

## REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC)

### Lithuania

#### ACCOUNTING AND AUDITING

June 28, 2002

#### Contents

##### Executive Summary

- I. Introduction
- II. Institutional Framework
- III. Accounting Standards as Designed and as Practiced
- IV. Auditing Standards as Designed and as Practiced
- V. Perception of the Quality of Financing Reporting
- VI. Policy Recommendations

#### Executive Summary

This assessment of accounting and auditing standards and practices in Lithuania was conducted by Bank staff. It focuses on the strengths and weaknesses of the institutional arrangements needed for the observance of International Accounting Standards (IAS) and International Standards on Auditing (ISA).

Financial reporting and accounting by Lithuanian enterprises are currently governed by laws and other regulations issued in 1992 and 1993. Only listed companies and banks are required to comply with IAS. New laws that came into effect in 2002 will significantly increase conformity between Lithuanian requirements and European Union (EU) Directives, establish a new national standard-setting body and require greater compliance with IAS. The Bank of Lithuania (BOL) requires that the financial statements of all banks should comply with IAS but only insofar as IAS do not conflict with the BOL's regulations. There is a risk, therefore, that banks may be unable to fully comply with IAS because of conflicting requirements under BOL regulations.

While the quality of many of the IAS financial statements reviewed was good, there were a number of possible conflicts resulting from the application of BOL regulations and other circumstances peculiar to Lithuania. There is currently no enforcement or monitoring of compliance with IAS or national standards. The audit of financial statements must be carried out by qualified auditors and in accordance with Lithuanian standards that are based on ISA. While many audit firms make strenuous efforts to carry out audits in accordance with ISA, there are variations in the quality of audits. Furthermore, the quality of some audits is affected by management attitudes and misconceptions about the role of audits.

Some of the powers granted to the Ministry of Finance for the supervision of auditors have not yet been implemented. The implementation of these powers plus further changes are required in order to achieve conformity with EU Directives and greater use of ISA. The report makes a number of policy recommendations that are designed to achieve greater conformity between Lithuanian law and EU Directives, improve compliance with IAS and ISA. These recommendations should form the basis of a country action plan.

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This report was prepared by a staff team from the World Bank on the basis of the findings from a diagnostic review carried out in Lithuania. The staff team was led by John Hegarty (ECSCS). The review was conducted through a participatory process involving various stakeholders and led by the country authorities.

## I. INTRODUCTION

1. An assessment of accounting and auditing practices in Lithuania was conducted within the World Bank-IMF joint initiative on the *Reports on the Observance of Standards and Codes (ROSC)*. The assessment focused on the strengths and weaknesses of the accounting and auditing environment which influences the quality of corporate financial reporting. The International Accounting Standards (IAS) and the International Standards on Auditing (ISA) were used as benchmarks in assessing Lithuania's accounting and auditing standards. The assessment involved a review of mandatory requirements and actual practices using a diagnostic template developed by the World Bank.
2. Lithuania became an independent country in 1991. It commenced an extensive privatization program and made significant revisions to its laws on accounting, auditing and securities regulation in order, among other things, to attract domestic and foreign investors. The National Stock Exchange of Lithuania (NSEL) and the Lithuanian Securities Commission were established in 1992. Nevertheless, the securities market remains underdeveloped and has limited significance in the financial system. As at December 2001, there were 1,259 active public joint stock companies of which 49 were listed on the NSEL. The securities of approximately 800 other public joint stock companies are sporadically traded on the NSEL. There were almost 25,000 active limited liability companies (public, private and other forms), about 22,500 of which are small or medium sized entities (SMEs).

## II. INSTITUTIONAL FRAMEWORK

### A. Statutory Framework

3. **Financial reporting and accounting by Lithuanian enterprises are governed by laws and other regulations issued in 1992 and 1993 but new laws were approved in 2001 and became effective at the beginning of 2002.** The new laws significantly increase conformity between Lithuanian requirements and European Union (EU) Directives, establish a new national standard-setting body and require greater compliance with IAS.
4. **The audit of financial statements of Lithuanian enterprises is governed by an audit law which was revised in 1999 and for which further revisions are being considered.** Some of the powers granted to the Ministry of Finance (MOF) have not yet been implemented. Their implementation plus further changes are required in order to achieve conformity with EU Directives and greater use of ISA.

