
Transposition of the new European Union audit regulation into the Croatian national law

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Abstract

The audit reform in the EU resulted in the adoption of the new regulatory framework. The European Parliament adopted Directive 2014/56/EU amending the Directive 2006/43/EC on statutory audit in the EU and the EU Regulation No. 537/2014 containing requirements that relate specifically to the statutory audit of public interest entities. Each Member State needs to transpose the Directive into its national legislation and also ensure its implementation. Within the framework of transposing the Directive into the national regulation, each Member State had many options that allowed them to tailor the provisions of the national law according to their needs and specific aspects of the national audit markets. However, the number of options brings risks that are connected to additional audit procedures and inefficiencies in the process of performing audit with potential effects on the quality and cost of audits. The aim of this article is to analyse the most important (not used options of the Directive and Regulation according to the Croatian national legislation. In that sense, the article provides information about the definition of statutory audit and the subjects of statutory audit as well as the definition of public interest entities in Croatia. In addition, the audit profession in Croatia is analysed in the context of the “European audit passport”. The results of this research can be a base for future comparisons between Croatia and the other EU Member States. Finally, the implementation of these provisions will answer the question: Does the implementation of different options bring convergence or divergence within the single EU audit services market?

Keywords: Transposition, Regulation 537/2014, Directive 2014/56/EU, Croatia, audit profession, Audit Act.

JEL Clasification: M42.

To cite this article:

Sever Mališ, S. (2016), A comprehensive conceptual profile on control, Audit Financiar, vol. XIV, no. 11(143)/2016, pp. 1213-1226, DOI: 10.20869/AUDITF/2016/143/1213

To link to this article:

<http://dx.doi.org/10.20869/AUDITF/2016/143/1213>

Introduction

The audit reform in the European Union (EU) had as a consequence, among others, the adoption of a new regulatory framework. The European Parliament adopted Directive 2014/56/EU amending the Directive 2006/43/EC on every statutory audit (hereafter referred to as “the Directive”) in the EU and the EU Regulation No. 537/2014 (hereafter referred to as “the Regulation”) containing requirements that relate specifically to the statutory audit of public interest entities. Both the Directive and the Regulation were published in the Official Journal of the EU on 27 May 2014 and came into force on 16 June 2014. Each Member State has had two years to adopt Directive into their national legislation, and the provisions of the Regulation became applicable as of 17 June 2016 onwards. From that time all the provisions in national legislation which are in contradiction with the Directive and Regulation are null and void.

According to the official web sites of the European Commission (2016), only 11 Member States have adopted and transposed the provisions of the Directive into national legislation so far. In other words, each Member State needs to transpose the Directive into its national legislation and also ensure the implementation of the Regulation. Within the framework of transposing the Directive into the national regulation, the Member States have many options that allow them to tailor the provisions of the national law according to their needs and specific aspects of the national audit markets.

On the other hand, Member States carried forward a long tradition of a variety of local corporate governance laws and regulations and the options are a necessity in that sense. However, divergence in the choices of Member States can increase complexity and costs on business in the unique European market, especially for cross-border operating companies. Disruption due to different legislative frameworks could lead to additional audit procedures and inefficiencies in the process of performing the audits, with potential effects on the audit quality and costs.

Croatia became a member of the EU on July 1st, 2013, after a long process of adopting European regulations into national legislation. However, due to the recent changes of the European audit legislation, Croatia has the complex task to transpose the audit provisions into national legislation. This process of transposition is still not finished in Croatia, although the transposition

deadlines has passed. The Ministry of Finance published the Proposal of Audit Act in August 2016 and all the interested parties were invited to give their criticism and suggestions in order to improve its content. The Proposal contains provisions regarding the transposition of the Directive, and also some provisions that are the result of deficiencies noticed on the audit market in Croatia. The aim of this article is to analyse the most important (not) used options of the Directive and Regulation according to the proposed national legislation in Croatia.

1. Key audit issues in Croatia in the context of the new EU audit regulation

Subjects of statutory audit. The Directive allows Member States some options in order to tailor their law provisions according to the specific aspects of their audit market. Among others, the most important options of the audit Directive refers to the definition of statutory audit. According to the article 2 of the Directive 2014/56/EU, Member States can define the subjects, other than those required by EU law, that are required to perform statutory audits. Statutory audit means an audit of annual financial statements or consolidated financial statements in so far as it is:

- a. Required by EU legislation;
- b. Required by national law concerning small undertakings;
- c. Voluntarily carried out at the request of small undertakings, and which meets the national legal requirements that are equivalent to those for an audit under point (b), where national legislation defines such audits as statutory audits. This option did not exist under the Directive 2006/43/EU. Namely, when that Directive passed, audits of small undertakings were required by the 4th and 7th Directives, subject to a Member State’s option to provide and exemption. Points (b) and (c) of the article 2(1) of the Directive ensure that small undertakings are still covered by the Directive even through the Accounting Directive no longer applies to the audits of small undertakings.

