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IFRS application in Slovenia

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Abstract: The paper aims to present the most important characteristics of the evolution of the accounting system in Slovenia, emphasizing the most important features of the national accounting standards as well as the institutional framework that has affected the accounting development. Slovenia is a code law country with underdeveloped financial markets, dominant bank financing, close linkage between financial accounting income and taxable income and a small auditing profession. IFRS are mandatory for all companies with publicly traded securities for consolidated financial statements and for all banks and insurance companies. All other companies report in accordance with national accounting standards, although they have an option to apply the IFRS for their consolidated as well as separate annual financial statements. Since the number of entities in Slovenia that prepare their financial statements in conformity with IFRS is in international terms rather small, our literature review reveals that studies about IFRS implementation in Slovenia are lacking. Until now there have been just a few studies exploring the level of IFRS compliance. The paper draws attention to possibilities for future research from the field of value reliability and value relevance.

Keywords: Slovene accounting model, Slovene accounting standards, institutional framework, IFRS, IFRS application

JEL codes: M41

1. Introduction

Slovenia became independent in 1991. The first Companies Act was adopted in 1993, followed by the adoption of the first Slovene accounting Standards (hereinafter SAS) in 1994. The Slovene accounting system is settled by the Companies Act, where the general provisions regarding the books of account,

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annual reports and general rules of valuation are defined. The concepts and bases of accounting in companies are provided by law and defined in detail by accounting standards.

Since Slovenia became independent many changes have occurred in the field of accounting. SAS 1993 were followed by two revised versions - SAS 2002 and SAS 2006. At first, in 1993, 32 SAS were issued. Gradually new ones were added. At one point there were 40 SAS issued, but some no longer apply and the number currently stands at 38 SAS.

The first omnibus revision of the SAS (SAS 2002) introduced into Slovene accounting some Anglo-Saxon accounting concepts, among others fair value. The latest SAS 2006 are, in the field of recognition and measurement, almost completely harmonised with the International Financial Reporting Standards (hereinafter IFRS).

Since Slovenia became a Member State of the EU in 2004 the EU Directives and Regulations had to be implemented. The companies whose securities are listed on one of the organized securities markets in the European Community Member States and which are subject to consolidation must prepare their financial statements in accordance with IFRS. IFRS must also be used for banks, insurance companies and other entities if so decided by the assembly of the entity (but minimum for five years).

The paper seeks to present the most important characteristics of the evolution of the accounting system in Slovenia. Thus, the paper presents the characteristics of the Slovene accounting system, focusing on the implementation of the IFRS, and related business environment characteristics that have affected the field of accounting in Slovenia.

After the introduction the paper presents the evolution of the Slovene accounting system, including the main changes made since the SAS 1993 were developed. Moreover, the main features of the Slovene financial market, tax system, characteristics of corporate governance and audit profession are disclosed, all of which undoubtedly affected and still affect the reporting system of Slovene companies. The third section follows the presentation of IFRS implementation. The conclusion presents the main findings of the paper.

2. Accounting developments in Slovenia

2.1 Development of national accounting standards

The theoretical concept of Slovene accounting is formally presented in the Code of Accounting Principles (hereinafter the Code). This collection of professional

solutions, which originates from the times of the former Yugoslavia, was last updated in 1995 by the Professional Council of the Slovene Institute of Auditors (Novak, 2007a).

The accounting principles presented in the Code were adopted mainly for the purpose of (Code, 1998: 3):

- helping professionals as a guidance and as an inspiration for their work,
- promoting the transfer of modern theoretical accounting accomplishments into practice and
- setting up solid professional foundations for the elaboration of accounting standards.

These principles basically examine the understanding of accounting and describe its fundamental features (Code, 1998: 4). If we compare these Slovene principles with the principles of other standard-setting bodies we can notice their very wide scope, which is due to the coverage of some accounting issues (especially principles of budgeting and organization of accounting departments) which are usually not covered in similar documents.

More specific rules concerning professional conduct in the field of accounting are presented in the SAS. The SAS were first issued in 1993 (adopted in 1994). They were developed based upon the drafts of the Yugoslav standards from 1989 and completed before the first Slovene Companies Act was passed¹. The SAS 1993 were based on the prudence principle (Garrod & Turk, 1995).

The first Companies Act of 1993 was inspired predominantly by the German/Austrian corporate law model. However, due to the existence of separate company laws and bankruptcy/reorganization laws, Slovenia does not have such an omnibus commercial code as Germany does. Since the territory of today's Slovenia was part of the Austrian Empire for a long time and due to all stated facts above we can confirm that Slovenia is a code law, a civil law² country.

In years that followed, the theory of accounting leapfrogged, and both the environment and the circumstances in which business organizations had been operating underwent considerable transformation: the rate of inflation was decreasing³; Slovenia opened up in political as well as economic terms and started the process of joining the European Union; greater exposure to the effects of globalization, which gave rise to a push for the international harmonization of accounting standards, etc. Thus, the revision of the SAS was inevitable. The first revised SAS - SAS 2002 - were issued in 2001 (with obligatory use for the financial years starting in 2002), following the major amendments of the Companies Act, which were the result of the PHARE sponsored project "Harmonization of Slovene Companies Act with the EU legislation"⁴, and changes of International Accounting Standards (Novak, 2007a).

