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Abstract

Globalization of business and free flow of capital resulted in strong demand for comparable financial reports worldwide. An important element of achieving de facto harmonization of financial reporting is de jure harmonization, i.e. harmonization of regulatory requirements on the country level. Although more than 100 countries have a requirement for use of IFRS (International Financial Reporting Standards) for listed companies, de facto harmonization is still an ongoing process. De facto harmonization is affected by many influential factors, among which de jure harmonization represents one of the most important factors. For the purpose of the study, the authors developed an index of de jure harmonization (IDJH) based on the EU regulatory framework and evaluated its value for 5 CEE countries (Croatia, Bosnia & Herzegovina, Montenegro, Slovenia and Serbia). Empirical findings reveal significant differences in de jure harmonization, related to the country's status in relation to EU integration processes.

Keywords: *de jure harmonization, financial reporting, CEE countries*

1. INTRODUCTION

The role of financial reporting and accounting information is very important for the efficient functioning of the capital markets. Since 2005, the financial reporting framework of the EU member states has been harmonized by introducing the mandatory application of IFRS for listed companies. All future EU member states need to adapt to this regulation. Financial reporting of listed companies in more than 100 countries is based on IFRS and many studies focused on IFRS implementation. Until 2013, conducted studies are silent on the quality of IFRS implementation and actual level of IFRS compliance, which may vary significantly among IFRS adopting countries.

Financial reporting under IFRS implies that the company discloses valuable accounting information to users of its financial statements in making decisions relating to providing resources to that company. Users of financial statements and researchers must be aware that the mandatory application of IFRS does not automatically mean full compliance with IFRS, especially in the former socialist countries of Central and Eastern Europe, where the selected countries from this study belong (Croatia, Bosnia & Herzegovina, Montenegro, Slovenia and Serbia). It is questionable whether IFRS are an effective solution to a serious agency problem. Companies that are required to apply IFRS operate in different institutional environments affecting their financial reporting regardless of the mandatory application of IFRS. Harmonization of financial reporting accompanied by the adoption of uniform accounting standards, differences in the implementation of these standards between countries will play a significant role in companies' financial reporting (Leuz, 2010).

The cross-country analysis that we have undertaken can serve as a helpful tool for countries to identify weaknesses in their accounting and auditing regulatory framework and, as such, contribute to the improvement of their legal framework, monitoring programs, prosecution, and application of penalties. These steps are necessary to enhance the national framework's harmonization with the EU regulatory framework and, ultimately, investor confidence.

The remainder of the paper is organized as follows. Section 2 provides a brief literature review on the issue. In Section 3, we analyze the process of the de jure harmonization of financial reporting. Section 4 describes the construction of an index of de jure harmonization (hereafter IDJH) and empirical findings. Section 5 concludes the paper.

2. PREVIOUS RESEARCH

Until 2005 and mandatory use of IFRS, the subject of most de jure harmonization research was the description of the development of international and national financial reporting regulatory frameworks with an emphasis on the IASB or its predecessor IASC (Garrido et al., 2002), identification and measurement of differences in national accounting regulations, i.e., legislation, capital market regulations, national accounting standards (Adhikari & Tondkar, 1992; Rahman et al., 1996; Brown & Tarca, 2005; Brown & Tarca, 2007), comparison of national accounting standards with international accounting standards (IFRS, US GAAP) in force 1990s or the early 2000s (Fontes et al., 2005; Ding et al., 2007) and examining the impact of EU directives and regulations on the national regulatory framework for financial reporting (Daniel et al., 2001; Larson & Street, 2004; Sucher & Jindrichovska, 2004; Haller & Eierle, 2004; Vellam, 2004; Delvaille et al., 2005).

Numerous previous scientific studies have conducted a classification of countries according to their legal system (according to La Porta et al., 1998), dividing countries into common law countries and code law countries. However, according to the general legalist orientation, such a division of countries does not provide insight into those segments of the legal system responsible for differences in companies' financial reporting at the time of mandatory application of IFRS. Selected 5 Central and Eastern European countries (hereafter CEE countries) belong to the same legalistic orientation (code law countries). However, there are significant differences in the de jure harmonization of financial reporting factors below the law, which affect the financial reporting practices of listed companies from that countries.

The analysis of the available relevant scientific papers from the available databases leads us to conclude that there is a limited detailed research of accounting and auditing regulation for the listed companies in the selected CEE countries.