Until the 1st of January 2016, in Croatia, the subjects of statutory audit were set in the Accounting Act (2007) and Auditing Act (2008). According to the Accounting Act

(2007) that was in force until the year 2016, statutory audit refers to the individual and consolidated annual financial statements of:

1. Large and medium-sized entities,
2. Entities whose securities are listed or are in the preparation for listing on the organized capital market, and
3. Entities under special regulations.

The conditions set in the Audit Act (2008), on the other hand, included the auditing of annual financial statements and consolidated annual financial statements of:

1. Joint stock companies,
2. Limited partnerships and limited companies if their total revenue in the previous year exceeded 30 million HRK (approximately 4,000,000 Euro). In the year 2014, 2,865 companies satisfied those conditions, which means that their financial statements were the subject of statutory audit (Sever Mališ and Brozović, 2016).

The Croatian Parliament adopted a new Accounting Act in 2015 and once again defined the subjects of statutory audit. This new Accounting Act (2015) entered into force on the 1st of January 2016. According to the new Accounting Act (2015), the subjects of statutory audit are:

1. Individual and consolidated annual financial statements of public interest entities as well as large and medium-sized entities that are not public interest entities;
2. Consolidated financial statements of parent companies of large and medium sized entities;
3. Individual and consolidated financial statements of joint stock companies, limited partnerships and limited liability companies if they meet at least two out of the following three criteria: total assets 15,000,000 HRK (approximately 2,000,000 Euro), total revenues 30,000,000 HRK (approximately 4,000,000 Euro), average number of employees 25;
4. Entities whose securities are listed or are in the preparation for listing on the organized capital market, and
5. Entities under special regulations (Table 1).

Table 1. Subjects of statutory audit in Croatia	
Until January 1 st , 2016.	After January 1 st , 2016.
Accounting Act (2007) Audit Act (2008)	Accounting Act (2015)
<p>Statutory audit refers to individual and consolidated annual financial statements of:</p> <ol style="list-style-type: none"> 1. Large and medium-sized entities, 2. Entities whose securities are listed or are in the preparation for listing on the organized capital market, and 3. Entities under special regulations (Accounting Act, 2007). <p>and</p> <p>Statutory audit refers to individual and consolidated annual financial statements of</p> <ol style="list-style-type: none"> 1. Joint stock companies and 2. Limited partnerships and limited companies, if their total revenue in the previous year exceeds 30 million HRK (approximately 4,000,000 Euro) (Audit Act, Art. 6a). 	<p>The subjects of statutory audit are:</p> <ol style="list-style-type: none"> 1. Individual and consolidated annual financial statements of public interest entities as well as large and medium-sized entities that are not public interest entities; 2. Consolidated financial statements of parent companies of large and medium sized entities; 3. Individual and consolidated annual financial statements of joint stock companies, limited partnerships and limited liability companies if they meet at least two out of the following three criteria: <ul style="list-style-type: none"> • Total assets 15,000,000 HRK (approximately 2,000,000 Euro); • Total revenues 30,000,000 HRK (approximately 4,000,000 Euro); • Average number of employees 25. 4. Entities whose securities are listed or are in the preparation for listing on the organized capital market, and 5. Entities under special regulations. <p>In addition, according to the Croatian Non-profit Organization Act, each non-profit organization that reported total revenue exceeding 10 million HRK (approximately 1,3 million Euro) is a subject of the statutory audit. Financial statements of non-profit organization operating with between three to ten million HRK (approximately between 400,000 to 1,3 million Euro) are the subject of the review engagement (Non-profit Organization Act, 2014).</p>

Source: Accounting Act, 2007; Accounting Act, 2015; Non-profit Organization Act, 2014.

In addition, according to the Croatian Non-profit Organization Act (2014), each non-profit organization that reported total revenue exceeding 10 million HRK (approximately 1,3 million Euro) is a subject of the statutory audit. Financial statements of non-profit organization operating with between three to ten million HRK (approximately between 400,000 and 1,3 million Euro) are the subject of the review engagement.

