

Ivana Mamic Sacer
Assistant Professor
Boris Tusek
Associate Professor
Lajos Zager
Professor

Faculty of economics and business
Department of Accounting
J.F. Kennedy 6
10 000 Zagreb, Croatia
Phone: +385-1-2383-126
Fax: +385-1-2335-633
e-mail: imamic@efzg.hr

HARMONISATION OF CROATIAN ACCOUNTING SYSTEM WITH EUROPEAN UNION'S REQUESTS

Abstract

A process of accounting harmonization is a result of a process of globalization. One of the fields that are certainly important for harmonisation, not only in Croatian case, but also for European and world economy consideration is the field of financial reporting. Because of differences in characteristics of national regulations, there are some differences in financial reporting framework for companies that are oriented only on national (domestic) market and for those that have global business policy. In this paper, authors compare Croatian Law on accounting with European Union requests and some world experiences in financial reporting.

Keywords

accounting system, EU directives, harmonization, IFRS, international accounting

ACM classification

J.1 ADMINISTRATIVE DATA PROCESSING, *Financial*

JEL classification

M4 – Accounting and Auditing, M41 – Accounting, N4 – Government, War, Law, and Regulation, N40 – General, International, or Comparative

INTRODUCTION

The Republic of Croatia is European Union candidate country. Harmonisation of accounting is just one part of going toward European and world flows. Capital market grows in Croatia and Croatian companies become part of international capital markets. Some of Croatian companies have international business, as well. Furthermore, foreign capital becomes more important for our companies and as a result, there are many companies that are "daughter" companies which "mother" company is abroad. Those entities should apply also international accounting rules. All these circumstances make accounting orientation not only local but also global. In that sense, legal acts that consider accounting and other similar parts as financial reporting have to be harmonized. A process of Croatian accounting harmonization is a long term process and there are some significant changes that are done during past several years. Still, European Commission reports give some

directions of further changes. The research object of this paper is to find out the grade of improvement in accounting act as the base for accounting harmonization process and to make some suggestions for further improvement. The main theses of this research are as follows:

1. Croatia is an EU candidate country. EU makes some request for its member states. On the field of accounting, Law on accounting is an important tool for accounting harmonisation in Croatia.,
2. Croatian Law on accounting is harmonized with certain EU requests. Still there are some parts of accounting that have to be arranged by some other regulations, for example Croatian accounting standards,
3. There is no satisfactory connection between Croatian Law on accounting and Croatian Law on audit in the sense of financial statements audit.

The methods that are used in this research are comparative method, analytical and inductive scientific methods.

1. HARMONISATION OF CROATIAN LAW ON ACCOUNTING WITH EU DIRECTIVES

One of the basic frameworks for financial reporting is the Law on accounting. The first Croatian Law on accounting was enacted 1992. The new Croatian Law on accounting was issued in 2005, and is effective on and after January 1, 2006 and the last one was issued during October 2007, and is effective on and after January 1, 2008. Among other, financial statements, classification of entrepreneurs and financial reporting standards are parts of this Law.

1.1. FINANCIAL STATEMENTS

A complete set of financial statements in Croatia comprises: balance sheet, income statement, cash flow statement, statement of changes in equity and notes. Despite that, the structure of basic financial statements is not prescribed by current law in Croatia. The Committee for Financial Reporting Standards made the Decision about the structures of these statements that follow fourth EU Directive, more than International financial reporting standards (IFRS). That means that layout of the balance sheet is harmonised with article 9 of the fourth EU Directive. But since EU Directives give the opportunities for choosing between some alternatives, than Croatian layout of the balance sheet is a result of adoption some of these alternatives. For example, an item called - subscribed capital unpaid is the first item in the balance sheet and if this capital is becoming due and payable during one year than this item is a part of current assets - debtors. Furthermore, formation expenses are part of long-term intangible assets rather than are shown separately before items of fixed assets. Prepayments and accrued income are shown separately rather than as a part of current debtors. Loss above the value of equity is the last item of assets. Profit or loss for the financial year is a part of capital and reserves. Beside that, accruals and deferred income are not part of creditors but is a separate item at the end of liabilities.

The layout of income statement (the profit and loss account) has been harmonized with article 23 of fourth EU Directive. In this kind of statement, expenses are analyzed by nature, not by function. The layout and nature of notes are not prescribed by the Decision of Croatian Board, but they have prescribed the layout of statement of changes in equity. As it is well known, the fourth EU Directive does not prescribe any information about statement of changes in equity. Contents of the annual report and financial statements publications that are prescribed by the newest Croatian Law on accounting follow the determinations from fourth EU Directive.

Although, the first Croatian Law on accounting had some provisions about consolidated financial statements, these provisions have been deleted from the second issue of the Law. But, in order to harmonize Croatian regulation with seventh EU Directive, the last issue of Croatian Law incorporates some provisions about this topic. Among others, this law prescribes the same conditions for the preparation of consolidated account as the seventh EU Directive. More detailed information about preparation such statements (for example, techniques or methods) are given in Croatian accounting standards or International financial reporting standards.