The amended Companies Act extended the requirement that all companies, including banks, insurance companies, and listed companies, prepare separate and consolidated financial statements in conformity with SAS. The World Bank (2004) noted that the changes in SAS 2002 were generally considered to be a massive step toward harmonization with IAS/IFRS, however some fundamental differences remained.

The SAS 2002 were a result of modern valuation of items in the financial statements, primarily recommending and underlining a true and fair presentation of assets and liabilities. In order to achieve this objective, the SAS 2002 introduced into the Slovenian accounting environment the basis for measuring individual items on the balance sheet at fair value, while profit and loss were still determined upon the recognition of realised revenues (and gains) and realised expenses (and losses) established on an accrual basis, which was also achieved through the peculiar version of revaluation (Novak, 2008). Revaluation resulting from changes in the prices of economic categories was undertaken at the end or during the reporting period due to:

- 'strengthening' of the assets - i.e. upward revaluation of the assets resulting in the increase of the carrying amount, if justified market information were available for property, plant and equipment (PPE) and financial assets;
- impairment of assets resulting in a decrease of their carrying amount, which could occur for all classes of assets if the carrying amount of the asset exceeded the asset's recoverable amount.

The impairments of all the assets were mandatory, while the upward revaluation of qualified assets (PPE or financial asset) was optional. When the qualified asset's carrying amount was increased as a result of an upward revaluation, simultaneously with the increase in the value of the assets a transitional 'revaluation adjustment'; i.e., revaluation surplus was formed in the equity section of the balance sheet. On the other hand, when an asset was impaired, the decrease of the asset's carrying amount (impairment loss) had to be taken through profit and loss of the reporting period via revaluation of the operating expenses (in the case of all the assets except financial instruments) or the revaluation financial expenses (financial instruments), unless revaluation surplus in respect of that asset was previously accumulated in the equity section (Novak, 2008).

The main differences between SAS 2002 and IFRS at that time⁵ were (World Bank, 2004):

- *Capitalization of foreign exchange losses.* SAS 9 Long-term Liabilities required that foreign exchange differences arising on reporting an enterprise's long-term liabilities at rates different from those at which they were initially recorded during the period, or reported in previous financial statements should be recognized as an adjustment to the acquisition cost when the debt is associated with the acquisition of a tangible or intangible asset. Such capitalization could result in overstated tangible and intangible

assets. In accordance with IAS 21 The Effects of Changes in Foreign Exchange Rates requires that foreign exchange losses are expensed.

- *Broader definition of extraordinary items.* The definition of extraordinary items under SAS 17 Expenses, was somewhat broader than under the IFRS, specifically including expenses resulting from the recognition of provisions for potential losses.
- *Capitalization of start-up costs.* Under SAS 2 Intangible Fixed Assets, start-up costs had to be capitalized and amortized over a period deemed to reflect their useful life. The maximum amortization period allowable was 20 years. Under IAS 38 Intangible Assets all expenditure on starting up an operation or a business needs to be recognized as expenses.
- *Treasury stock is recorded as an investment.* SAS 3 Long-term Investments required the recording of costs incurred by an enterprise to re-acquire its own equity instruments as a financial asset. The IFRS do not allow the presentation of treasury stocks as investments in the balance sheet. They are presented as a deduction from equity.

The World Bank (2004) also identified some specific differences between SAS 2002 and IFRS pertaining to banks and insurance companies.

Upon its accession to the European Union in 2004, Slovenia had to adopt the European Union's legal framework, including the law relating to undertakings, which among various pieces of legislation comprises accounting directives; i.e., Fourth Council Directive on the annual accounts of certain types of companies and Seventh Council Directive on consolidated accounts, and Regulation (EC) No 1606/2002 on the application of International Accounting Standards, issued by the International Accounting Standards Board (hereinafter IASB) (Novak, 2008).

The new Slovene Companies Act in 2006 (ZGD-1) provided the basis for the second amendment of the Slovene Accounting Standards (hereinafter SAS 2006), which entered into force on 1 January 2006.

It is still specific to SAS, though, that they are not focused exclusively on external financial reporting of past performance as, for example IFRS, which are issued by IASB. The SAS are based on the fundamental idea that the external financial reporting should also have an impact on the fundamental accounting system with specific solutions provided for internal reporting. The detailed aspects of internal reporting are not elaborated in the SAS since they largely depend on the needs and requirements of each specific business organization.

The SAS 2006 are, in the field of external financial reporting, almost completely harmonized with the IFRS. In order to achieve this level of harmonization, profound amendments of SAS were required in the following cases: property, plant and equipment – introduction of the clear separation of cost model and revaluation model for measurement after recognition; investment property – separate

accounting treatment, the possibility of using the fair value model for measurement after recognition; intangible assets – introduction of a clear separation of cost model and revaluation model for measurement after recognition, prohibition of amortization of intangible assets with indefinite useful life; financial assets – introduction of four categories of financial assets: financial assets at fair value through profit and loss, available-for-sale financial assets, held-to-maturity investments, loans and receivables – with different accounting treatment for measurement after recognition, and last but not least some changes in the balance sheet, income statement and cash flow statement (Novak, 2008).⁶

In the field of disclosure, the SAS 2006 are, in our opinion, a typical example of a differential disclosure regime. The SAS 2006 contain rather simplified note disclosure requirements compared to the full IFRS. However, the majority of them are mandatory only for the companies which shall be audited by external auditors. In accordance with the Slovene Companies Act (2006), the auditing of annual reports is obligatory for large and medium-sized Slovene companies and small companies whose securities are traded on a regulated market.⁷ The other entities shall thus at the very least make disclosures according to the mandatory very limited disclosure provisions contained in the Companies Act.