Definition of public interest entities. The most recent definition of public-interest entities in the EU is included in Article 2 point 13 of the Directive 2014/56/EU and is as follows: public-interest entities means: “(a) entities governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State, (b) credit institutions; (c) insurance undertakings or; (d) designated by Member States as public-interest entities, for instance undertakings that are of significant public relevance because of the nature of their business, their size or the number of their employees”. In the legislative text, the definition of public interest entities in itself has not significantly changed as compared to the 2006/43/EC Statutory Audit Directive or the 2013/34/EU Accounting Directive. However, the identification of public interest entities and thus their definition is now crucial to determine the entities that are within the scope of the Regulation (EU) No. 537/2014 for the specific requirements regarding statutory audit of public-interest entities. In other words, according to the Directive, each Member States has the option to define the public interest entities. Croatia used this option and included the definition of public interest entities into the new Accounting law (2015) that enter into the force on January 1st, 2016 (Table 2). Public interest entities are defined as:

- Large entrepreneurs;
- Companies whose securities are listed on any organised securities exchange in an EU Member State;
- Companies which the Croatian government has listed in the register of legal entities of special national interest;
- Credit institutions;
- Croatian Bank for Reconstruction and Development;
- Electronic money institutions;
- Insurance and reinsurance companies;

- Pension fund management companies, pension funds (both obligatory and voluntary) and pension insurance companies;
- Leasing and factoring companies;
- Investment fund management companies, investment funds, alternative investment funds,
- Retirement plan funding companies;
- Stock exchanges, the central depository and clearing companies, investment companies, multilateral trading facility operators, central register operators, settlement system operators and investor compensation fund operators (Accounting Act, 2015).

Although some countries have implemented the minimum requirements, Croatia has included a number of other entities into the definition of public interest entities. Among other European countries, the rules are stricter in Croatia, Italy, Romania and Slovakia (FEE, 2014, p. 8). Therefore, the major segment of public interest entities definition includes large entities. Due to the fact that all large companies are public interest entities, they must observe specific requirements regarding the statutory audit. It means that these entities must comply with more rigours requirements for the statutory audit performance, which include stricter rules for independence and objectivity of audit firms, mandatory rotation of audit firms, restrictions on non-audit services and, among other requirements, more detailed reporting. In other words, it should be noted that the Regulation should apply not only the statutory auditors and audit firms carrying out the statutory audits of public interest entities, but also to the public interest entities.

On the one hand, these additional requirements complicate tendering of small and medium sized audit firm on the audit market of public interest entities. On the another hand, some large companies are not interested in applying these additional requirements towards the public. There are many advocates of the fact that large enterprises should be excluded from the definition of public interest entities. Although the changes of definition are being discusses within the framework of the Directive’s implementation, the Ministry of Finance will make the final decision with regard to whether the definition of public interest entities will be changed in the new Audit Act.

Directive 2014/56/EU art. 2 p. 13	Accounting Act (2015)
<p>“(a) entities governed by the law of a Member State whose transferable securities are admitted for trading on a regulated market of any Member State, (b) credit institutions; (c) insurance undertakings or; (d) designated by Member States as public-interest entities, for instance undertakings that are of significant public relevance because of the nature of their business, their size or the number of their employees.”</p>	<ul style="list-style-type: none"> • Large entrepreneurs; (if they meet at least two out of the following three criteria: <ol style="list-style-type: none"> 1) total assets 15,000,000 kunas (approximately 2,000,000 euro), 2) total revenues 30,000,000 kunas (approximately 4,000,000 euro) 3) average number of employees 25 • Companies whose securities are listed on any organised securities exchange in an EU member state; • Companies which the Croatian government has listed in the register of legal entities of special national interest; • Credit institutions; • Croatian Bank for Reconstruction and Development; • Electronic money institutions; • Insurance and reinsurance companies; • Pension fund management companies, pension funds (both obligatory and voluntary) and pension insurance companies; • Leasing and factoring companies; • Investment fund management companies, investment funds, alternative investment funds, • Retirement plan funding companies; • Stock exchanges, central depository and clearing companies, investment companies, Multilateral Trading Facility operators, central register operators, settlement system operators and investor compensation fund operators.

Source: Directive 2014/56/EU, art. 2, p. 13; Croatian Accounting Act, 2015.

Auditing profession in Croatia. The minimal requirements for certified auditors did not significantly change in the process of audit reform. According to the Directive „a natural person may be approved to carry out a statutory audit only after having attained university entrance or equivalent level, then complete a course of theoretical instruction, undergone practical training and passes an examination of professional competence of university final or equivalent examination level organised or recognised by the Member States concerned (art. 6 of the Directive 2006/43/EU). However, except theoretical knowledge, a candidate

shall complete at least three years of practical training. At least two thirds (two years) should be completed under the mentorship of statutory auditors approved by any Member States (**Table 3**). It can be emphasized that some Member States addressed the requirement of a minimum two years of practical training by establishing the register of trainees. This register should, among other tasks, document the time the candidates spent on professional training. The aim of forming this register is to regulate the audit market, and to protect employers and candidates in their rights and obligation in the process of appointment as a certified auditor.

