



**The European Union's Regional IPA Programme
for the Western Balkans**

**Accounting Reform and Institutional
Strengthening for SME Development
in the Western Balkans**

EU-REPARIS

Under the Enterprise Development Innovation Facility

Project concept (revised April 2012)

Prepared by the World Bank
Centre for Financial Reporting Reform



1. Context

The countries of the Western Balkans (Albania, Bosnia and Herzegovina, Croatia, Kosovo,¹ Macedonia,² Montenegro, and Serbia) are all candidates or potential candidates for EU enlargement. As such, they are in the process of aligning their domestic legislative framework with the EU *acquis communautaire*. They are also all participants in the Western Balkans Enterprise Development Innovation Facility (EDIF), which seeks to reduce the barriers to the development of high-potential SMEs in the region.

In particular, these countries are seeking to adopt the *acquis* in the area of corporate financial reporting. Since 2008, they have been supported in these efforts by the Road to Europe – Program of Accounting Reform and Institutional Strengthening (REPARIS), funded by Austria, Luxembourg and Switzerland. The REPARIS program comes to an end in 2013 and both donors and beneficiaries are very satisfied with the progress made under the program. As Croatia will join the EU in 2013 after successfully implementing the EU *acquis communautaire*, it will play an important role in the proposed program by providing its practical experience to the other countries.

As well as being a requirement of EU accession, strong financial reporting systems with reporting requirements that reflect the needs of different types of businesses help in several ways to create a business climate which supports sustainable economic growth and reduces the barriers facing high-potential SMEs:

- The credibility provided by sound financial reporting gives banks and other providers of external finance the confidence to move beyond basing lending decisions solely on the collateral available toward lending on the basis of the business cash flows. This will help to overcome one of the main barriers to the growth of innovative SMEs;
- For high-potential SMEs seeking venture capital finance, appropriate financial reporting standards (such as the IFRS for SMEs) can reduce the barriers to an eventual flotation, making early stage equity investment more attractive;
- Adopting shared and internationally recognized reporting standards across the Western Balkans will make it easier for domestic businesses to expand to operating on the regional and the wider European markets – a key factor for fast-growing firms.
- Modern and effective financial reporting systems, if aligned with national tax systems, can also help to reduce the burden of tax compliance for growing SMEs; and
- Relevant financial reporting can help growing businesses monitor which activities generate the greatest returns and thus manage their operations more effectively.

Reform of corporate financial reporting therefore plays a key role in meeting EDIF's objective of encouraging the development of high-potential enterprises in the Western Balkans. The countries of the Western Balkans have already expressed strong interest in a *new program* to support the next phase of financial reporting reform, placing particular emphasis on completing the process of aligning their national frameworks for financial reporting with the relevant provisions of the *acquis*, while fostering the development of SMEs with the potential for rapid growth.

¹ This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo Declaration of Independence.

² Former Yugoslav Republic.



2. Objectives

The Centre for Financial Reporting Reform (CFRR) is therefore proposing a new two-year program, EU-REPARIS, as part of the Technical Assistance (TA) component of the Western Balkans Enterprise Development Innovation Facility (EDIF), financed by IPA funds.

By the time it is completed, EU-REPARIS aims to have achieved the following objectives:

- (a) in each participating country, there is an effective framework for corporate financial reporting which is aligned with the *acquis* and contributes towards an improved environment for supporting, and funding growing SMEs;
- (b) the accounting profession in each participating country is better equipped to provide business support services required by SMEs; and
- (c) a pilot project has demonstrated how improved financial reporting can lead to easier access for SME borrowers to bank finance; the lessons from this study have been disseminated throughout the region.

As part of EDIF, the proposed EU-REPARIS project would deliver policy advice and technical support in partnership with the other institutions contributing to the Facility (EC, OECD, EIB/EIF and EBRD). The project would also work closely with EU institutions responsible for policy in this area (including the EC's DG Enterprise and DG Internal Market and Services) and national institutions supporting SME development in the region (such as the Centre for Entrepreneurial Learning in Croatia and the Serbian Innovation Fund). It will build on the significant work completed under the current REPARIS program by helping the countries of the Western Balkans to complete alignment of their financial reporting laws with the *acquis communautaire* in a way that reduces the barriers to the growth of high-potential SMEs and also assists them to develop the capacity to implement the *acquis* effectively. In addition, it will help local financial reporting practitioners provide relevant expert advice to assist high-potential SMEs in moving to the next stage of their development. In that regard, it will undertake a pilot project with banks and the business and accounting communities in participating countries to develop practical tools and approaches that will enhance the financial reporting of SMEs and reduce related barriers to lending.

