter company as small or micro, and therefore mandated to use a different set of accounting standards. Lastly, compliance threats could be observed in cases when legal entities cross classification thresholds for large, medium, small and micro enterprises, from one year to the next, thus changing the applicable accounting framework. However, most members of the profession interviewed expressed the view that the 2013 framework is a significant improvement from prior law.
140. **Further impediments to compliance included instances of delayed adoption of by-laws relevant for implementation of the law.** It was not a rare occurrence in the past that by-laws were passed towards the end of a year with the view of applying them for that very reporting year. This caused problems and imposed pressures on preparers of financial statements.

IV. Auditing Standards as designed and practiced

A. Standards Gap

141. **Serbia has officially adopted ISAs, but up-to-date translation of ISAs remains an issue.** The latest available official translation of ISAs dates back to 2012⁶⁸ under provisions of the old Law on accounting and auditing (2006). The translation related to *2010 Handbook of International Quality Control, Auditing, Review, Other Assurance and Related Services Pronouncements*. Application of the code of ethics in conducting statutory audits is stipulated in the Law on Auditing. IFAC's "Code of Ethics for Professional Accountants" which was translated in 2012 and related to the 2012 Handbook.
142. **Lack of translated standards impedes application in itself, although to a lesser extent comparing to lack of translated IFRS.** The audit community is in general more familiar with original standards as issued and demonstrates more capacity to follow the standards and any changes to those even in the absence of up-to-date translations. Such outcome does not undermine the need for translation of standards at all times, particularly to assure enforceability.

⁶⁸ Conclusion on establishing translation of International Standards on Auditing (Official Gazette 47/2012)

B. Compliance Gap

143. **Awareness of the purpose and added value of audit remains at a low level among preparers of financial statements.** The audit is largely perceived as a mere legal requirement for companies subject to mandatory statutory audit. Companies that are not mandated to have an audit by law have their financial statements audited only in rare instances, such as with a group or parent company request. The reasons for lack of interest in audit are many, including that banks do not put particular emphasis on analysis of financial statements in their lending activities, capital markets are underdeveloped, and investment opportunities are lacking.
144. **Fierce competition combined with lack of demand for quality of audits put pressure on audit fees and compromise application of ISAs.** Because of the above-mentioned lack of awareness of added value from audits and perception of auditing as only needed to fulfill legal requirements, potential auditees are generally willing and even eager to sacrifice audit quality for lower audit fees. This drives audit fees down, and imposes challenges on auditors in complying with ISAs as a logical consequence.
145. **The perception prevails that there are significant differences in application of ISAs across audit firms.** Discussions with auditees and a review of a sample of audit reports suggests that adequate application of ISAs varies significantly between firms depending on their capacity, audit methodology, and quality assurance and control mechanisms.
146. **There are some common challenges in the application of auditing standards.** Based on discussions with the audit community, findings of the quality assurance function of the Chamber, and the experience of some assessment team members with the Serbian audit market and practice, recurring issues identified relate to the following:

Table 9: Recurring Issues in Application of Auditing Standards

Issue	Nature of the Problem	Relevant Standards
Planning	Insufficient planning for an audit compromises its efficiency and effectiveness and negatively influences end results. Audit plans are often formalistic and only vaguely informative documents or they do not exist at all.	ISA 300 - Planning an Audit of Financial Statements
Understanding Client's Business/ Risk assessment	Lack of appropriate assessment of risks related to financial statements through understanding the client's business, including internal controls, results in an increased risk of not detecting material misstatements and expressing inappropriate audit opinion. Without proper risk assessment, the auditors are not able to identify primary risk areas and design appropriate audit procedures.	ISA 315 (revised) - Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment
Audit documentation, adequacy of audit evidence	Not all audit work is appropriately documented and audit working papers do not substantiate and fully support conclusions reached and the audit opinion expressed, which undermines credibility	ISA 230 – Audit Documentation, ISA 500 – Audit Evidence