Table 3. Conditions for certified auditors according to the regulatory framework of the EU

Educational qualifications Art. 6. 2006/43/EU	Minimal requirements for certified auditors Art. 10. st. 1 Directive 2014/56/EU	Continuous education Art 13. Directive 2014/56/EU
A natural person may be approved to carry out a statutory audit only after having attained university entrance or equivalent level, then complete a course of theoretical instruction, undergone practical training and passes an examination of professional competence of university final or equivalent examination level organised or recognised by the Member States concerned.	In order to ensure the ability to apply theoretical knowledge in practice, a test of which is included in the examination, a trainee shall complete a minimum of three years' practical training in, inter alia, the auditing of annual financial statements, consolidated financial statements or similar financial statements. At least two thirds of such practical training shall be completed with a statutory auditor or an audit firm approved in any Member State.	Member States shall ensure that statutory auditors are required to take part in appropriate programmes of continuing education in order to maintain their theoretical knowledge, professional skills and values at a sufficiently high level, and that failure to respect the continuing education requirements is subject to appropriate sanctions.

Source: Directive 2014/56/EU; Directive 2006/43/EU.

To summarize, the basic prerequisites for entering the audit profession according to the demand of the EU Directive on statutory audit are: formal high university degree, practical experience as well as the examination of professional competence. However, **Table 4** shows that selected countries, including Croatia implemented more rigorous measures for entering the auditing profession than it is requested by the Directive. Slovenia and Slovakia require a minimum five years of experience in the field of accounting and auditing. According to the

Proposal of Audit Act (2016), Croatia requires, among other criteria, at least six years of practical training. These demands are actually in contradiction with the efforts of the EU to reduce the barriers for entering the integrated EU service market. However, due to the fact that auditors act in the public interest, this makes understandable the efforts of Member States to allow entering the profession only for the professionals with a sufficient level of knowledge and practical experience.

Table 4. Conditions for “certified auditors” in selected EU countries

Slovenia	Slovakia	Croatia
<ul style="list-style-type: none"> • A master degree or equivalent level of education; • At least five years of practical experience in auditing in the last eight years in an audit firm, as a certified auditor; • Practical training and passed the examination for certified auditor; • No withdrawal of licence of certified auditor in past; • No criminal records; • Active knowledge of Slovenian language. 	<ul style="list-style-type: none"> • Full legal capacity; • Good reputation; • Second-level university degree; • At least five years of practical training in the area of accounting; • Took part in continuing education of assistants to statutory auditors; • Submitted to the authority officially certified copies of certificates and licences from other Member States and third countries held by the applicant, including the name of the issuing authority and their numbers; • Passed the examination of professional competence. 	<ul style="list-style-type: none"> • Professional or university undergraduate or university integrated undergraduate and graduate master degree with at least 300 ECTS or second level university degree; • Passed the auditor's exam; • At least three years of practical training in auditing services under a certified auditor's guidance after passing the examination; • Good reputation.

Source: Systematization of author according to National Council of the Slovak Republic, (2015), Ministry of Finance Slovenia (2016), Proposal of Audit Act (2016).

The certification/licence to perform statutory audits is usually time limited. This is in compliance with the EU regulation where “statutory auditors are required to take appropriate programmes of continuing education in order to maintain their theoretical knowledge, professional skills and values at a sufficiently high level, and that failure to respect the continuing education requirements is subject to appropriate sanctions” (art. 13, Directive 2014/56/EU). It is important to stress out there was no licensing system for statutory auditors in Croatia. In other words, according to the Auditing Act (2008) that is still in force, the conditions for getting the license of certified auditors are:

- High level university degree;
- Three years of practical training in auditing out of at least two years of practical training under the mentorship of certified auditors with licence in any Member State;
- Passed the auditor’s exam;
- Good reputation.

One of the most important issues of auditing profession is dealing with the licensing of certified auditors in Croatia. According to the new Proposal of Audit Act (2016), the licence has to be renewed, which requires a continuous education in the field of accounting and auditing. The extension of the licence to perform statutory audit is usually connected with the requirement for continuous professional development according to the rules of body in charge with the oversight of the audit profession. The licence of certified auditors can be renewed after completing at least 120 hours of

continuous education in a period of three years (Proposal of Audit Act, 2016). There will be performed a special examination if the auditor does not meet this requirement of 120 hours (Proposal of Audit Act, 2016).