In accordance with the Companies Act (2006) currently in use, small companies whose securities are not traded on a regulated market are obliged to prepare a balance sheet at the end of each financial year (at least), as well as income statement (profit and loss statement) and notes to financial statements. Annual reports of large, medium-sized and small companies with securities traded on a regulated market shall prepare the balance sheet, income statement, statement of cash flows, statement of changes in equity, notes to financial statements and a management commentary.

Bookkeeping and the drafting of annual reports for the national budget users, as well as entities of public law (e.g., local municipalities) and private law entities, which do not keep books of accounts based on the Companies Act (e.g., private institutes) are regulated by the Accounting Act implemented in 1999.

Ding *et al.* (2007) state that accounting standards are important, but not the only determinant of financial reporting quality and that they exist as part of a mosaic of complex institutional frameworks. Therefore, we present the institutional framework of financial reporting in Slovenia.

2.2 Slovene institutional framework

Slovenia has a small securities market with the Ljubljana Stock Exchange (LJSE) as the only organised market for securities trading and only 55⁸ listed (i.e., publicly traded) companies, none of them foreign, and share market capitalisation of only €4.91 billion as of 30 December 2012⁹ (CEESEG, 2013). At the same time, total

market capitalization was €17.66 billion (LJSE, 2013). Annual domestic equity trading volume for 2012 was €360 million (LJSE, 2013). A large part of total turnover was generated by equity share trading (84%). The value of equity share trading was merely 6.1% of year-end equity share market capitalisation (302/4,911 million), which indicates relatively low turnover and general illiquidity. Moreover, 46.6% of that turnover was accounted for by one stock (Krka) and 70% by three of the most liquid stocks (CEESEG, 2013).

The shares currently traded on the LJSE are basically the consequence of a mass privatisation process and thus companies rarely received any money - i.e., raised any additional funds. The only substantial Initial Public Offering (IPO) occurred in 2008 when the government's minority stake in the second largest Slovene bank, NKBM, was sold – mainly - to the general public.¹⁰ Instead, bank financing is still the norm for most companies in Slovenia (OECD, 2011).

The taxation legislation - i.e., Corporate Income Tax Act - recognises the validity of the SAS and requires that the reports for income tax purposes are based on these standards. The basis for the calculation of taxable income is thus the commercial income from the individual entity income statement, which shall be for tax purposes modified according to specific tax rules.

In recent years not only did the corporate income tax rates decrease¹¹, but also another possibility for calculation of income tax for smaller entities was added, the special corporate income tax scheme. Since 1 January 2013, companies¹² have the possibility to determine the taxable base with respect to the revenue-based “normalized” deductible expenses. The precondition for having the possibility of choosing this special corporate income tax scheme is that the revenues (determined under the applicable accounting standards) in the year preceding the applicable fiscal year not exceed 50,000 EUR. The taxable base is in this case determined by deducting the normalized expenses amounting to 70% of taxable revenues from the taxable revenues of the applicable fiscal year.

The authors would like to emphasise that in Slovenia the financial statements of an individual, i.e. legal entity (separate financial statements) do not serve only information purposes, but also as a basis for determining taxable income and dividend payments. Since there is a close link between commercial accounting and tax accounting and because of the fact that all companies must submit to tax authorities not only the calculation of taxable income but also the financial statements and corresponding notes, we could argue that the tax authorities are an indirect general enforcement authority for accounting standards.

Regulatory and enforcement powers covering the operation of capital markets in Slovenia are largely concentrated in the hands of *Agencija za trg vrednostnih papirjev* (ATVP – the Securities Market Agency).¹³ According to OECD (2011),

Slovene legal, regulatory and institutional structures that govern the transparency and disclosure regimes for listed companies are strong and generally consistent with the relevant chapters of the OECD Principles and the Guidelines.

All large and medium-sized companies (as defined in the Companies Act), whether listed or unlisted, and all listed small companies must have their annual report audited by a registered external auditor. The auditor must also examine the management (business) report to verify whether its content is in conformity with the other elements of the annual report. Skitek (2009) found that in 2005 auditing firms audited annual reports of 645 large companies (59 of them listed), 624 medium-sized companies (14 of them listed) and 29 listed small companies.

The certification and regulation of the auditing profession was until the Auditing Act of 2008 in the sole domain of the Slovene Institute of Auditors (hereinafter the Institute), a private sector body, which is also authorised to issue the SAS¹⁴ (OECD, 2011). The Auditing Act actually introduced a two-tier structure of auditing quality supervision, where the Institute still continues the systematic process of monitoring, but which is authorised and supervised by *Agencija za javni nadzor nad revidiranjem* (Agency for Public Oversight of Auditing, hereinafter the Agency) that became operational on 1 March 2009. However, that does not preclude the Agency from performing its own supervision of the quality of auditing by individual certified auditors and auditing companies. In addition, the Agency is now responsible for all disciplinary proceedings and sanctions for breach of auditing standards, or professional requirements, which resolved the tension inherent in the previous structure.¹⁵ Since Slovenia is a small country it should not come as a surprise that the auditing profession is also rather small, comprising 56 auditing firms and 130 individual certified auditors. This creates particular difficulties in ensuring adequate auditor independence.