#### *A.1 The Current Statutory Framework – Financial Reporting*

5. **Financial reporting by Lithuanian enterprises is governed by the *Law on the Principles of Accounting*, decrees and other pronouncements issued by the Ministry of Finance, the *Rules on Periodic Disclosure of Information about Issuers' Activities***

**and their Securities issued by the Securities Commission and the regulations of the Bank of Lithuania.** The Lithuanian Securities Commission (LSC) requires listed companies to comply with IAS. The Bank of Lithuania (BOL) requires banks to comply with IAS insofar as they do not conflict with its own regulations. The application of the requirements to different enterprises is summarized in Table 1.

**Table 1: The Statutory Framework for Accounting and Financial Reporting (2001)**

| Requirements<br>Entities                 | Law on the Principles of Accounting | Decrees and other MOF regulations | Rules on Periodic Disclosure                                       | Regulations of the Bank of Lithuania | IAS  |
|--|-------------------------------------|-----------------------------------|--|--------------------------------------|--|
| Listed public joint stock companies      | Required                            | Required                          | Required   | Not applicable                       | Required   |
| Other public joint stock companies       | Required                            | Required                          | Required   | Not applicable                       | Optional   |
| Banks                                    | Required                            | Required                          | Required if public joint stock companies; otherwise not applicable | Required                             | Required insofar as IAS do not conflict with BOL regulations |
| Large/medium limited liability companies | Required                            | Required                          | Not applicable   | Not applicable                       | Optional   |
| Small limited liability companies        | Required                            | Required                          | Not applicable   | Not applicable                       | Optional   |

6. **The Law on the Principles of Accounting** requires that the financial statements of all enterprises should provide ‘timely and exact’ information to tax assessment agencies, state statistics, owners, creditors and commercial partners and ‘ensure an informational basis’ for business and commercial transactions. The financial statements should include a balance sheet, income statement, cash flow statement and notes. The financial statements should be presented in the formats laid down by the Ministry of Finance and in accordance with the procedures established by Decree 804 of 1993. The financial statements may be drawn up in accordance with taxation rules. The Law and the related decrees and guidance issued by the MOF incorporate some, but not all, aspects of the EU Fourth Company Law Directive. There is no requirement to prepare consolidated financial statements and, therefore, the Law does not comply with the EU Seventh Company Law Directive.

7. **The Rules on Periodic Disclosure of Information about Issuers’ Activities and their Securities** issued by the Securities Commission require that the financial statements of listed companies (but not other public joint stock companies) be prepared in compliance with the International Accounting Standards. The Rules also include detailed requirements which apply to all public joint stock companies and that are consistent with, but much less detailed than, IAS requirements. Listed companies must prepare financial statements under the *Law on the Principles of Accounting* and other MOF requirements in addition to IAS financial statements.

8. **The BOL requires all banks to prepare financial statements in accordance with its banking supervision regulations and with IAS insofar as IAS do not conflict with those regulations.** The *Law on Commercial Banks* gives the Bank of Lithuania the responsibility for promulgating financial reporting requirements for banks and other financial institutions. When promulgating requirements, the BOL makes no distinction between the financial statements prepared for banking supervision purposes and the financial statements prepared for shareholders. Therefore, there is a risk that banks may be unable to comply with both IAS and BOL regulations in the same financial statements. For example, the BOL requires that loan loss provisions should be determined in accordance with its prudential regulations which may conflict with the requirements of IAS. Similarly, BOL regulations prohibit the consolidation of any non-financial activities of a bank whereas IAS 27 *Consolidated Financial Statements and Accounting for Investments in Subsidiaries* requires the consolidation of all subsidiaries irrespective of their activities. It is understood that, for many banks, no conflicts have so far arisen in practice.