2. Key options in the proces of transposing the EU audit regulation into croatian legislation

2.1. Selected options of the Directive (2014/54/EU)

Approval of auditors from another Member State.

Another important issue on new proposed legislation is enabling statutory auditors and audit firms to provide services in a Member State other than that in which they were approved. The elimination of barriers to the development of statutory audit services between Member States can contribute to the integration of the Union audit market. However, the Directive gives the option about whether a statutory auditor seeking approval is to be subject to an adaption period or an aptitude test. According to the Proposal of Audit Act (2016) statutory auditors seeking approval in Croatia will be subject to an aptitude test. Aptitude tests will require from statutory auditors adequate knowledge of legislative rules of Croatia, including company law, fiscal and social law.

Table 5. The selected options entered into the Croatian national legislative

Approval of auditors from another Member State	Audit reporting	National auditing standards	Public oversight body
Art. 14	Art. 28	Art. 26	Art. 32
The host Member State shall decide whether a statutory auditor seeking approval is to be subject to an adaptation period... or an aptitude test	Member States may lay down additional requirements in relation to the content of the audit report.	Member States may apply national auditing standards, procedures or requirements as long as the Commission has not adopted an international auditing standard covering the same subject-matter.	4a. Member States shall designate one or more competent authorities to carry out the tasks provided for in this Directive.
Croatian solution			
Aptitude test	No additional requirements	Applying International Auditing Standards (IFAC)	Oversight body: Croatian Financial Services Supervisory Agency

Source: Directive (2014/54/EU), Proposal of Audit Act (2016).

Additional reporting. Although the Directive provides the opportunity for each Member State to impose additional requirements to the content of the audit report, in Croatia the content of the report is prescribed in the Accounting Act (2015) as presented in **Table 6**. Due to

the fact that statutory auditors in Croatia must comply with the International Auditing Standards and the Accounting Act (2015), there probably will be no additional requirements for the form and the content of the audit report in the new Auditing Act.

Table 6. The structure and form of the audit report according to the Accounting Act in Croatia

The independent auditor's report includes:

1. Introduction that sets the financial statements subject to audit, together with the applicable financial reporting framework;
2. Description of the scope of statutory audit stating the auditing standards in accordance with which the statutory audit was carried out;
3. The auditor's opinion which clearly expresses whether the annual financial statements give a true and fair view of the undertaking's financial position in accordance with this Law and the Croatian financial reporting standards or IFRS or whether the annual financial statements are in accordance with the company law if the regulation requires such an opinion. The auditor's opinion may be positive, qualified or adverse, or the auditor can give disclaimer of opinion if he/she is not able to express an opinion;
4. Highlighting the questions and other issues that were in the interest of the auditor without expressing a qualified opinion, if so required by the International Auditing Standards;
5. Opinion about the compliance of the management's report with the annual financial statements for the same business year;
6. Opinion whether the management's report is prepared in accordance with this Law;
7. A statement as to whether, based on the knowledge and understanding of business of the entrepreneur and its environment, as acquired during the audit mission, the auditor has identified significant misstatements in the annual report and, if any, a description of the nature of such errors.

Source: Accounting Act, 2015.

National auditing standards. To ensure the high-quality of statutory audits within the EU, all audits should be performed under the same "rules of the game". According to the FEE (2015) publication, not all the Member States have yet adopted the International Auditing Standards, although the FEE (2015) noted that significantly more countries adopted ISAs voluntarily, as compared to 2013. Although the Directive (2014) requires Member States to apply the International Auditing Standards issued by the European Commission, these standards are not yet adopted. The European Commission has a five-year period to adopt these standards. Member States have an option to enforce additional national audit procedures or requirements but only if they stem from specific national legal requirements relating to the scope of statutory audit. In other words, these audit procedures and standards can be imposed in national legislation only

if they have not been covered by the adopted International Auditing Standards. Croatia has a long tradition of applying the International Auditing Standards; therefore, applying national auditing standards is not an option.

Simplifications for SMEs. Although the EU recognised the central role played by small and medium-sized enterprises in the Union's economy and aims at reducing administrative and other burden that complicate their operations, some provisions of the Directive are not in the function of reducing costs. In that sense, the Directive provides numerous options for each Member State to simplify the requirements for the audit of small entities. However, according to **Table 7**, in the Proposal of Audit Act (2016) there are no simplified requirements for the audit of small entities.