In addition, many Slovene companies are characterized by a high ownership concentration, quite often due to direct and/or indirect government holdings¹⁶. These major shareholders have access to information channels beyond financial statements and therefore the genuine demand for external monitoring (also auditing) might in this case be limited (Ashbaugh & Warfield, 2003; Ernstberger *et al.*, 2012).

Skitek (2009) calculated concentration ratios for the four biggest Slovene auditing firms (CR4)¹⁷ in terms of financial statement audit revenues for the period 2002-2005. Interestingly, the values of concentration ratios began to decrease in 2003 with values of 0.6418, 0.6472, 0.6334 and 0.6101 in 2002, 2003, 2004 and 2005. According to Le Vourc'h, and Morand (2011), the values of CR4 between 0.50 and 0.80 indicate oligopoly.¹⁸ The same can be observed for the values of the Herfindahl-Hirschman Index (HHI), which were 0.1357, 0.1265, 0.1258 and 0.1130 in 2002, 2003, 2004 and 2005. HHI values below 0.15 according to Le

Vourc'h, and Morand (2011) indicate that the particular market, in our case Slovene financial statement audit services market for the period 2002-2005, was not concentrated.

In addition, Le Vourc'h, and Morand (2011) calculated the following concentration ratios for Slovenia in 2009 in terms of the number of audit mandates in companies listed on the regulated national stock exchanges in 2009: CR1=0.34, CR4=0.66, CR8=0.88 and HHI=0.1672. Huber (2011) using 2010 data demonstrates a dominant Big 4 share of audit mandates in Slovene listed companies with a market cap greater than €100 million (91%, 10 out of 11) as well as in Slovene listed companies with market cap greater than €50 million (59%, 10 out of 17).

From its inception in 1993, Slovene company law adopted a two-tier board structure for corporations, comprising a supervisory board and a management board. Under the current Companies Act of 2006, corporations can also choose a single tier board structure. Currently the two-tier model prevails amongst larger, listed corporations, while single-tier boards are mainly adopted by smaller corporations. Supervisory boards in Slovenia have the power to establish an audit committee, but are not obliged to do so, though the Slovene Corporate Governance Code recommends the establishment of an audit committee as a standard practice.¹⁹ The Code also sets out the main responsibilities that the audit committee should perform, including monitoring the company relationship with the external auditor. These responsibilities include: cooperating in the selection of the auditor and preparing the agreement between the auditor and the company, calling the external auditors' attention to important or problematic areas, and monitoring the independence, impartiality and effectiveness of the auditor. While the adoption of the Code by listed companies has increased the use of audit committees, outside the listed sector their use is not widespread (OECD, 2011). Hence, we could conclude that some Slovene corporations have established additional financial reporting enforcement mechanisms in the form of auditing committees.

Therefore, it could be concluded that the degree of enforcement in Slovenia varies due to the differences in enforcement mechanisms applicable for various types or sizes of companies. Nevertheless, if a company is not listed and is not a corporation with an audit committee, but is subject to statutory external audit, then there is no other direct official financial reporting enforcement authority apart from the external auditor.²⁰

Table 1 summarizes the most important characteristics of the Slovene accounting and institutional framework.

Table 1. Characteristics of the Slovene accounting and institutional framework

Accounting model	Continental European model
Legal system	Code law
Source of financing	Mostly banks
Accounting principles	SAS 1993 – Dominant prudence principle; SAS 2002 – Strong prudence principle, principles of fair value introduced; SAS 2006 – In line with the IFRS
Users of financial statements	Most often existing and potential creditors
Relationship with taxation	Close connection - the basis for the calculation of taxable income is thus the commercial income
Stock market	The Ljubljana stock exchange is small in international terms – 55 listed companies, relatively low turnover and general illiquidity, approximately two-thirds of turnover by the three most liquid stocks
Corporate governance	Companies Act 1993 – Two-tier board structure for corporations Companies Act 2006 – Companies can choose between single-tier or two-tier board structure

Most of the characteristics presented in the table 1 remained unchanged from the time when Slovenia became independent. Changes occurred only in the case of accounting principles (in SAS 2002 the fair value principle was introduced) and the field of corporate governance (from 2006 companies can choose between two different types of board structure).

3. IFRS application

Upon accession to the European Union,²¹ Slovenia had to adopt the European Union's legal framework, including law relating to undertakings, which among various pieces of legislation comprises Accounting Directives and 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 (IAS Regulation). The IAS Regulation requires all European Union (EU) listed companies - i.e., companies with publicly traded securities - to adopt IFRS when preparing group accounts; i.e., consolidated financial statements for financial years starting on or after 1 January 2005²² (Novak, 2008).

According to IAS Regulation Member States may permit or require IFRS to be applied to the consolidated financial statements of companies whose securities are not admitted to trading on a regulated market in the EU and/or to separate annual financial statements regardless of whether the company has EU publicly traded securities.