Issue	Nature of the Problem	Relevant Standards
	of the audit. It is not always possible to confirm that there is sufficient appropriate audit evidence for conclusions reached.	
Overreliance on tests of details; failure to assess internal controls or consider control testing	Alternative audit responses to assessed risks, including testing of design and implementation of internal controls, are inadequately considered. Tests of details are used as the default primary audit procedure without documenting the process and rationale for such approach. This is in particular common to audit firms which do not use an audit software in their work.	ISA 330 – The Auditor’s Responses to Assessed Risks
Inadequate support of explanation of conclusions	Rationales, evidentiary basis, and reasoning supporting audit opinion are often inadequately explained and documented.	ISA 700: Forming an Opinion and Reporting on Financial Statements
Misuse of emphases of matter	“Emphasis of matter” paragraphs in the audit opinion and management letters are misused with the apparent objective of providing a more favorable audit opinion than warranted while including what should be modifications to the audit opinion as emphasis of matter or management letter points.	ISA 705: Modifications to the Opinion in the Independent Auditor’s Report, ISA 706: Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report
Sample testing	Audit firms that do not use an audit software apply non-statistical methods of sampling, without documenting the process and reasons how the sample was selected	ISA 530 – Audit Sampling
Quality control	Quality control mechanisms are either not established or not applied in practice with reference to various elements of the quality control system, such as acceptance and continuance of clients and engagements, human resources, engagement performance and monitoring. It should be noted though that each audit firm is mandated to deliver its Quality Control Manual to the Ministry of Finance.	ISQC 1 - Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements

V. Perception and Use of Financial Reporting

147. **The perceived quality and reliability of financial reporting are still relatively poor.** That perception somewhat varies by sector and size of an entity, with financial institutions, large

companies and those that are part of international groups being perceived to produce financial statements of better quality. Reasons for general issues with quality could be found in (i) lack of capacity of preparers of financial statements; (ii) the added value and significance of financial reporting not being fully comprehended (iii) general issues with the quality of auditing and awareness of its value and (iv) few users of financial statements, with banks not putting emphasis on analysis of debtors' financial statements, the low level of development of capital markets, and stagnating foreign and domestic investment in the wake of the 2008-2009 global financial crisis.

148. **Lack of use of financial statements impedes improvements in their quality.** The actual use of information from financial statements by economic decisions-makers creates an incentive for companies and their auditors to cultivate a reputation for reliability, so that companies can obtain loans, credit, equity investment, and other beneficial arrangements on favorable terms. The incentive to comply with governing laws and regulations is generally inadequate by itself to assure reliable financial reporting, because systems of monitoring and enforcement inevitably have resource constraints and therefore limited reach. Consequently, over the long run, widespread understanding and use of information from financial statements in economic decision-making is likely the single most important factor in fostering a reliable and sustainable system of corporate financial reporting, with its accompanying benefits to the broader economy.⁶⁹

VI. Areas for Consideration

149. **The legal framework needs further revision to comply with the *acquis* and strengthen its provisions.** Perhaps most significantly, conformity with the 2014 Directive and Regulation governing statutory audit will require changes in Serbian law to mandate full independence of all members of the POB from the profession and the POB's assumption of direct responsibility for quality assurance and discipline for auditors for PIEs. In addition, while reporting requirements for smaller enterprises have already been somewhat simplified, the current requirement to apply IFRS for SMEs is burdensome and unrealistic for small companies. In addition, Serbia may wish to consider whether the requirement to apply full IFRS for all "large" companies sweeps too broadly, and whether a narrower requirement might render compliance more realistic and cost-effective while still providing adequate information to users of their financial statements. In addition, the law should assure that an auditor cannot evade CPD requirements by allowing his license to lapse and seeking readmission.
150. **Both tertiary and professional education in accounting and auditing need further development.** University curricula should be adjusted to assure that undergraduates are trained in IFRS and ISAs, and that instruction includes a focus on practical application of governing standards. The education and examination process for statutory auditors should be reviewed and potentially revamped. Better linkage should be established between university educators and professional bodies and other members of the profession, to assure that

⁶⁹ E.g., Opper, Sonja. "Enforcement of China's Accounting Standards: Reflections on Systemic Problems." *Business and Politics*. Vol. 5, Issue 2, Article 2 (2003).

university students who focus on accounting and auditing will be adequately prepared to enter the profession. More focus on internal controls may be needed in professional training.