Finally, there are some national regulations that concerns financial reporting, as well.¹

1.2. IFRS VS. CROATIAN ACCOUNTING STANDARDS

Although, Croatian accounting history, from the beginning of 1993 till 2006 was very strong oriented to International financial reporting standards, today there is a big difference from that time. Namely, the first Law obligated all companies to prepare their financial statements in accordance with IFRS. This provision caused very much problems in IFRS' application in practice of small and medium-sized companies. Because of that, today, Croatian companies have to apply Croatian accounting standards (CAS). This means that application of IFRS is not obligatory for all entities in Croatia. According to the second and the third Croatian law,

¹ For example, Law on Register of annual financial reports obligates only preparing balance sheet and income statement with some additional datas.

only large entities and listed companies or those entities that are in a position to prepare for a listing on markets, have to apply IFRS. As it can be seen, this segment has been harmonized with the Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards.

Banks, some financial organizations, insurance companies and some other institutions are considered as large companies according to Croatian Law.

There is one problem here. Though, the second and the last issues of Law on accounting have obligated application of Croatian accounting standards, these standards are still in the phase of development. That means that now, Croatian companies, actually, can apply only IFRS. There are no any issued CASs. The structure of Croatian accounting standards is as follows (Tadijancevic, 2007, p. 9):

- CAS 1 Financial Statements
- CAS 2 Consolidated Financial Statements
- CAS 3 Accounting policies, Changes in Accounting Estimates and Errors
- CAS 4 Events After the Balance Sheet Date
- CAS 5 Non-current Nonmaterial Assets
- CAS 6 Non-current Material Assets
- CAS 7 Investment in Property
- CAS 8 Non-current Assets Held for Sale and Discontinued Operation
- CAS 9 Financial Assets
- CAS 10 Inventories
- CAS 11 Receivables
- CAS 12 Equity
- CAS 13 Liabilities
- CAS 14 Revenues
- CAS 15 Expenses
- CAS 16 Accruals/Deferrals.

It has to be mentioned that the Draft of CAS has got 134 pages only. Croatian accounting standards shall follow some European Union requests but also the main topics and some solutions from IFRS. As it could be seen from the above, the question whether an entity should apply IFRS or national accounting standards is a matter of entity classification and some qualitative criteria. Croatian criteria for entity classification on small, medium-sized and large entity are harmonized with EU recommendations. Micro entity is not mentioned in Croatian Law on accounting.

1.3. AUDIT OF FINANCIAL STATEMENTS

When making public annual financial statements, auditor's opinion is also to be presented.

Towards, current Croatian Law on Audit, audit represents procedure of questioning and evaluation of financial statements, and consolidated financial statements of tributaries of audit, data and methodologies used for their preparation. Goal of that is to express opinion on reality and objectivity of financial position and business results. In the period of time 1993-2005, Law on accounting has been regulated obligatory audit of financial statements for every business year, for all large companies, and all SMEs organized as joint stock companies. Besides that, it was regulated by law to provide shorten audit i.e. inspection of financial statements of small companies if they were organized as joint stock companies. However, according to the second Law on audit some provisions have changed. So, financial statements of:

- joint stock companies, limited partnership and limited company which annual total revenue is higher than, in the year that precedes the year of audit, amounts cca. 4.093.933 €²,
- banks, insurance companies, investment funds, pension funds, pension insurance companies and other companies according to special regulations, as well as affiliated company no matter their size, if they are dominant company, and
- consolidated financial statements, is a subject of an audit for every business year.

Limited companies and limited partnerships with total revenues less than 4.093.933 € are obligated for audit only if their own regulations, statement on floatation or social contract says that. According to the last issue of Law on accounting, annual financial statements and consolidated annual financial statements of large and medium-sized companies and listed companies or those entities that are in a position to prepare for a listing on markets, shall be audited. But, if we compare current Law on audit and the last issue of Law on accounting, we can conclude that provisions about audit are not harmonized and there is a need for a change of Law on audit, as well.

² The middle exchange rate HNB on date 12.05.07. www.hnb.hr, 1€ = 7,327916 kn

2. COMPARISON OF ACCOUNTING REGULATIONS IN THE REPUBLIC OF CROATIA AND WORLD EXPERIENCES

The question of entity classification is a very important question. Beside quantitative criteria, in entity classification, qualitative criteria are used too. The reason for that is the fact that many companies can earn revenues with permanent employees, and other can outsource the labor force. In addition, some industries can earn the same amount of revenue with the lesser number of employees, while some other industries need the greater number of them. Let us consider the case of USA. In USA entity classification criteria are annual total revenue and number of employees, ownership and business independence, but also the criteria - dominance in the field of entity's operation. So, size as a criterion differs towards industry classification.³ The North American Industry Classification System (NAICS) respect differences in industries and criteria is determined especially for each industry. These criteria are not unique for every country and figure 1 shows the most often criteria. There are several criteria for classification SME and large entity in Croatia (chapter 1).