9. **In April 2000, the Bank of Lithuania decided to prohibit the application of IAS 39 Financial Instruments: Recognition and Measurement in the financial statements of Lithuanian banks.** Several reasons have been given for the BOL's decision. Some BOL officials believe that the complexity of IAS 39 would place undue demands on Lithuanian banks. BOL officials also see little reason why Lithuania should adopt IAS 39 before it becomes mandatory in the EU in 2005, particularly as some EU banking regulators are opposed to IAS 39. The BOL's decision may reflect concerns about its ability to understand IAS 39 fully and ensure its proper application in practice. The larger banks and some auditors do not share the view of the BOL but the position of the BOL remains firm. Banks that wish to comply fully with IAS in their 2001 financial statements may, therefore, do so only in a different set of financial statements from those submitted to the BOL. The IAS financial statements may not be subject to review or regulation.

10. **The Rules on Periodic Disclosure of Information about Issuers' Activities and their Securities require that all public limited liability companies should file their financial statements with the Securities Commission.** Listed companies are also required to file their financial statements with the Stock Exchange.

11. **The Law on the Register of Enterprises requires all companies to file their financial statements with the Register.** Currently public access to the information is not a reality. Reforms to the system, being introduced by a new *Law on Legal Persons' Register*, which complies with the EU First Company Law Directive, should make financial statements more readily accessible to a broader range of users.

#### ***A.2 The New Statutory Framework – Financial Reporting***

12. **Financial reporting by Lithuanian enterprises will be governed by the Accounting Law, the Law on Financial Statements and the Law on Consolidated Financial Statements which were approved in November 2001 and which came into**

**effect at the beginning of 2002.** The *Law on Companies*, the *Rules on Periodic Disclosure of Information about Issuers' Activities and their Securities* issued by the Securities Commission and the BOL regulations will remain in force. The new laws, the rules of the Securities Commission and the BOL regulations require some enterprises to comply with IAS. The application of the requirements to different types of enterprises is summarized in Table 2.

**13. The new *Accounting Law* and the *Law on Financial Statements* require that listed and publicly traded companies should prepare IAS financial statements and that other companies (other than banks) should prepare financial statements in accordance with national standards and laws.** Listed and publicly traded companies that prepare IAS financial statements need not prepare financial statements in accordance with national standards and laws.

**14. The new *Accounting Law* authorizes the establishment of a standard-setting body that will issue National Business Accounting Standards that should be prepared in compliance with EU Directives and IAS.** The new standard-setting body will supersede the Institute of Audit, Accounting and Asset Evaluation and is expected to commence its work in the near future.

**15. The *Law on Consolidated Financial Statements* requires that all parent entities (with certain exceptions) should prepare and publish consolidated financial statements.** The Law incorporates many of the requirements of the EU Seventh Directive and IAS 27 *Consolidated Financial Statements and Accounting for Investments in Subsidiaries*. The consolidated financial statements should be prepared in accordance with the law and National Business Accounting Standards.

**Table 2: The Statutory Framework for Accounting and Financial Reporting  
(From beginning of 2002)**

| Requirements                             | Accounting Law | Law on Financial Statements | Law on Consolidated Financial Statements | Regulations of the Bank of Lithuania | IAS  |
|--|----------------|-----------------------------|--|--------------------------------------|--|
| <b>Entities</b>                          |                |                             |  |                                      |  |
| Listed public joint stock companies      | Required       | Required                    | Required                                 | Not applicable                       | Required   |
| Other public joint stock companies       | Required       | Required                    | Required                                 | Not applicable                       | Required   |
| Banks and other credit institutions      | Required       | Not applicable              | Required                                 | Required                             | Required insofar as IAS do not conflict with BOL regulations |
| Insurance companies                      | Required       | Not applicable              | Required                                 | Not applicable                       | Optional   |
| Large/medium limited liability companies | Required       | Required                    | Required                                 | Not applicable                       | Optional   |
| Small limited liability companies        | Required       | Required but abridged       | Required from 2004                       | Not applicable                       | Optional   |

### ***A.3 The Statutory Framework – Audit of Financial Statements***

16. **The *Law on Companies* requires that the financial statements of all public limited companies and all limited liability companies except small companies should be audited.** The financial statements of small limited liability companies need not be audited. The purpose of the audit is to:

- evaluate whether the financial statements ‘duly, validly and in all and every important respect’ reflect the financial position, results of operations and cash flows of the enterprise;
- evaluate whether the financial statements have been prepared in accordance with the requirements of Lithuanian accounting laws and principles; and
- help avoid error and preclude instances of abuse.