151. **The system of audit quality assurance and auditor discipline need to be bolstered.** While a promising start has been made in developing an effective system of quality inspections for auditors, the function needs to develop and implement a risk-based system for selecting audits to review, to assure that its limited resources are targeted as much as possible to areas of greatest risk. Some mechanism for providing expertise for review of specialized audits, most importantly of financial institutions, needs to be found and implemented. Proper written guidance and other tools must be developed and implemented for these inspections of more complex audits. Inspections must address the adequacy of auditors' assessment of internal controls in their audit risk assessment, and the adequacy of their communications with management and others charged with governance regarding control deficiencies, both to help assure the efficiency and effectiveness of audits, and to exert pressure on companies to improve their internal controls, which are generally of low quality.
152. **Other mechanisms to provide some monitoring and enforcement for corporate financial statements should be considered.** If funds cannot be found to create a regulatory group charged with routine review of financial statements to assess compliance with accounting standards, other approaches should be considered. Some training of tax inspectors in IFRS might provide at least some (very limited) additional monitoring of compliance, at least for egregious reporting abuses. When economic conditions improve and Serbia's fiscal condition strengthens, policymakers should consider investing in more direct mechanisms to monitor the quality of financial statements and their compliance with governing accounting standards.
153. **Supervision, regulation, and operation of SOEs need further development.** Ministerial officials charged with monitoring SOEs should be provided with sufficient capacity and tools to develop and implement procedures for assessing the quality of their financial reporting and responding to information contained within them, including accompanying audit reports. They should also be provided with sufficient capacity and tools to monitor and require improvements in internal controls. SOEs should be required to give due weight to audit quality, rather than just fees, in selecting and retaining auditors. When an SOE receives a modified audit opinion, regulators should assure that issues of deficient reporting are addressed. Improvements in the quality of reporting for SOEs could help in selling some of them on more favorable terms, and have ripple effects on the perception and use of corporate financial reporting in Serbia. Improvements in reporting are thus a key part of the agenda for reforming the SOE sector.
154. **Understanding and use of financial reporting should be promoted where possible.** Regulation, monitoring and enforcement alone will be inadequate to drive substantial improvements in the quality of financial reporting if companies perceive no value other than legal compliance, because there will never be sufficient resources for ubiquitous monitoring. If companies come to perceive that they will be more likely to obtain loans, credit, capital infusions, and other beneficial arrangements on favorable terms if they provide reliable financial reporting, they will have an incentive to invest adequate resources in accounting and auditing. In the long run, it is critical to raise awareness and encourage use of information from financial statements, while also working to augment the general reliability of financial

reporting, to reap the potential benefits to the broader economy. Policymakers should look for opportunities to explain the use and promote the value of financial reporting.

Appendix 1: Summary of the 2005 A&A ROSC recommendations and implementation

	Recommendation	Status
1	<p>Serbia should amend its laws and regulations in a manner that is consistent with the <i>acquis communautaire</i>, including:</p> <ul style="list-style-type: none"> • Application of IFRS by public interest entities but not SMEs • Alignment of the new Accounting and Auditing Law with the requirements of the Fourth and Seventh EU Company Law Directives. • Harmonization of financial reporting requirements with the Company Law and Contract Law. • Elimination of conflicting or ambiguous financial reporting requirements. 	<p style="text-align: center;">Partially implemented</p> <p>Serbia has amended its laws and regulations, however, they are still not fully in accordance with the latest EU Directives.</p> <ul style="list-style-type: none"> • IFRS is required for large companies. The definition of public interest entities may be too broad. SMEs are required to apply IFRS for SMEs. • The 2013 Accounting and Auditing Law is in line with the requirements of the Fourth and Seventh EU Company Law Directives, which was superseded by the new EU Directives on Accounting and Auditing. Serbian laws should therefore be amended in conformity with these new Directives. • Financial reporting requirements and related legislations have been harmonized with Company Law. • There are still ambiguous financial reporting requirements in place, especially relating to reporting for statistical purposes.
2	<p>Serbia should exempt a number of limited liability companies from the statutory audit requirement so that only the large limited liability companies would be required to be audited.</p>	<p style="text-align: center;">Implemented</p> <p>Statutory audits are compulsory for large and medium sized companies; small companies have been exempted, in accordance with the <i>acquis</i>. The <i>acquis</i> requires audits for medium-sized companies.</p>
3	<p>Serbia should create a business registry to accept filings of legal entity and consolidated financial statements, together with the auditor's report (where applicable), and to make these documents readily publicly available</p>	<p style="text-align: center;">Implemented</p> <p>There has been established the Business Registry Agency, which collects filings of financial statements from all legal entities and makes them publicly available free of charge for legal entities subject to statutory audit requirements. For other legal entities, the financial statements ending with 2013 are publicly available if the fee is paid. Starting with financial statements for 2014, according to the Law on Accounting, they are publicly available through the internet, free of charge.</p>
4	<p>Serbia should regulate dismissal of</p>	<p style="text-align: center;">Implemented</p>