Slovenia extended the mandatory application of IFRS to both consolidated and non-consolidated financial statements of all banks and insurance companies. Banks are obliged to report under IFRS for financial years beginning after 2006 as are insurance companies. On the other hand, Slovenia accepts the application of IFRS to all types of companies for separate annual (non-consolidated) financial statements and consolidated financial statements (of non-publicly traded companies), but only if the company's annual general meeting decides on the usage of IFRS for the minimum of five successive fiscal years. Other companies need to apply the SAS 2006.

Although IFRS were implemented by many companies worldwide, that is not the case in Slovenia. The main reason involves the characteristics of the Slovene economy. The majority of Slovene companies are small and medium-sized (non-publicly quoted) and thus do not prepare consolidated financial statements. According to the data of the Slovene statistical office (SORS, 2014), in 2013 Slovenia had the following structure of companies by size (measured by the number of employees): 94.3% micro companies (fewer than 10 employees), 4.2% small companies (10-49 employees), 1.3% medium-sized companies (50-249 employees) and 0.2% large companies (more than 250 employees). Most of these companies use the SAS 2006.

Table 2 shows the most important characteristics of the IFRS application in Slovenia.

Table 2. IFRS application in Slovenia

Listed companies	Mandatory adoption for consolidated financial statements for financial years starting on or after 1 January 2005; allowed to use IFRS for separate financial statements.
	Mandatory for consolidated and separate financial statements of companies in prime market for public releases on or after 1 January 2006.
Not-listed companies	Allowed to use IFRS for separate and consolidated financial statements (minimum for 5 years).
Banks	Mandatory adoption for financial years starting on or after 1 January 2006.
Insurance companies	Mandatory adoption for financial years starting on or after 1 January 2007.
Expected benefits/costs	IFRS adoption enables an entity to present its financial statements on the same basis as its international competitors and thus enhances comparability. That should also facilitate raising capital abroad and decrease the cost of capital. It could also positively influence the quality and transparency of financial reports. There is general consensus that the transition to IFRS is a costly, complex and burdensome process (see Jermakowicz & Gornik-Tomaszewski, 2006; De George <i>et al.</i> , 2013).
National accounting standards	The SAS 2006 are harmonized with IFRS in basically all aspects of recognition and measurement.

Referring to the Slovene stock market²³, the prime market participants are required to comply with the IFRS and to provide all market releases in both English and Slovene (OECD, 2011). All the other publicly quoted companies (except banks and insurance companies, which must report under the IFRS) are obliged to report under IFRS only if they are obliged to prepare consolidated financial statements.

Since the number of prime market participants is small (only 9) and at the same time not all of the remaining publicly quoted issuers of shares (46) have to prepare consolidated financial statements, the number of companies which have to apply the IFRS is rather small in international terms.

4. Consequences of IFRS application

4.1 Companies Act and Corporate Income Tax Act

The implementation of IFRS in Slovenia required amendments of the Companies Act and Corporate Income Tax Act. At that time Odar (2003) emphasized the need to introduce into the Slovene Companies Act the fair value concept of valuation (he especially emphasized the field of financial instruments). The updated version of the Companies Act entered into force at the end of 2004 and introduced more specific principles of valuation. The Act introduced the fair value principle. Since the principles were supposed to be applied in accordance with the accounting standards, the Companies Act provided no further guidance for their use in practice.

Considering that the SAS 2002 have already introduced into Slovene accounting environment the basis for measuring individual items in the balance sheet at fair value, the transition to IFRS was in this sense not problematic. The SAS 2002 were already based on modern valuation of items in the financial statements, primarily recommending and underlining a true and fair presentation of assets and liabilities.

However, Duhovnik (2007) emphasises that the fair value concept is problematic in countries with less developed markets. Among all the items that can be valued at fair values, the most problematic are the financial instruments. According to the accounting standards, the best evidence of fair value is a quoted price in an active market. The question arises as to whether an active market in fact implies an efficient market. As stated by Duhovnik (2007), the Slovene capital market is not efficient. She argues that the prime and standard markets are a weak form of market efficiency, while the entry market is even less efficient (the volume and number of transactions is very low). This is why the fair value measurement in such circumstances might be questionable.

In the Corporate Income Tax Act the particular changes referred to the fact that companies were giving the option to calculate the tax base based on revenues and

expenses recorded under the IFRS (and not only the SAS), the possibility of recognizing deferred taxes and the option of drawing up the tax return even for periods which are not equal to the calendar year. According to Odar (2003) the implementation of the IFRS was easier than it would have been if the SAS 2002 would not have been based on the similar theoretical bases as the IFRS.

4.2 Review of research from the field of IFRS application

The structure of Slovene companies by size and the number of publicly quoted companies on the Ljubljana stock exchange (in April 2014 only 55) which have to prepare consolidated financial statements (and thus report under the IFRS) are most probably the principal reasons why the scientific research from the field of the IFRS implementation and continuous use of the IFRS in practice of Slovene companies is very limited.²⁴

Since Slovenia's independence the Slovene Institute of Auditors has been performing surveys to assess the state of accounting development in Slovene companies. The survey was performed in 1995, 2001, 2006 and 2011 (see for example Kavčič *et al.*, 2010; Kavčič *et al.*, 2011) and is the largest of its kind in Slovenia. However, the survey was never focused exclusively on IFRS adopters and thus the results of the survey were never presented separately for companies of this kind. Moreover, the majority of their scientific papers refer mostly to the field of management accounting.