The World Bank experts periodically analyze progress in adopting standards and codes in transitional and emerging economies. The World Bank studies exist for all selected 5 CEE countries (World Bank, 2007a, 2007b, 2010, 2014, 2015) and analyze basic regulatory framework (Companies Act, Accounting Act and Auditing Act) in order to identify the legal basis for IFRS and International Standards of Auditing (ISA) implementation.

Alongside with one-country studies: Slovenia (Garrod & Turk, 1995; Jerman & Novak, 2014; Novak & Valentinčič, 2017), Croatia (Šodan & Aljinović Barač, 2017), Bosnia & Herzegovina (Tomić et al., 2009), Serbia (Denčić-Mihajlov, 2009) the limited number of papers conducted analysis in cross-country settings, like Janković, Ljutić, and Klikovac (2009) who used the sample of 2 CEE countries. The authors described the development of the regulatory framework for external audit in Croatia and Serbia. They emphasized that Croatia is significantly more successful in adopting and implementing IFRS than Serbia, which has a long way to establish a stable institutional framework for financial reporting. They emphasized the importance of audit role in increasing public confidence in corporate financial reporting due to corporate scandals that have decreased the credibility of regulators and described the process of developing the regulatory audit framework in the US and EU.

Pervan, Horak and Vasilj (2010) made a comparative analysis of the financial reporting regulation for six Eastern European countries. The authors concluded that the stage of EU accession directly affects the harmonization of financial reporting regulation in the selected countries since the empirical analysis revealed that Slovenia is completely harmonized with the EU. At the same time, non EU countries like Croatia and FYR Macedonia are harmonized with the EU in many elements. Other sampled countries are less harmonized with the EU requirements, and their financial reporting requirements are at a lower level.

Sever Mališ and Brozović (2015) conducted a comparative analysis of the public audit oversight system of selected seven European Economic Area countries (Croatia, United Kingdom, Switzerland, Malta, Netherlands, Norway, and Slovenia). The analysis showed that national public oversight systems meet at least the minimum requirements laid down in Directive 2006/43/EC, but there are significant differences between their public oversight systems.

The regulatory authorities of the EU are aware of the importance of enforcement mechanisms that aim to ensure the rigorous application of IFRS by listed EU companies concerning the fact that there have been many changes in the audit and accounting enforcement environment since the mandatory adoption of IFRS began in 2005. European Commission (2000) emphasized the importance of disseminating implementation guidance, encouraging high-quality audits, and reinforcing coordinated regulatory oversight. Therefore, it is important that national accounting and auditing frameworks are harmonized with the EU. Accordingly, scientists have become aware that a basic legal framework is not enough; enforcement is crucial for companies to follow the rules (Carvajal & Elliott, 2009). Some studies demonstrate their significance in developing proxies related to accounting and auditing enforcement rather than the legal system more generally (Al-Shammari et al., 2008; Preiato et al., 2013a; Brown et al., 2014). The authors selected items that are likely to affect the quality of information available in capital markets and thus to be important for investor decision making.

To achieve better, deeper insight into national accounting, auditing framework, and corporate governance systems, it is necessary to develop an index with disclosure provisions based on the EU requirements concerning accounting, financial reporting, auditing, corporate governance valid for listed companies. This is in line with a stream of research like Brown et al., 2014, Tsalavoutas et al., 2014.

3. DE JURE HARMONIZATION OF FINANCIAL REPORTING

Alexander and Nobes (2010) define harmonization as a process of increasing the compatibility of accounting practices by setting bounds to their degree of variation. According to Alexander and Nobes (2010), it is necessary to distinguish between de jure harmonization (that of rules, standards, etc.) and de facto harmonization (that of corporate financial reporting practices).

De facto harmonization is affected by many influential factors, among which de jure harmonization represents one of the most important factors. The development of the capital

markets and increasing business complexity is changing financial statement users' needs, so the regulatory framework of financial reporting changes and develops to respond to changes in the business environment by influencing the company's accounting practices.

The dynamics of the transition process towards free market economy in the early 1990s were not the same among selected 5 CEE countries. The privatization process itself is pretty challenging and complex. In the selected CEE countries, it took place in parallel with the institutions building process. These countries have opened up to global trade, expanded the role of the private sector and built the institutions needed to support a free market economy. Selected CEE countries differ in GDP per capita, financial stability, institutional reforms, capital market development, development and independence of the accounting and auditing profession, protection of shareholders' rights, the efficiency of law enforcement mechanisms, quality of education, EU accession phase, etc. Croatia and Slovenia are EU member states. Montenegro and Serbia are candidate countries, while Bosnia & Herzegovina is a potential candidate country. These countries are trying to become EU members, so they are integrating EU legislation into national law.