The CFRR was set up to provide specific expertise in the area of corporate financial reporting. It draws on the World Bank Group's extensive resources and experience in promoting a growth-friendly business environment and, in particular, in reducing the barriers to investment in SMEs. In addition to REPARIS, the CFRR is implementing the Financial Reform Technical Assistance Program (FRTAP) for countries that joined the EU in 2004, with funding from the Swiss Contribution to the EU. This provides a unique opportunity for enlargement countries to benefit from the recent experience of these Member States in implementing the *acquis* in the area of corporate financial reporting.

The CFRR has developed close relations with all relevant institutions of the EU, as well as specific expertise in implementing reforms to align financial reporting systems with the *acquis*, while taking account of the particular needs of SMEs, both for countries which have recently joined the EU and those which are preparing to join.

3. The project's focus: building corporate financial reporting systems that support SME development and are aligned with the EU *acquis*

In line with EDIF's objectives, improving SME access to finance is the key priority of this project. This will be addressed at the overall policy level, and also in relation to management skills and financial expertise of SMEs. Working with governments and in-country stakeholders, the proposed program seeks to improve the quality of corporate financial reporting in the participating countries by:

- **Establishing *acquis*-compliant regulatory frameworks** to foster an improved financial information ecosystem targeted at the needs of SMEs in particular, but also bringing the benefits of the internal market to the other CFR stakeholders;
- **Building the supporting network of institutions**, several of which are independent of government (professional bodies for accountants and auditors), required to implement these frameworks effectively;
- **Developing the capacity of financial reporting specialists** to provide relevant business advice tailored to the needs of SMEs; and
- **Enhancing the capacity of local banks** to use the information in financial reports as a tool for lending to businesses which would otherwise face difficulties in accessing credit.

Corporate financial reporting: the main elements

Corporate financial reporting aims to produce a reliable picture of the financial performance of a business. This involves producing a report on its current activities (the profit and loss account or income statement), as well as its level of assets and liabilities (the balance sheet) and a range of additional information (disclosures).

The amount of information that a business entity needs to produce reflects the entity's size, economic importance and ownership structure. In particular, enterprises listed on public stock markets are subject to more comprehensive reporting requirements. The *acquis* requires such companies to compile their consolidated reports using International Financial Reporting Standards (IFRS) and to have them audited by independent auditors. In turn, these auditors are subject to a system of public oversight.

As the Commission's proposals for a new Accounting Directive and for the reform of audit regulation demonstrate, it is important to ensure that the level of reporting required is appropriate. Micro enterprises usually need to submit accounts only for tax purposes, and a simple reporting framework is appropriate for most SMEs. However, for more established firms that aim to grow rapidly, the IFRS for SMEs, which acts as a stepping stone to full IFRS, may be more relevant. As SMEs play a key role in the Western Balkans, ensuring that the financial reporting framework reflects their needs forms the core of the proposed program.

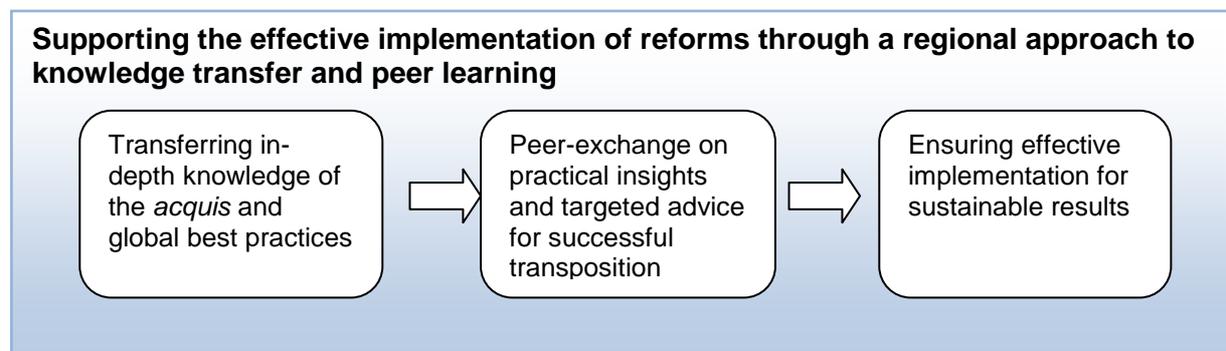
Most policy attention is usually devoted to the legal aspects of corporate financial reporting: it is relatively easy to check whether the regulatory framework is in place and is consistent with the *acquis*. The second aspect is equally important, but is more difficult to monitor and influence. If the necessary institutional support is lacking, financial reports may appear to meet the requirements of the *acquis* but the information in them will have little credibility and so will not have the anticipated effects in improving reporting firms' access to external finance. The third and fourth aspects of the program aim to assist SMEs and local banks directly in making more effective use of the information contained in SME financial reports.