The *Audit Law* allows the BOL, the Securities Commission and the State Insurance Supervision Authority to set additional audit requirements.

17. **The *Law on Companies* allows every shareholder to contract an audit firm to audit the activities and accounting documents of the company.** The purposes of such shareholder audits are wide-ranging and include such matters as:

- the determination of any indications of insolvency or fraudulent bankruptcy;
- the squandering of assets and the existence of loss-making contracts; and
- the infringement of shareholders’ rights.

The costs of such an audit are borne by the contracting shareholder(s) but may be recovered from the company if the audit confirms the concerns of the shareholder(s).

18. **The *Audit Law* requires that audits should be carried out in accordance with Lithuanian law and standards.** The Chamber of Auditors is authorized to approve and issue national auditing standards. It has approved and issued 11 standards, all of which are based on ISA and are mandatory. The Chamber has developed 17 further Standards which are also based on ISA and which are expected to be approved by the annual meeting of members of the Chamber within the next few months.

19. **An audit should be carried out by an auditor who has passed the examination set by a commission comprised of representatives of the Ministry of Finance and of the Chamber of Auditors, has taken an oath and is a member of the Chamber of Auditors.** The Chamber may initiate steps to suspend or cancel audit licenses in certain circumstances. An auditor may carry out audits only through an audit company. The conditions to be met to establish an audit company are laid down in the *Audit Law*. The Ministry of Finance reviews all applications to create new audit companies to ensure compliance with these conditions, and it compiles and publishes a list of these authorized audit companies.

20. **The Chamber of Auditors is authorized by the Government to supervise the activities of individual auditors.** The Chamber's Honor Court deals with complaints about auditors. The Court consists of three members of the Chamber plus two lawyers appointed by the MOF. Both the MOF and the Court can instigate a complaint. The Court may punish an auditor in several ways including suspending the audit license or recommending that the audit license be revoked. While the Chamber is authorized to supervise individual auditors, its work is not monitored or regulated in any way. Furthermore, the Chamber is not generally accountable to the MOF.

21. **Neither the Ministry of Finance nor the Chamber of Auditors carries out any quality assurance activities in respect of individual auditors or audit firms.** Although the *Audit Law* authorizes the MOF to appoint an institution to supervise the activities of audit companies, this authority has not been exercised. The institution, if appointed, would be required to check the audit working papers and audit methodology, request explanations from auditors, audit companies and each employee who participated in the audit. The institution would verify whether an audit had been performed in accordance with the *Audit Law*. The work of the institution would be financed by a levy of 0.1% of the annual income of each audit company.

22. **The liability of auditors is unlimited but the exposure to litigation risk is not significant at the present time.** The *Audit Law* requires that an audit company should hold a minimum of Litās 50,000<sup>1</sup> professional indemnity insurance. There have been no legal actions against auditors and no Lithuanian auditor has ever had her/his license withdrawn for unsatisfactory performance.

## **B. The Profession**

23. **There are approximately 400 auditors who are members of the Chamber of Auditors and approximately 200 audit companies.** The Chamber believes that the number of auditors is adequate for Lithuania's needs. The firms include local member firms of major international networks, other German and Scandinavian firms employing up to 15 people and purely local firms. Local firms do not perform audits of listed companies, other large companies, banks or insurance companies.

24. **The *Audit Law* requires the Chamber of Auditors to draft and approve a professional code of ethics for auditors.** The Chamber of Auditors requires compliance with a national code of ethics that is based on the main principles of the original version of the Code of Ethics issued by the International Federation of Accountants (IFAC).<sup>2</sup> It also intends soon to start monitoring compliance with the Code. Certain aspects of the Code are included in the *Audit Law*, for example the *Law* requires that an auditor should be independent and prohibits an auditor from acting for a company for which that auditor has kept the books, prepared the financial statements, has a close family link, has been employed by or been a customer of the company within the last three years or has held

<sup>1</sup> Litās 50,000 was equivalent to approximately US\$ 12,500 at the end of 2001.