Up to date studies in this field explore only the content and extent of disclosures provided by IFRS users.

The contest for the best annual report is widely recognized in Slovenia; it has taken place for the last 14 years and is organized by Slovenia's largest business journal "Finance". The evaluators of annual reports are highly qualified professionals from the field of finance and accounting. Annual reports for the financial year 2012 were evaluated by five professionals (one academic and four from practice). Companies are classified into four groups: large companies, medium-sized and small companies, financial institutions and other entities. Annual reports were given a maximum of 1,000 points. The evaluators were giving scores for six parts of the report - i.e., a) introduction part (highlights, management report, report of supervisory board) – max. 100 points; b) performance analysis, economic trends, vision, strategy, plans – max. 150 points; c) risk analysis, system of corporate governance, chief executive report - max. 150 points; d) environmental aspect, social responsibility, information about human resources and research and development - max. 100 points; e) accounting report - max. 350 points and f) communication strategies - max. 150 points. A more detailed list of evaluation criteria is not publicly available. The journal "Finance" publishes the winners and their total score. At the latest contest among all the participants the highest score

was received by the pharmaceutical company Krka (936 points). Krka Group was the biggest Slovenian exporter in 2013 (second in 2012) with 1.11 bn in sales realised abroad, representing 93% of its total sales.²⁵

Each year many publicly quoted companies which report under the IFRS take part in this contest; e.g., in 2008 when the financial crisis in Slovenia had only just begun, 33 companies applied for the contest, among which 15 reported under the IFRS. On the other hand the annual report for the financial year 2012 was submitted for evaluation by 24 companies, among which 8 used the IFRS (none of them used the IFRS on a voluntary basis). Even if the results of the analysis may not be completely generalizable to IFRS preparers, we present some of the evaluators' findings, since we believe that many of them hold also for IFRS preparers that take part in the contest. Horvat (2013a) who is the head of the contest states that annual reports for 2012 have in contrast to previous ones better disclosures in the field of business and financial risks. Moreover, a novelty in the 2012 annual reports is the disclosures about the usage of going concern principle and deferred tax receivables (Horvat, 2013a). Companies are becoming more willing to provide more information, especially about liquidity and credit risk. Horvat (2013b) indicates that companies began disclosing information about violations of debt covenants. On the other hand deficiencies refer to too general descriptions of internal controls and risk management in processes of financial reporting (i.e., the description of controls which are set up to ensure that data and disclosures in annual reports are correct and complete). Some companies even omitted this information. In terms of notes to financial statements the evaluators state that the overall quality of notes is good and, moreover, that their extent is increasing from year to year. Nevertheless, it seems that there is still a lot of room for improvements in this field, especially since the following issues were identified (Horvat, 2012):

- in some of the financial statements the note references are missing;
- in notes where the changes of tangible and intangibles assets are provided, the data for previous period(s) is from time to time missing;
- in the case of financial instruments, it is not clear to which of the groups they belong and the information about valuation methods used to determine their value is not always provided;
- disclosures about deferred taxes are often not in conformity with the requirements of the IFRS;
- disclosures about the short-term account receivables are not compliant with the IFRS. The information about their maturity, changes in value adjustments, secured claims is often missing;
- disclosures about related parties are not sufficient;
- disclosures about the credit risk were incomplete;
- as part of accounting policies disclosures, improvements could be done also by providing more detailed information about impairment policies for property, plant and equipment (PPE), intangibles and investment property.

During the latest financial crisis the annual report contest evaluators noticed that the overall quality of the disclosures in the annual reports did not deteriorate because of the decline of companies' performance (Horvat, 2011).

Another study was focused particularly on intangible assets (Jerman, 2013). The analysis was focused on companies being part of primary and standard quotation on the Ljubljana Stock Exchange (21 companies) using data from the five-year's period: 2007–2011. These types of studies assume that larger companies provide a broader extent of disclosures in comparison with smaller companies.

Financial institutions were excluded from the analysis. In total the author explored 90 annual reports. Selected companies reported in accordance with IFRS. The analysis of disclosures revealed that companies almost solely provide disclosures required by the IFRS, while voluntary disclosures are not provided. The reason most probably concerns the fact that for Slovene publicly quoted companies the most important financial sources are banks and thus they are not stimulated to provide additional disclosures (as in Anglo-Saxon accounting system). Moreover, the analysis found some deficiencies and thus provided guidance for the further improvement of reporting. The author also found that reporting practice had improved since the occurrence of the latest financial crisis.

Up to date studies are still lacking from the field of the cost/benefits of IFRS implementation, value reliability and value relevance (table 3). The reason likely concerns the fact that a relatively small number of companies is publicly quoted, and thus some frequently used statistical methods of analysis are difficult to apply. There have been some attempts in master's theses, but scientific research has yet to be done.