4. Rationale for a regional program

Common challenges, shared goals and opportunities

The proposed program is organized on a regional basis, complemented by national initiatives to support financial reporting reform.

The participant countries have a **shared goal** of accession to the EU and also face many **common challenges** in setting up effective systems of financial reporting and fostering the growth of SMEs. The regional approach of the proposed program helps participating countries to tackle these shared issues together, while learning from each other's experiences. This “**peer-learning**” aspect of the proposed program will reduce the costs of financial reporting reform by helping participants to avoid problems that others have already faced.



A regional approach also magnifies the convening power of the program. The leaders of global accounting and standard-setting bodies, as well as the leading EU institutions in financial reporting, have taken part in past REPARIS events and have met the participants.

In addition, the proposed program will provide a **coordinating framework** for reforms to be implemented at the country level, so helping to ensure that the various national reform programs are mutually consistent and thus contribute to the creation of a single economic space in the Western Balkans. Less formally, the program will foster a **spirit of cooperation** between the participating countries, helping to break down the political and institutional barriers to integration in the region.

Moreover, the World Bank Centre for Financial Reporting Reform (CFRR) is also assisting several new EU member states to **implement strengthened corporate financial reporting systems**. The CFRR will draw on this experience to facilitate the cascade of knowledge from these states to the countries of the Western Balkans.

The **proposed EU-REPARIS builds upon the current REPARIS program**, which has been running since 2009. The current REPARIS program, which has funding from Austria, Luxembourg and Switzerland to cover its operations to the end of 2013, integrates the assessment of reform needs with support for drawing up and implementing corporate financial reporting reforms.

Current REPARIS program achievements: some highlights

- The program has established effective regional communities of practice that regularly bring together the stakeholders in corporate financial reporting: Ministers of Finance (Biennial Ministerial Conference), Senior Officials (annual workshops of the Deputy Finance Ministers and Heads of Accounting and Audit Departments within Ministries of Finance, professional bodies, standard setters, Audit regulators and accounting educators) from the Western Balkans countries;
- Working together with CFRR, the regional program has assisted most of the professional accounting and auditing bodies in the region to achieve membership of the International Federation of Accountants (IFAC), so formally joining the global community of professional accountancy bodies, and committing to implementing international standards.
- With the program's support, several countries have started transposing the accounting and audit *acquis* into national law, and the CFRR has commenced a program of support to Ministries of Finance support effective implementation
- Several countries have started to implement quality assurance systems for auditors.
- Two countries have introduced the IFRS for SMEs and others are considering doing so.
- The program has fostered strong regional cooperation among stakeholders in corporate financial reporting. Bosnia and Herzegovina, Montenegro and Serbia now share a "single passport" for accountants, with full mutual recognition and reciprocity. This is in the process of being extended to Croatia and Macedonia.²

Building on these successes, the new program will concentrate on ensuring that financial reporting frameworks are aligned with the *acquis*, meet the needs of SMEs and are implemented effectively. The program will also assist participating countries in their accession negotiations with the European Commission on the relevant parts of the *acquis*.

The proposed program concentrates on **providing support for carrying out financial reporting reform and on assisting SMEs in the region to benefit to the greatest extent possible from these reforms**. It covers both the actions required by public bodies (including government ministries and the bodies overseeing auditors) and by private-sector stakeholders. These activities will be tailored to the particular needs of the countries taking part in the program.

5. Drawing on insights from market participants to meet EDIF's objectives

The proposed program is clearly aligned with EDIF's objectives of improving access to finance and the business environment for high-potential SMEs. Moreover, if required, the content of the program could be expanded to reflect the priorities of market participants, for example, to include technical assistance for improving the corporate governance of high-potential SMEs.

The CFRR will report on a regular basis on the progress of EU-REPARIS to the Manager of the TA Program and through them to the EDIF Advisory Board. In addition, the CFRR will work closely with DG Market and Internal Services (in view of its responsibility for the *acquis* in financial reporting) and DG Enterprise (in light of its role in encouraging SME development in the EU) in designing and implementing EU-REPARIS.

The CFRR plans to set up a monitoring group of ministry of finance senior officials from the participating countries who will review the progress of EU-REPARIS. This will help to ensure appropriate **participating countries' commitment to the program**.