The reporting platform is the same, i.e.; companies use IFRS. Still, de jure harmonization at each country's level is different due to different ways of adapting national legal systems and all national institutions related to the accounting and auditing profession to international harmonization of accounting and auditing regulations. De jure harmonization of financial reporting includes harmonization of laws, regulations, requirements for audit quality, rules of the accounting and auditing profession, capital market rules, supervision of the auditing profession, and all regulations which regulate mandatory financial reporting, auditing, corporate governance of listed companies with the relevant regulations in force in the EU.

4. RESEARCH METHODOLOGY AND RESULTS

4.1. Methodology for de jure harmonization measurement

The challenge for scientists may be to develop an instrument to measure differences in national legal systems, institutional arrangements, and enforcement mechanisms on which the application of IFRS in each observed country depends (Brown et al., 2014). For the purpose of the study, the authors developed an IDJH based on the EU regulatory framework and evaluated its value for 5 selected CEE countries for 2016 and 2020. The developed index shows the level of harmonization of national financial reporting regulations with EU regulations in 2016 and 2020. Financial reporting is very dynamic in terms of frequent regulatory changes, so it should emphasize that the study of de jure harmonization of financial reporting is conducted on the regulations in force for 2016 in the EU. 2016 is associated with significant changes in financial reporting regulations at the EU level, which are still in force. So it is interesting to analyze the level of the jure harmonization of national regulative with EU requirements by countries with different status in the accession process (member country, candidate country and potential candidate country) and the progress of that process over time.

Directive 2014/95/EU, the application of which began on 1 January 2017, is not included in the IDJH in 2016 and 2020 because it was not mandatory in 2016, so it would not be possible to compare results of IDJH for 2016 and 2020 if provisions of that Directive are part of IDJH for 2020. However, country compliance with the Directive in 2020 will be mention within the interpretation of the results. Preiato et al. (2013a) state that the lack of studies that analyze regulatory frameworks for financial reporting is that rules change over time. Hence, it is necessary to consider the period to which the research results relate.

The IDJH includes the provisions of Accounting Directive 2013/34/EU, which is also different from previous studies that relied on the Fourth and Seventh Directives, which were repealed after the introduction of Accounting Directive 2013/34/EU, which entered into force in

2016. In studies examining the implementation of IFRS, the audit profession, i.e., the national organization and supervision of the audit profession, stands out as one of the most important implementation mechanisms (Preiato et al., 2013b; Tsalavoutas et al., 2014). So the IDJH also includes the provisions of Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts, provisions of Directive 2014/56/EU amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts and Regulation no 537/2014 on specific requirements regarding statutory audit of public-interest entities. The role of external auditors and independent enforcement bodies is key to the process of improving compliance with IFRS (Al-Shammari et al., 2008). An important element of EU regulation for listed companies is Transparency Directive.

Accounting directives and regulations issued by the EU and IFRS prescribed by the EU affect not only the member states but also non-EU countries. Efforts and desire of non-EU countries to become members of the EU and their economic and trade ties with the EU are the reasons for that. Boross et al. (1995) proved that Hungary's efforts to become a member of the EU greatly influenced the formation and enactment of the Accounting Act, which entered into force in 1991. Given Serbia's desire to become a member of the EU, there are political pressures to build and ensure a regulatory system and corporate governance practices that will provide a sufficient level of transparency and market efficiency (Denčić-Mihajlov, 2009). The strongest driver of reform in non-EU countries is the EU accession process.

Conclusions of scientists (Al-Shammari et al., 2008; Preiato et al., 2013a; Brown et al., 2014; Tsalavoutas et al., 2014) who are aware of the importance of enforcement mechanisms for the consistent application of IFRS in practice provide an incentive to include enforcement-related items valid at the EU level in the developed index.

Calculation of the IDJH is performed for each country in the sample by assigning a value of 1 for each item if compliance with EU regulations is present or 0 if there is no compliance. The maximum value of the IDJH for each country is 63, in which case there is a complete de jure harmonization of financial reporting in the observed country.

4.2. Empirical findings

Sampled countries have different laws which regulate accounting and auditing. Common in all countries is usage of IFRS for the segment of listed companies and all the sampled countries require International Standards of Auditing for the auditing of financial statements. This paper is not about basic characteristics of accounting and auditing; we conducted detailed analyses of auditing, accounting, and corporate governance provisions in comparison with EU regulation in force.

Collected valid data for 2016 and 2020 for measurement of the level of de jure harmonization are from the websites of national institutions, accounting and auditing bodies, capital market regulators, local capital markets and companies. The highest value of IDJH in 2016 is in Slovenia, where it is 61, and the lowest in Montenegro, where it is 18. The highest value of IDJH in 2020 is in Croatia, where it is 63, and the lowest in the Federation of Bosnia & Herzegovina, where it is 36.