What is law regulations concern, it can be stated that this is a national domestic question. Also, the decision about the choice between full IFRS application, national accounting standards or IFRS for SME is certainly national decision. While in some countries IFRS are obligated for all business entities, in other, IFRS are allowed or even forbade (Gulin, D. (2006)). However, almost all EU countries, commit those companies which stocks are quoted on stock markets to use IFRS while preparing consolidated financial reports. All other countries can chose between IFRS and national standards.⁴ There are several approaches in developing national standards for SMEs. First is so called "top-down approach" and second "bottom-up approach".

Figure 1. The usual criteria for SME and large entity classification

Quantitative criteria	Qualitative criteria
1. employees number	1. market share
2. total balance sheet	2. owner's vs. management function
3. total revenue	3. organizational structure
	4. independence
	5. industry classification
	6. being dominate in a parent industry sector
	7. fast/slow ascending entities
	8. quoting on stock markets
	9. number of vendors or customers
	10. public responsibility
	11. non/profit orientation
	12. legal status

"Top-down approach" includes obligated IFRS application for large companies, and use of simplified IFRS standards for SMEs. This is the case in Swede or New Zealand. "Bottom-up approach" includes developing whole new standards for SMEs.

Table 1. Examples of Financial reporting standards⁵

COUNTRY/AREA	Standards/guidance
United Kingdom and Ireland	UK Financial Reporting Standard for Smaller Entities - FRSE
Slovenia	Slovenian accounting standards (SRS)
New Zealand	"Framework for Differential Reporting"
Hong Kong	Hong Kong Financial Reporting Standard for Smaller Entities - FRSE
Countries in the SAFA region	South Asian Federation of Accountants' Financial Reporting Standard for SMEs ED
Sri Lanka	the Sri Lankan Accounting Standard for Small Entities (SLASSE)
Canada	"Section 1300: Differential Reporting"
?	IASB Exposure Draft of a Proposed IFRS for Small and Medium-sized Entities
Croatia	Croatian accounting standards (CAC)

³ The Small Business Act states that a small business concern is „one that is independently owned and operated and which is not dominant in its field of operation.“, 29.03.2007.

⁴ The exception are Ciprus and Malta where all entities should apply IFRS.

⁵ More details are available in Small and Medium Practices Committee (2006). Slovenski računovodstveni standardi, (2006)

As it was mentioned in chapter 1, according to the Croatian law, certain entities have to apply IFRS.

CONCLUSION

Accounting harmonization process is an important process for all countries which are part of certain region. So, Croatia as an EU candidate country has had the obligation to harmonize, among other, Croatian accounting regulation with EU Directives. The main accounting regulation is Law on accounting. This law consist of some important parts, for example, entity classification, financial reporting, audit of financial statements etc. This law is important for every entrepreneur incorporated in the Republic of Croatia and there are some penal provisions that obligate Croatian companies to follow directions from this law. Because of that, Law on accounting has a certain strength and is an important tool for accounting harmonisation in Croatia. As it was mentioned in this paper, Croatian Law on accounting has had some changes from its first issue (1992) to the last issue (2007). These three issues of the Law show significant efforts of Croatia to satisfy European Union requests. Still, there are some parts of accounting that have to be arranged by some other regulations. It is important to stress, that Law on accounting has to prescribe some provisions, but more detailed information about some methods, techniques or policies have to be determined by some other instruments of accounting harmonisation. This means, that Croatian accounting standards can be an important instrument for further more detailed harmonisation of accounting. Finally, paper shows analysis of provisions about financial

statements audit. We can conclude that, there is no satisfactory connection between Croatian Law on accounting and Croatian Law on audit in the sense of financial statements audit. As a result, current Croatian Law on audit has to be changed too.

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Authors Biography:

Ivana Mamica Sacer works as Assistant Professor and teaches Accounting, Basics of accounting, Accounting reporting and International accounting. Ivana is certified internal auditor and have got several awards for teaching course book and her doctoral dissertation. She has published several books and articles, and has taken part in several national and international accounting conferences and works together with many Croatian companies.

Boris Tusek works as Associate Professor. He is also vice-president of Croatian Institute of internal auditors. He teaches Accounting, Basics of accounting, Internal audit and controls. Boris is certified internal auditor and has got several awards for teaching course book and his doctoral dissertation. Boris has published several books and articles, and has taken part in several national and international accounting conferences and he works with many Croatian companies.

Lajos Zager works as Professor and teaches Accounting, Basics of accounting, Financial statement analysis and Audit. He is head of Section of internal auditors and is certified accountant, certified auditor and certified internal auditor and cooperates with many Croatian companies and institutes. Lajos has got several awards for teaching course book and doctoral dissertation. He has published several books and articles, and has taken part in several national and international accounting conferences.