	Recommendation	Status
	statutory auditors to assure that it is done only for good cause, to help preserve auditor independence.	Dismissal of statutory auditors is regulated by the Law on Auditing, Article 25, which prohibits dismissal of statutory auditors during an engagement term and allows only dismissal due to a justified reason.
5	A program should be developed to specifically target the significant need for training, retooling, and capacity-building for accountants in industry.	Partially implemented/Not implemented There is no specific program developed for the training, retooling and capacity-building for accountants in industry. There are some individual approaches and also the Serbian Association of Accountants and Auditors perform education and licensing program for accountants, which is not admitted by the regulatory authority.
6	<p>Serbia should modernize and strengthen its institutional framework governing financial reporting and auditing, including:</p> <ul style="list-style-type: none"> • Creating a quality assurance system for the audit profession, in line with the requirements set forth in IFAC’s Statement of Membership Obligations and the <i>acquis</i>, to ensure that auditors comply with applicable auditing and ethical standards, as well as independence requirements. • The quality assurance system should be supervised by a public oversight body consisting of a majority of non-practitioners. • A ‘Chamber of Auditors’ should be established, constituted as a professional body enjoying delegated regulatory authority but subject to public oversight. The Chamber should regulate “external auditors,” i.e. those responsible for financial statement audit in accordance with “full ISA.” 	<p>Implemented</p> <ul style="list-style-type: none"> • A quality assurance system for the audit profession has been created. Individual auditors are required to pass the examination in order to become certified auditors and there is continual professional development requirements. Audit firms are subject to the quality assurance inquiry done by the Chamber of Auditors and supervised by the Public Oversight Board. • The quality assurance system is supervised by the Public Oversight Board and majority of its members are non-practitioners. • The Chamber of Auditors has been established as a professional body and regulatory authority which is subject to public oversight. The Chamber conducts external auditors of those responsible for financial statement audit in accordance with full ISA.
7	Regulators should play an active role at least in enforcement of accounting standards in the general-purpose financial statements of public interest entities.	Partially implemented/Not implemented Regulators themselves do not play an active role in the enforcement of accounting standards. The only monitoring and enforcement activity is done through the Supreme Audit Institution.

Appendix 2: List of SOE monitoring tasks

Main roles of the Ministry of Economy:

- prepares a manual for the annual budgets and monitors the budgets are prepared in compliance with the manual (structure and elements of the budget)
- prepares proposals (document for the government) for approving the annual budgets and recommends changes or amendments to the annual budgets
- prepares proposals for approving the SOEs statute, its changes, setting up daughter companies and profit distribution (or loss covering)
- prepares proposals for approving investments in other companies
- prepares proposals for approving the guarantees and other collaterals
- prepares proposals for approving the financial statements
- proposes bonuses for executive directors in SOEs which generate profits
- prepares documents for appointment or dismissal of managing bodies in SOEs
- prepares documents for public procedure for general manager appointment
- prepares documents for appointment of general manager
- proposes dismissal of general manager
- collects approved annual budgets for all SOEs
- collects and analyzes quarterly reports on actual results
- informs the government about the variances from the annual budget
- monitors financial and non-financial KPIs
- proposes the recommendations for improving performances

Main roles of the Ministry of Finance:

- defines the forms for quarterly reporting
- defines the forms for reports on outstanding liabilities for controlling payment terms
- monitors KPIs and assesses the fiscal risks
- controls salaries calculations and approves payouts
- monitors the amounts of the salaries payouts
- cooperates with SOEs in order to fulfil obligations from agreement with the IMF

Appendix 3: Entities interviewed for ROSC 2015

1. Ministry of Finance

Discussed the statutory framework in Serbia, implementation of the new accounting and auditing legislations in Serbia, the ROSC project objectives, issues regarding SOEs, translation of IFRS issues, quality of the auditing

2. Ministry of Economy

Discussions of MoE role in SOE monitoring

3. Privatization Agency – conducts and monitors all privatization processes

Discussed issues within the PA and potential support from the World Bank (in particular for the financial reporting and analysis), ongoing privatization processes and future plans

4. Chambers of Auditors

Discussed organization and operations of the CoA, quality assurance function, education and enforcement, education and examination practices for the certified auditors and licensing process, areas for the improvement,

5. Public Oversight Board

Discussed with the newly appointed director methodologies for the quality control, plans for 2015, relationship with the CoA, work within the POB, quality of the auditing in Serbia

6. PwC

Discussed auditing challenges in Serbia in respect with quality of audit, competitions, audit fees and procedures for selecting the auditors with emphasis on the SOEs, work of the CoA and the POB,

7. NBS (National Bank of Serbia)

Discussed off-site and on-site control procedures and methodologies for banks and financial institutions, organization of activities in the respective departments, the NBS requirements for the financial reporting and assuring certain quality level for audits, interaction with the POB and the SEC, major issues regarding the control function