Table 3. Consequences of IFRS implementation in Slovenia*

Levels of compliance	Increasing, especially since the beginning of the financial crisis; however there are still deficiencies
Factors affecting the level of compliance	Studies are lacking
Transparency	Studies are lacking
Costs/benefits	Studies are lacking
Value relevance studies	Studies are lacking

* *Note:* the authors would like to point out that the analysis is based on a very limited number of studies. At the same time some studies have limitations concerning the generalisability of the results to IFRS users.

5. Conclusions

Since Slovenia became independent many changes in the accounting field have occurred. The first SAS (1993) were prepared based on the Code of Accounting Principles and characterized by the prudence principle. The issuance of SAS 2002 was a response to the changing economic environment (decreasing inflation rate, increasing globalization, beginning of the process of joining the EU). At that time the new SAS (SAS 2002) for the first time introduced the fair value principle. The SAS 2006 were a further step toward harmonization with the IFRS. The basic financial statements in the SAS are still separate financial statements, which also provide the basis for tax reports. While the SAS 2006 are less comprehensive than the IFRS, in the field of recognition and measurement they are almost completely harmonised with the IFRS and should, according to the Slovene standard setter, yield similar reporting results to the IFRS in most cases. Since the IFRS are considered high quality accounting standards (see, for example Chen & Zhang, 2010), the same conclusion could probably also be reached for the SAS 2006, especially in the field of recognition and measurement.

The evolution of Slovene national accounting standards was also affected by the institutional characteristics among which we found the most important to be underdeveloped financial markets, concentrated ownership, dominant bank financing, close linkage between financial accounting income and taxable income, and a limited auditing profession.

In 2005 Slovenia introduced the mandatory application of the IFRS for consolidated financial statements of publicly traded companies (for the financial years starting on or after 1 January 2005). Slovenia extended the mandatory application of the IFRS to both consolidated and non-consolidated financial statements of all banks and insurance companies. Slovenia also allowed the application of the IFRS to be available for entities other than publicly traded companies for their consolidated financial statements and to all types of companies for separate annual (non-consolidated) financial statements. Companies listed on the prime market of the Ljubljana Stock Exchange are also required to comply with the IFRS for their separate financial statements. Nevertheless, in practice smaller listed companies and the small and medium-sized entities (hereinafter SMEs) are typically still relying on the SAS 2006.

This could thus be considered a two-tiered structure of accounting regulation, which generally impairs comparability. But this is not entirely the case in Slovenia, because the SAS 2006 are, in the field of recognition and measurement, almost completely in conformity with the IFRS (see Novak, 2008).

We argue that the characteristics of the economy (in terms of companies' sizes) and the number of publicly quoted companies (which is rather small) are a primary

reason why only a relatively small number of companies report under the IFRS. The majority of SMEs most likely perceive the preparation of financial statements under the IFRS to generate more cost than benefits and thus they do not adopt the IFRS on a voluntary basis. We also believe that the IFRS for SMEs, which was issued by the IASB in July 2009, would also not be attractive for entities with a domestic orientation. The EU Member State could place the IFRS for SMEs in its legal framework only if it is not in conflict with EU Accounting Directives, whereas the European Commission has not yet officially proclaimed whether any conflict really exists. Concerning adoption of the IFRS for SMEs we can expect that Slovenia will follow the example of other EU Member States although it is in our opinion quite likely that due to the enormous economic significance of the SMEs in the EU the issue will be decided at the EU level. Nevertheless, the Slovene accounting profession is not overly enthusiastic about the IFRS for SMEs because it believes Slovenia already applies a sort of simplified version of the IFRS, tailored to the needs of Slovene SMEs and proved in practice – SAS 2006. We found a pronounced limitation of studies performed on samples of IFRS users in Slovenia. To date studies of this kind almost exclusively explored the level of disclosures compliance. Their findings indicate that the disclosure level is improving, especially from the beginning of the latest crisis.

The literature review from the field of IFRS application in Slovenia shows that there are numerous possibilities for further research. To date there are no scientific studies from the field of value relevance, value reliability and furthermore studies which would determine the costs and benefits of IFRS application.

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¹ The first SAS were issued by the Association of Accountants, Treasurers, and Auditors of Slovenia. In 1994 the Association of Accountants, Treasurers, and Auditors of Slovenia founded the Slovene Institute of Auditors, which became responsible for developing accounting, auditing and other (closely related) professions in Slovenia. Since 1994, SAS were adopted by the Slovene Institute of Auditing in agreement with the minister for economy and finance. The Slovene institute of auditing is also in charge of carrying several professional certification programmes (i.e., certified accountant, certified auditor, etc.).

² See La Porta *et al.* (1998). Ball (2001) wrote that public versus private provision of information is an important difference between common-law and code-law governance systems. The implication for accurate and independent public financial reporting is simple: the demand for such information is lower in code-law countries than in common law countries. See also Ball (2006) for the differences in financial reporting quality between common-law and code-law countries.

³ One particular characteristic of the SAS was the compulsory revaluation (indexation) of assets with the inflation rate (affecting the value of owners' equity).