Table 1 IDJH value by the country for 2016 and 2020

Country	IDJH (max value = 63)	
	2016	2020
B & H - Federation of Bosnia & Herzegovina	34	36
B & H - Serbian Republic	44	49
Croatia	60	63
Montenegro	18	53
Serbia	48	57
Slovenia	61	62

Source: author's calculations

Bosnia & Herzegovina consists of two separate entities, Federation of Bosnia & Herzegovina (hereafter FBiH) and Serbian Republic. Two entities have separated capital markets and regulation.

Accounting and Auditing Act from 2010 is in force in the FBiH. FBiH didn't implement amendments to the Act despite significant changes in accounting and auditing regulations at the EU level and in the environment. Companies use forms for financial reporting adopted in 2013 that are available in Excel format on the website of the FBiH Securities Commission. The Members of the administrative, management and supervisory bodies are not collectively responsible for drawing up and publishing annual financial statements and management reports in 2016 and 2020. Audit firms, which have licenses for the work, establish the Chamber of Auditors. The same Chamber of Auditors supervises the quality of work of audit firms and certified auditors in the FBiH. So, the independence of the supervisory body is questionable.

The Serbian Republic adopted a new Accounting and Auditing Act in 2015 and amended the existing Securities Market Act in 2017 and the Companies Act in 2019. Serbian Republic conducted specific steps to increase auditing and financial reporting quality compared to the FBiH. Hence, the national regulations are more harmonized with EU regulations.

In Bosnia & Herzegovina greater attention should be paid to the process of audit, corporate governance and transparency of companies so that annual and semi-annual statements are available to investors in the long run, both domestic and foreign. There was no significant increase in the IDJH value in 2020 compared to 2016 in FBiH and Serbian Republic.

Provision of the IDJH for Croatia, which is not harmonized with EU regulations in 2016, refers to the Recommendation of the European Commission on the quality of corporate governance reporting ('comply or explain'). Also, in 2016, the Audit Act (Official Gazette, No. 146/2005, 139/2008, 144/2012, and 78/2015) was in force in Croatia, so the provision from Regulation no. 537/2014 on specific requirements regarding statutory audit of public-interest entities was not adopted as part of national legislation. Although this Regulation is fully binding and directly applicable in all EU member states, Croatia has not adopted appropriate provisions to ensure the effective application of this Regulation in 2016. In June 2017, the European Commission reported Croatia to the Court of Justice of the EU for incomplete transposition of the EU Audit Directive into national legislation. Namely, as an EU member, Croatia was late with the implementation of Directive 2014/56/EU amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts.

One of the essential determinants of the Audit Directive 2014/56/EU is the strengthening of public oversight. At the same time, the independence of supervisors in the audit profession is crucial. As a consequence of full compliance with Directive 2014/56/EU and Regulation no. 537/2014, a new Audit Act (Official Gazette, No. 127/2017) was adopted and entered into force on 1 January 2018. This Act brings reform in reorganizing the existing system of public audit oversight so that the Ministry of Finance is assigned the supervisor's role who is independent of the audit profession. As of 2018, the Public Audit Oversight Committee ceases to function, and the Croatian Chamber of Auditors no longer has a supervisory role. The Ministry of Finance is responsible for all aspects of the audit profession - approvals, education, standards, quality assurance, oversight, etc. In 2020, Croatia was harmonized with all provisions of the IDJH.

Montenegro has a very low value of IDJH for 2016 because the regulations governing accounting, financial reporting and auditing are from 2011. Therefore, we can conclude that the national regulations in 2016 were significantly inconsistent with EU regulations due to significant changes in EU regulations since 2013. From 2017, all companies, auditors and all participants in financial reporting are obliged to apply the provisions of the new Accounting Act (Official Gazette of Montenegro, No. 052/2016) and the new Audit Act (Official Gazette of Montenegro, No. 001/2017). The main reason for adopting these Acts is the harmonization of existing accounting and auditing regulations with EU regulations and the amended and new EU directives governing the field of accounting, financial reporting and auditing. From 2018, Montenegro introduced mandatory drawing up and publishing the semi-annual financial statements and semi-annual management reports.

Montenegro recorded the most significant increase in the IDJH value in 2020 compared to 2016 due to new harmonized Acts. Montenegro published Corporate Governance Code in 2009 and, as such, is not harmonized with the European Commission's Recommendations on the quality of corporate governance reporting or the amended Transparency Directive.