<sup>2</sup> The IFAC Code of Ethics for Professional Accountants was expanded in the revised version issued in November 2001.

shares in the company during the past three years. However, most IAS financial statements are prepared by the audit companies that audit those financial statements which may, in certain circumstances, be a threat to the auditors' independence and objectivity.

### C. Professional Education and Training

25. **In order to sit for the audit examination, an applicant must have a university degree, have worked for at least three years in an audit company as an auditor's assistant, and have a good reputation.** The pass rate for examinations is currently very low - only six out of 200 candidates passed the 2000 examination. Nevertheless, there is a perception among member firms of major international networks that the level of the examination is inadequate with the result that they encourage many of their staffs to study for the examinations of the Association of Chartered Certified Accountants (ACCA).

26. **The Chamber of Auditors requires 20 hours continuing professional education a year but does not monitor compliance with that requirement.** The Chamber itself provides up to 100 hours of continuing education a year. It also intends to increase the mandatory requirement to 40 hours a year with effect from 2002.

### D. Setting Accounting and Auditing Standards

27. **There is currently no 'standards gap' as far as accounting standards for listed companies are concerned.** The rules of the Securities Commission require that the financial statements of all listed companies should be prepared in accordance with IAS.

28. **There is currently the possibility of a 'standards gap' as far as accounting standards for banks are concerned and that gap will become a reality in 2001 with the prohibition on the application of IAS 39.** The BOL regulations require that the financial statements of banks should be prepared in accordance with IAS insofar as IAS do not conflict with BOL regulations. BOL regulations on loan loss provisions and consolidated financial statements (see paragraph 8) may conflict with the equivalent IAS but conflicts do not arise currently in practice. The BOL's prohibition on the application of IAS 39 means that the 2001 financial statements of banks prepared in accordance with BOL regulations are unlikely to comply with IAS.

29. **While the *Law on the Principles of Accounting* and MOF requirements are largely consistent with IAS, their requirements fall significantly short of full IAS requirements.** There are, for example, many IAS that are not covered by equivalent Lithuanian requirements.

30. **There is currently a large 'standards gap' as far as the auditing standards are concerned but that gap will reduce significantly in the near future.** The Chamber of Auditors has, so far, approved only 11 ISA as national auditing standards. The Chamber intends to approve a further 17 ISA as national standards in the coming months which will reduce significantly the 'standards gap'.



## **E. Compliance with Accounting and Auditing Standards**

31. **The Securities Commission does not enforce or monitor compliance with IAS or national standards.** Although it has the legal powers to do so, the Securities Commission currently undertakes no systematic review of the audited financial statements submitted to it, because of a lack of sufficient staff with the necessary skills.

32. **The BOL enforces compliance by banks with IAS and BOL regulations.** The quality of the bank financial statements reviewed during this assessment suggests that the BOL's enforcement of accounting standards is generally effective.

33. **There is no enforcement or monitoring of compliance with IAS or national standards for companies other than banks and listed companies.**

34. **While the *Audit Law* authorizes the MOF to appoint an institution to supervise the activities of audit companies, this authority has not been exercised.** The institution, if appointed, would check the audit work documents and methodology and verify whether an audit was performed in accordance with the *Audit Law*.

## **III. ACCOUNTING STANDARDS AS DESIGNED AND AS PRACTISED**

35. **The financial statements of seven listed and publicly traded companies, six banks and one insurance company were presented for review.** The financial statements of one company did not purport to comply with IAS and the financial statements of another company were incomplete.

36. **While the quality of the IAS financial statements of banks is good, banks currently follow a number of practices that could lead to material non-compliance with IAS.** The general areas of possible conflicts with IAS include:

- the determination of loan loss provisions and write-offs in accordance with the BOL regulations rather than IAS;
- non-disclosure of fair values of financial assets and financial liabilities or the assertion that cost based carrying amounts approximate fair values;
- financial assets carried at amounts in excess of fair value; and

Areas of possible conflicts with IAS in the consolidated financial statements of individual banks include:

- non-consolidation of leasing, insurance and other financial subsidiaries (the effect is currently immaterial but potentially significant).
- inadequate disclosures about the reasons for fully consolidating subsidiaries in which a bank holds 50% or less of voting rights;
- failure to show equity accounted associates as separate line-items in the income statement and balance sheet;

- the inclusion of loans (assets) made by other entities, but under the banks' management, as if there were the bank's own assets; and
- inadequate disclosures about a restructuring provision arising on the acquisition of another business.