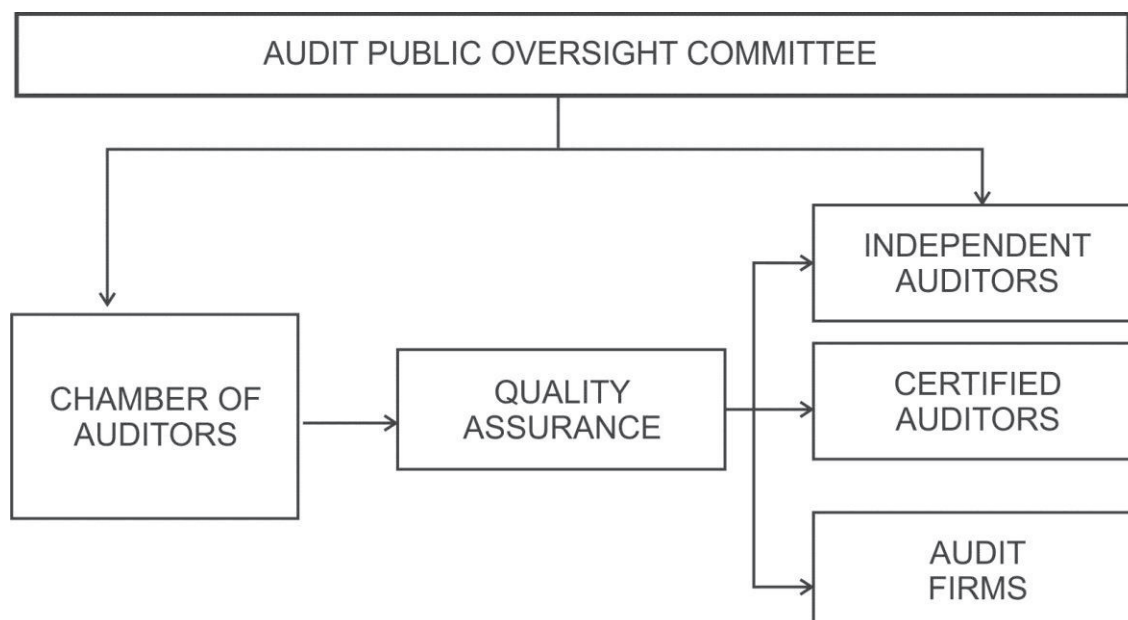
Table 7. Selected simplifications for audit of SMEs		
Preparation for the statutory audit and assessment of threats to independence	Internal organisation of statutory auditors and audit firms	Proportionality
Art. 22b	Art. 24a	Art. 26
Member States may provide simplified requirements for the small entity audits.	Member States may provide simplified requirements for the small entity audits.	Member States may take measures in order to ensure the proportionate application of the auditing standards to the statutory audits of small undertakings.
Croatian solutions		
No simplified requirements	No simplified requirements	International Auditing Standards (IFAC)

Source: Directive 2014/56/EU, Proposal of Audit Act, 2016.

Principles of public oversight. Another important issue of the EU audit reform refers to the systems of auditing public oversight. The public oversight of statutory auditors and audit firms encompasses the approval and registration of statutory auditors and audit firm, the adoption of standards in respect of professional ethics and internal control of audit firms, continuing educative and systems of quality assurance, as well as

investigation and sanctions for statutory auditors and audit firms. The Directive (2014) highlights that the independence of public oversight authorities is a core prerequisite for integrity, efficiency and orderly functioning. In that sense, to fulfil the demands of the Directive, and especially the Regulation (2014), there will be significant changes in the Croatian system of public oversight.

Figure 1. Current organization of the public oversight system in Croatia



Source: Auditing Act, 2008.

Currently the tasks set up in the Directive (2006), and according to the existing Auditing Act are performed by the Croatian Chamber of Auditors under the surveillance of the Audit Public Oversight Committee founded by the Ministry of Finance (Figure 1). However, due to the changes in the audit legislation as a result of the Directive and Regulation, the system of public audit oversight should be reorganized. It is necessary to organize a system of public oversight of statutory auditors and audit firms and to designate a competent authority responsible for such oversight. Although the Member States can designate one or more competent authorities to carry out the tasks provided in this Directive and Regulation, taking into the consideration the size of the audit market in Croatia the Ministry of Finance appointed the Croatian Financial Services Supervisory Agency (CFSSA) (<http://www.hanfa.hr/>). In other words, according to the Proposal of Audit Act (2016), the tasks and responsibilities for the public oversight of statutory auditors and audit firms will be taken over by the CFSSA. Member States are able to delegate or allow competent authorities to delegate the tasks of those competent authorities to other authorities. It is currently not clear what responsibilities and tasks the CFSSA will delegate, because of the very intensive negotiation process with the Croatian Chamber of Auditors. However, regardless of the delegated responsibilities, the competent authority should bear the ultimate responsibility for the oversight of the audit profession.