Serbia adopted the Accounting Act in 2013, harmonized with the Fourth and Seventh EU Directives. Those Directives were repealed that year by the Accounting Directive 2013/34/EU. The discrepancy between the national regulation and Directive 2013/34/EU is mainly related to non-listed companies. IDJH value for Serbia in 2016 is 48, so we can conclude that Serbia has taken significant steps to harmonize national accounting and auditing regulations with EU regulations valid for listed companies. In 2016, Serbia did not fully harmonize national regulation prescribing the financial reporting of listed companies; namely, the content of the annual management report is defined differently by different laws. Also, some rules are not available in Latin script. In Serbia, in 2016 and 2020, the issuer is obliged to ensure that the annual report and semi-annual report are available to the public for at least 5 years from publication, which is different from EU regulation (Directive 2013/50/EU amending Directive 2004/109/EC of the European Parliament and of the Council on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market) which defines 10 years as a mandatory period. From 2020, Serbia has a new Accounting Act, Audit Act, updated IFRS, new translations of IFRS, the Conceptual Framework, and related interpretations. These changes are the result of the adjustment to accounting and auditing regulations in force in the EU. The most significant amendments to the Accounting Act relate to non-financial reporting, reporting on payments to governments and the Corporate Governance Statement. Until 2020, all listed companies prepared consolidated or annual financial statements in a format prescribed by the Ministry of Finance, which was not following the requirements of the updated IFRS since the companies were preparing financial statements following IFRS's requirements valid until July 31, 2013. Due to these changes in 2020, the IDJH value also increased in 2020 compared to 2016.

The provisions of the IDJH for Slovenia that are not harmonized with EU regulations in 2016 refer to the Recommendation of the European Commission on the quality of corporate governance reporting ('comply or explain'). In 2020 Slovenia was harmonized with this Recommendation. There is no public announcement of the list of companies that have achieved the highest compliance with the provisions of the Corporate Governance Code for listed companies in 2016 and 2020.

Non-financial statement as the part of the management report is mandatory in 2020 for large undertakings which are public-interest entities exceeding on their balance sheet dates the criterion of the average number of 500 employees during the financial year, in Croatia, Montenegro, Serbia, and Slovenia.

5. CONCLUSIONS

Financial reporting is an essential process for improving international comparability in financial statements, thereby enhancing global capital flows and reducing the cost of preparing financial statements for multinational companies. At the time of mandatory application of IFRS, the country's accounting and auditing system remain primarily a reflection of the national institutional framework, emphasizing the importance of the functioning of the regulatory framework for financial reporting and public oversight of the audit profession.

The Ministry of Finance directly influences the companies' financial reporting in the selected countries. Their national regulatory frameworks rely more on the legal provisions themselves, which require the mandatory application of IFRS, rather than on proactive institutional oversight that affects companies' compliance with IFRS mandatory disclosure requirements.

It is necessary to improve the quality and transparency of financial reporting in English if companies from the selected CEE countries want to attract foreign investors. Regulatory authorities must monitor changes and adopt new IFRS and ensure their continuous translation into the national

language. Most companies from selected CEE countries will not supply sufficient information to investors without potential regulatory intervention, so sampled countries must harmonize their accounting, audit regulatory framework, and corporate governance system with EU directives, regulations, and recommendations. This topic is significant because sampled countries have different statuses in the accession process (member country, candidate country, and potential candidate country). As such, they are continuously integrating EU legislation into national law.

The empirical analysis of the current regulation has revealed that the EU member states (Croatia and Slovenia) and two candidate countries (Serbia and Montenegro) have more harmonized financial reporting regulation with the current EU requirements in comparison to potential candidate country from the sample (Bosnia & Herzegovina) in 2020. In 2016, Montenegro had the lowest value of the index, but from 1 January 2017, Montenegro has passed new laws due to the harmonization of existing accounting and auditing regulations with EU regulations. Here we should also point out that Slovenia is an EU member state since 2004. Croatia is an EU member state since 2013 and has the most developed capital market compared to the selected CEE countries. In the case of candidate countries, Serbia and Montenegro, harmonization of financial reporting has resulted from the negotiations with the EU and incorporating the EU regulation for listed companies into the national regulation.

There is no perfect and definitive financial reporting framework. Still, it is necessary to continuously improve the national financial reporting framework by harmonizing it with the international regulations of developed capital markets of EU member states and relevant EU requirements concerning accounting, financial reporting, auditing, and corporate governance. That is the way to reduce information asymmetry and increase investor confidence in companies' financial reporting.

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