8. SMPs (IEF, Grant Thornton, UHY, Moore Stephens)

Discussed the new Law on Accounting and its implications on SMEs and potential impact on the auditing process, internal controls function within the clients, statutory framework consistency and impact on the audit engagements, major issues that their clients faces in the application of IFRS

9. SAAA (Serbian Association of Accountants and Auditors)

Discussed the new Law on Accounting and its quality, potential implications on the companies in Serbia, education and examination process within the SAAA for accountants

10. SEC (Security and Exchange Commission)

Discussed shares and bonds trading on the stock exchange, financial reporting requirements for the listed companies, listing requirements, municipality bonds performance

11. Banca Intesa (private held bank)

Discussed a full IFRS implementation requirements for the banks, group reporting requirements and quality, NPLs level and issues, credit approval process and requirements of the clean auditors opinions, request of the second audit for certain clients, new legislations for the banks and its impact on the financial reporting

12. EPS (Electric Power Industry of Serbia) – 100% state owned company producing and supplying electricity

Obtained their view on the financial reporting of SOEs, the accounting legislation and standards in Serbia, process of selection of the auditors, their issues in financial reporting and compliance with the laws, internal control procedures established

13. Road Company – managing and monitoring roads constructions, 100% state owned company

Obtained their view on the financial reporting of SOEs, the accounting legislation and standards in Serbia, process of selection of the auditors, their issues in financial reporting and compliance with the laws, internal control procedures established

14. Big 4 – Workshop

Obtained their view on the accounting and auditing legislations in Serbia, accounting practice and quality of financial reporting, main issues, quality of auditing, selection process, competition and fees, areas for improvement, education and licensing process, quality assurance, relationship with the CoA

15. SAI – Supreme Audit Institution

Discussed the work performed by the SAI and its methodology, selection process and plan for the next period, systematic issues identified during the auditing of SOEs, after audit sanctions and enforcement

16. National Accounting Commission

Discussed the role of the National Accounting Commission, procedure for the adoption of the new Law on Accounting

17. Telekom Serbia – majority state owned telecommunication company, with minority free float shares

Obtained their view on the financial reporting quality, the new Law on Accounting and its implication on the financial reporting, internal controls with the company, corporate governance structure, selection process for the auditors, quality of the audit, reporting to the government.

Appendix 4: Assessment from Sample Review of Twenty Corporate Financial Statements

As a test of the quality of reporting, the assessment team reviewed a selection of financial statements for 2013 to assess the extent of compliance with the Serbian Law on Accounting and translated IFRSs. In 2013, the latest Law on Accounting was only partially in force. All major newly introduced provisions compared to the previous law and all related by-laws are applicable from the financial statements for 2014 onwards. Therefore, the translated full IFRSs were applicable for all companies regardless of their size. The selected sample of financial statements included 20 companies including 5 SOEs, 5 banks, 2 listed, 2 insurance and 6 randomly selected companies (3 large and 3 medium). All selected companies are subject to the annual statutory audit and all prepared their financial statements in accordance with translated full IFRSs. In addition, companies were selected to assure a diversity of auditors, including each of the Big Four; other international network firms; and domestic firms.

The review results are summarized below. Findings were as follows:

- 70% of the selected companies received a clean auditors' opinion. Two opinions were qualified and four with emphasis of matter. There were no adverse opinions within the sample.
- The quality of the financial statements varied according to the size, industry and listing status of the company.
- Based purely on presentation and disclosure, the quality of the financial statements in the financial institutions and listed companies appear to be of better quality than the financial statements in other industries and medium sized companies.
- Notes to the financial statements provide more detailed disclosures for large companies than those for medium-sized companies. The disclosures in some reports of medium size companies were of poor quality - too short, insufficient or incomplete. This raises the issue of insufficient enforcement mechanisms.
- Notes to the financial statements of the companies audited by larger audit companies are more detailed than those of the companies audited by local audit firms. This is also linked to the size of the companies, since large companies usually engage large and network- member audit firms, while medium size companies engage local audit firms.
- In general, companies with problematic performance and management present greater risk of poor quality financial statements.
- In many cases, the financial reporting is driven more by tax goals than by commitment to faithful representation.

All large companies were audited by international audit companies or by local audit companies that are members of some international networks. Only one medium-sized company was audited by a "questionable" local audit company. This medium-sized company had the least fulsome disclosures, which appeared potentially inadequate on their face. However, this company received a clear auditors' opinion. We are not able to conclude as to the quality or compliance of these financial statements because of insufficient information, but there is a significant concern whether this company fully complied with reporting standards.

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