Furthermore, building on the CFRR's experience with involving market participants in the existing REPARIS program, the CFRR will support the Manager of the TA Component in setting up a stakeholders' group, bringing together market participants from the region, foreign investors and other stakeholders. This will allow market participants' insights to improve the design and implementation of EU-REPARIS and the TA Component as a whole.

The program will be implemented by the CFRR, the World Bank's specialized unit in corporate financial reporting for the Europe and Central Asia region. The **CFRR's technical knowledge and its access to the broader World Bank network** will give participating countries access to a wide range of expertise in fostering SME development and supporting the implementation of financial reporting reforms. The CFRR's **close partnerships with member states**, including those who have recently been through the EU accession process, the EC and all the international organizations with an interest in financial reporting, allow participating countries to draw on the lessons learned from previous reform efforts and to keep up to date with the latest developments in financial reporting and regulation. The CFRR's location in Austria means that it is easily accessible for all participating countries.

A wide range of material on the current REPARIS program and the CFRR's other programs can be found on the CFRR's website (www.worldbank.org/cfrr).

6. Main activities of EU-REPARIS

- (i) Direct technical assistance for the alignment of company law with the *acquis* and for candidate countries' negotiations on Chapter 6 of the *acquis*, drawing on the experience of countries that have completed this process, especially Croatia;
- (ii) Equipping the professional accounting organizations with tools to train accountants in providing effective financial reporting support to SMEs. This will focus on helping high-potential SMEs to create fundable business plans, raise finance, take advantage of fiscal and other incentives, and generate credible financial information that meets the needs of investors, lenders and guarantors;
- (iii) Implementing international auditing standards and quality assurance of auditors that are necessary for a credible information infrastructure that supports SME financing;
- (iv) Working with banks and business associations in participating countries to carry out a pilot project to implement a financial report template to be used by SMEs for accessing bank financing;
- (v) Fostering regional cooperation in financial reporting reform and capacity development and leveraging the work carried out and lessons learned by WBIF regional and national initiatives, multi-beneficiary and national IPA programs, and other donors; and
- (vi) Supporting the replication of successful SME-development strategies created by EDIF-supported initiatives within the countries, promoting innovative approaches and facilitating knowledge transfer and the dissemination of good practice in SME corporate financial reporting.

The program's main activities will be organized in two components, concentrating on designing and implementing the **framework for corporate financial reporting** and on **developing capacity in financial reporting**, respectively. For both components, regional workshops will be held for country officials and experts in corporate financial reporting with representatives of relevant EU institutions. These will be a balanced mix of virtual events, primarily for passing on knowledge of technical material through the World Bank's GDLN network, and face-to-face events to allow participants to learn from each others' experiences in implementing reforms. The CFRR will also provide direct assistance to national stakeholders in designing and implementing reforms. As the beneficiaries are at different stages of implementing reforms, this **assistance will be customized** to meet their needs, including those of Croatia which will be an EU member as from 1 July 2013.

In addition, **regular regional meetings of the ministers and senior officials responsible for directing the overall program of financial reporting reform** will be held in each country. These will help maintain the political momentum needed to implement the reform program and keep the accession process in this area on track.

In order to meet the needs of participating countries, as reflected in the priorities which will be set by the Manager of the TA Program, the activities of EU-REPARIS could be expanded to include technical assistance in other areas of the business environment linked to corporate financial reporting that also play a role in SME access to finance, such as corporate governance or insolvency practices. The CFRR would supplement its existing expertise with resources from other parts of the World Bank in designing and delivering activities in these areas.

7. Implementation arrangements

A project closely integrated within EDIF

- As an element of EDIF's TA Component, EU-REPARIS will be able to provide direct support in the form of technical advice or otherwise to the other EDIF activities on financial reporting and auditing issues.
- The World Bank CFRR will liaise regularly with the EC and other partners within EDIF to update them on progress and relevant developments.
- Progress reporting, visibility and other implementation arrangements will follow strictly the arrangements agreed upon at EDIF level.
- The CFRR will make its office facilities in Vienna available for EDIF activities for regional meetings as needed.

Funding needs for the new project: EUR 3.6 million for 2 years

The proposed program has an indicative budget of EUR 3.6 million to cover its activities for a two-year period, provisionally running from 2014 to 2016. The detailed proposal for the project (the project *fiche*) will contain a log frame articulating targeted project development objectives together with a range of objectively verifiable indicators which will be used to track progress during implementation. The Austrian government will provide office space free of charge to support the implementation of the new program.