2.2. Selected options of the Regulation (2014/537/EU)

Restrictions on non-audit services. Independence is a basic prerequisite for achieving the public interest role of auditors. However, the provision of non-audit services can compromise the auditor's independence and increase the risks of conflicts of interests. The Regulation provides a "black list" of non-audit services and prohibits the provision of certain non-audit services to audit clients such as tax, consultancy and advisory services. However, Member States have an option to allow the provision of certain tax and valuation services under the prescribed requirements. It is important that, according to the Proposal of Audit Act (2016), Croatia used the option to allow provision of certain tax services under the conditions set in the Regulation but only if:

- a. They have no direct or have an immaterial effect on the audited financial statements, separately or in the aggregate;
- b. The estimation of the effect on the audited financial statements is comprehensively documented and explained in the additional report to the audit committee; and
- c. The principles of independence are complied with by the statutory auditor or the audit firm.

However, the provision of valuation services including valuations in connection with actuarial services or litigation support services is not allowed under some conditions. In other words, that means that this option is not used (Table 8).

The Member States also have an option to prohibit other services that those prescribed, but there are no additional prohibited non-audit services in the Croatian Proposal of Audit Act (2016). Therefore, the audit firms and statutory auditors can provide non-audit services to their clients if they do not audit their financial statements. Except statutory audits, the audit firm can perform, in the framework of their business activities, services from the following areas:

1. Finance and accounting;
2. Financial analysis and control, including due diligence;
3. Tax and other business consultancy ;
4. Valuation of companies, assets and liabilities;
5. Litigation support services;
6. Business evaluation of investment projects;
7. Expert seminars and education; and
8. Publication of experts papers (Proposal of Audit Act, 2016).

The provisions of the Regulation apply only to the statutory auditors and audit firms carrying out statutory audits of public-interest entities and public interest entities according to the European legislation. However, according to the proposed audit legislation in the Croatia, the "black list" of non-audit services will apply in performing all statutory audits. Therefore, it can be concluded that Croatia applied more rigorous requirements for the regulation of non-audit services.

Regulation 537/2014		Croatian solution	
Prohibition of the provision of non-audit services. Prohibition of non-audit services shall mean: (a) tax services relating to: (i) preparation of tax forms; [...] (iv) identification of public subsidies and tax incentives unless support from the statutory auditor or the audit firm in respect of such services is required by law; (v) support regarding tax inspections by tax authorities unless support from the statutory auditor or the audit firm in respect of such inspections is required by law; (vi) calculation of direct and indirect tax and deferred tax; (vii) provision of tax advice; [...]		Member States may allow the provision of the services referred to in points (a) (i), (a) (iv) to (a) (vii) and (f), provided that the following requirements are complied with: (a) they have no direct or have immaterial effect, separately or in the aggregate on the audited financial statements; (b) the estimation of the effect on the audited financial statements is comprehensively documented and explained in the additional report to the audit committee; and (c) the principles of independence laid down in Directive 2006/43/EC are complied with by the statutory auditor or the audit firm	Allowed under the requirements
(f) valuation services, including valuations performed in connection with actuarial services or litigation support services;			Not allowed
Prohibition of the provision of non-audit services.	Art. 5	Member States may apply more stringent requirements.	No stringent requirements
Prohibition of the provision of non-audit services	Art. 5	Member States may prohibit other services where they consider that those services represent a threat to independence.	No additional prohibited audit services

Source: Regulation 2014/537/EU, Proposal of Audit Act, 2016.

Mandatory rotation of auditors and audit firms. As per the Regulation, public interest entities need to appoint their auditor or audit firm for a minimum of one year and a maximum of ten years. However, Member States can extend the maximum duration period in specified circumstances. In that sense, Member States are provided with an option to:

- Set the minimum duration to more than one year; and
- Set the maximum duration to less than ten years.

The results of research conducted on the sample of listed Croatian companies showed that the average audit tenure is shorter than the maximum of 10 years as set in the EU regulation. The average audit firm tenure for listed companies in Croatia in the seven-year period is 3.58 years, and it depends on the industry. The *Construction* industry is characterized by the longest average audit tenure of 5.25 years (Sever Mališ and

Brozović, 2016). Additionally, there is no correlation between the length of the audit tenure and the size of the listed company. The main limitation of the study is the length of the analysed period, which covered only the last seven years. A longer timeframe would allow for more representative conclusions. However, it can be concluded that the “limits” for mandatory audit duration are set very broadly and that implementation of the new legislative should not cause any significant “shocks” on the audit market in Croatia. The proposed legislative solution in Croatia sets the minimum duration of the audit engagement to one year and the maximum duration to ten years, although in the existing laws applied in Croatia there are demands for a duration of the audit engagement shorter than ten years. For instance, according to the Credit Institution Act (2015, art. 170) an audit firm may audit the financial statements of a particular credit institution for no more than seven consecutive years.