- ⁴ Project was coordinated by Hans Jürgen Zahorka from Deutsche Stiftung IRZ and the Care Experts were Prof. Peter Dorlat from Wirtschaftsuniversität Wien (Austria) and Prof. Marijan Kocbek from University of Maribor, Law Faculty (Slovenia) (*Zakon o gospodarskih družbah s komentarjem*, 2002).
- ⁵ The details on the differences between SAS 2002 and the IFRS at that time can be found in Novak (2007b) and are summarised in Table 10.4.
- ⁶ The remaining minor differences are identified in Novak (2007b) and are summarised in Table 10.3.
- ⁷ The Slovene Companies Act (2006) classifies companies into four categories - micro, small, medium-sized and large. The criteria are: average number of employees during the financial year, net turnover (sales) and balance sheet total (value of total assets). Thresholds for small and medium-sized categories are the same as in the previous (old) EU Accounting Directives (http://ec.europa.eu/internal_market/accounting/sme_accounting/thresholds/index_en.htm), while the micro undertakings are those which on their balance sheet date does not exceed the limits of at least two of the three following criteria: average number of employees: 10, net turnover 2,000,000 EUR and balance sheet total 2,000,000 EUR.
- ⁸ As of 11 April 2014 (<http://www.ljse.si/cgi-bin/jve.cgi?doc=2567>).
- ⁹ Immediately after the mass-privatisation process, there were over 200 companies listed on the LJSE. However, their number has steadily diminished over time, partly as the result of leveraged management buyouts. As a result, there has been a substantial delisting of smaller companies. In the middle of 2008 LJSE was taken over by the Vienna Stock Exchange.
- ¹⁰ On 20 December 2013, NKBM received a decision of the Ljubljana Stock Exchange on the de-listing of 323,103,520 KBMR shares (<http://www.nkbm.si/content/11834/Delisting-of-KBMR-shares-and-KBM9-bonds>). That was the consequence of extraordinary measures imposed by the Slovene central bank (Bank of Slovenia) in order to prevent NKBM's bankruptcy. For more details, see <http://biznes.interia.pl/news/nova-kbm-received-a-decision-on-extraordinary-measures-and-a,1974449,1081>.
- ¹¹ The general corporate income tax rate for the fiscal year 2012 was 18%, decreased to 17% in 2013 and remained the same for 2014. It had been declining from 25% for one percentage point each fiscal year until it reached 20% in 2010. The special tax rate of 0% is applicable for investment funds, pension funds and venture capital companies if they fulfil prescribed conditions defined by tax law. The tax law also delineates special tax deductions; for example, a 100% R&D investment deduction. See Garrod *et al.* (2008) for taxation under former *Zakon o davku od dobička pravnih oseb* (ZDDPO – Corporate Income Tax Act [consolidated version 2003]).
- ¹² This is applicable also for sole proprietorships, which are subject to personal income tax.
- ¹³ Bank of Slovenia and Insurance Supervision Agency have general regulatory and enforcement authority, including accounting provisions, over banks and savings banks and insurance companies, which must apply the IFRS for their consolidated as well as separate annual financial statements.
- ¹⁴ For more details see World Bank (2004) and Slovene Institute of Auditors (2007) for standard-setting in Slovenia. Auditing firms are not directly involved in the standard-setting process, although among the seven members of the Slovenian Accounting Standard Committee of Slovene Institute of Auditors two need to be certified auditors.

Other members are: two university professors, two certified accountants working as preparers of financial statements and a permanent chairperson.

- ¹⁵ In the period 2003-2008, the Institute issued 24 public warnings, 27 remedial actions and withdrew one license for various breaches of required auditing procedures (OECD, 2011).
- ¹⁶ See OECD (2011: 18-19), and Cankar & Deakin (2010) for the process of post mass privatisation ownership consolidation in Slovenia.
- ¹⁷ Although Skitek (2009) was not specific about that we can assume that those are the Big 4 accounting firms.
- ¹⁸ Please note that Skitek (2009) claims that the oligopolistic nature of financial statement audit services market in Slovenia applies only for auditing of listed companies. He also found out that auditing firms cumulatively earned 66 % of their revenues from big company audits.
- ¹⁹ For companies with a single-tier structure, audit committees are compulsory if they are listed or have workers participation in management (OECD, 2011).
- ²⁰ We have already pointed out that in Slovenia tax authorities are an indirect general accounting standards enforcement authority. Please also note that the Slovene central bank Bank of Slovenia reviews financial statements of banks, however the main enforcement responsibility rests with the auditors.
- ²¹ Slovenia became a member of the European Union on 1st May 2004 and a member of the European Monetary Union on (EMU) 1st January 2007.
- ²² See van Hulle (2004) and Zeff (2012) for more details on the developments in this field.
- ²³ The listed equity market is segregated into three tiers: a prime market (9 issuers), a standard market (13 issuers) and an entry market with 33 issuers (<http://www.ljse.si/cgi-bin/jve.cgi?doc=2567>). All three tiers of the market are “regulated markets” within the meaning of the European directives. The higher tier markets are also subject to greater transparency and disclosure requirements under the listing rules. For instance, issuers on the prime and standard markets are required to issue quarterly financial reports and to issue annual statements about compliance with the Corporate Governance Code, whereas entry market issuers are not (OECD, 2011).
- ²⁴ Moreover, in Slovenia there are very few academics working in the field of accounting. There are four universities, among which only two have an accounting department. In total there are only about 20 academics doing scientific research in this area.
- ²⁵ Available on-line at <http://www.izvozniki.si/8502929/Novome%C5%A1ka-Krka-je-najve%C4%8Dji-izvoznik>.