Member States are also given two separate options to extend the maximum duration of a renewed audit engagement – by imposing “tendering” or “joint audits” (Table 9). By enabling one of these options, the same auditor may stay in place for a total period of maximum:

- 20 years or
- 24 years.

Some professional organizations are warning that Member States which do not take up these duration

extension options will significantly limit the options and flexibility for businesses, their audit committees, boards and shareholders (FEE, 2014b). Due to the number of options available to Member States, the extent to which these are exercised will significantly impact regulatory convergence. Diverging the minimum and maximum duration of the audit engagements in different Member States will generate practical difficulties, potentially increasing costs, especially for business operating across the borders (FEE 2014b).

Table 9. Duration of audit engagement

Basic requirements	Options - Regulation 537/2014		Croatian solution
a) Initial engagements.	Require that the initial engagement referred to in paragraph 1 be for a period of more than one year;		1 year
b) A maximum duration of 10 years.	a) May be extended to the maximum duration of:	(a) 20 years, where a public tendering process.	20 years
		(b) 24 years – joint audit.	20 years
	b) Set a maximum duration of less than 10 years for The engagements referred to in the second subparagraph of paragraph 1.		10 years
Key audit partners rotate every:	7 years		7 years
Cooling-off period:	3 years		3 years

Source: Regulation 2014/537/EU, Proposal of Audit Act, 2016.

These risks are possible to mitigate if the Member States adopt the “basic” options. However, it is rational to expect that some Member States will adopt these options according to their needs and attitudes. In that sense, in the Proposal of Audit Act (2016) Croatia used the option for the extension of the maximum duration of the audit engagement to a maximum duration of 20 years in the case of a public tendering process and 20 years (not 24 years as in Regulation) for the joint audits. The concept of joint audit is one of the possibilities to reduce audit market concentration in the provision of audit services. However, only the implementation of these provisions in practice will show if, in the future, these measures for reducing audit market concentration are sufficient. The auditors do not have a lot of experience with joint audits, although these measures were strongly supported by small audit firms in Croatia.

Conclusions

The implementation of the Directiva and Regulation into national legislative should result in a more secure and harmonised audit environment. However, due to

the number of available options, each Member State has the unique opportunity to create a regulatory framework that is the most appropriate to the environment in which the certified auditors, audit firms and subjects of statutory audit activate. Any new regulation is essentially setting up new and stricter rules, especially when the provisions are defined and need only to be transposed into the national legislation. The process of implementing the new regulatory framework is always under the influence of different stakeholders. These stakeholders are questioning how to use all the mechanisms at their disposal to create the “rules of the game” according to their interests or needs. They need to evaluate whether the options from in Directive and Regulation are sufficiently adapted to the current business environment and whether there are other opportunities to adopt some additional solutions allowed by the European legislation. Although the options offer a certain “freedom”, they also carry certain risks. Due to the number of options, their extension to the Member States could impact regulatory convergence, especially to the cross-border operating companies

and audit firms. The adoption of different options by Member States could generate practical difficulties in terms of their implementation and potentially increased costs and reduced audit quality. In that sense, Member States must carefully consider the effects of applying different options.

The aim of this research was to provide information about the current audit environment in Croatia, while highlighting some key issues on the transposition of the Regulation regarding the statutory audit of public interest entities and the European Directive on the statutory audits of annual accounts and consolidated accounts. Croatia did not yet finish the process of transposing the Directive into national legislation, although the transposition deadlines have passed. However, the intensive work of the Ministry of Finance resulted in the Proposal of Audit Act (2016).

All the stakeholders are invited to give their comments and suggestions in order to improve the content of the existing proposal. Despite ongoing debate and negotiations on the provision of a new auditing law, this article provides information regarding the options that were selected from the Directive and Regulation. Some changes can be expected when the final Audit Act will be adopted by the Croatian Parliament. The most significant changes are expected with regard to the organizing and performing of the public audit oversight in Croatia. Because of uncertain results of the negotiation about organizing and financing the competent authority for public audit oversight, the provisions regarding the public audit oversight topic in this article are modestly represented. In that sense, the financing and organization of oversight activities will be an interesting topic for further research and comparisons.

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