**37. The quality of the IAS financial statements of other companies was good and revealed no general areas of concern.** Areas of possible conflicts with IAS in the consolidated financial statements of individual companies include:

- delayed application of new or revised IAS; and
- failure to apply split accounting for compound financial instruments as required by IAS 32.

**38. Companies and their auditors face a number of practical difficulties in implementing current IAS in the particular circumstances of Lithuania.** The most frequent problem is the inclusion of statutory revaluation of property, plant and equipment, a practice that may conflict with IAS 16/IAS 29. Other issues include the application of IAS 14 *Segment Reporting* to companies with single business (but multiple geographical) segments, the availability of information about the fair value of financial assets, the treatment of goodwill and (possibly) deferred taxes.

**39. The disclosures in Lithuanian GAAP financial statements are inadequate to make an independent assessment of the level of compliance with Lithuanian GAAP.** In one company that reported under only Lithuanian GAAP, the auditors issued a qualified opinion that indicated that the carrying amounts of assets were significantly overstated and the carrying amount of liabilities were significantly understated. Therefore, these financial statements would appear not to comply with Lithuanian GAAP. Given the limited disclosures in the financial statements, it would have been impossible to derive these conclusion from the financial statements themselves.

**40. Auditors sometimes do not see or approve the published version of the annual report/financial statements prior to its submission to the Securities Commission and the wrong audit report may be included in the annual report or attached to the financial statements.** In the case of two of the seven banks reviewed, the annual report included an incorrect version of the audit report. In one case, the audit report included a disclaimer that had been attached to the electronic version sent to the bank but which should not have been included in the published annual report. In the other case, the audit report on Lithuanian GAAP financial statements was attached to the IAS financial statements. The auditors suggested that these errors arose as a result of their not seeing the annual reports before they are published. Auditors claim that they are unable to control the dissemination process once they have issued their reports. Furthermore, these Lithuanian practices may conflict with the requirements of paragraph 48 of the EU Fourth Company Law Directive on the publication of the financial statements and the audit report.

#### IV. AUDITING STANDARDS AS DESIGNED AND AS PRACTISED

41. **While many audit firms make strenuous efforts to carry out audits in accordance with ISA, there are significant variations in the quality of audits and the quality of some audits is materially affected by management attitudes.** It is clear that many audits are carried out to a high standard by both local member firms of major international networks and other firms and comply fully with ISA. Nevertheless, the quality of some audits is affected by management attitudes including misconceptions about the nature of the audit. In addition, auditors frequently have to prepare the IAS financial statements from Lithuanian statutory data. This work is carried out by the audit team but is not seen by auditors as a conflict giving rise to an independence issue. Examples of problems identified during discussions with the audit firms include:

- while the larger firms appear to carry out appropriate planning procedures, this is not necessarily the case for smaller local firms;
- it is sometimes difficult to obtain audit evidence particularly for related party transactions and fair values;
- auditors are sometimes not allowed to know the identity of bank depositors which means that auditors rely on circularizations carried out by the banks themselves;
- there are no reliable statistics which can be used for comparison purposes in analytical reviews;
- there are different approaches to the review of working papers of previous auditors and the granting of access to those papers (even among the local member firms of major international networks);
- there is currently no reliable source of public information about companies that helps auditors identify related party transactions – as a result, auditors have to place considerable reliance on the representations of management that all related party transactions have been disclosed;
- companies are unwilling to pay for experts such as actuaries which may affect the reliability of the estimates of some liabilities, for example those of insurance companies; and
- practice varies about whether the individual auditor or the audit firm (or both) signs the audit opinion.

While some of these problems undoubtedly occur in other countries, including those with developed audit requirements and practice, it is understood that the extent of some of the problems is more widespread in Lithuania than in some other countries.

#### V. PERCEPTIONS OF THE QUALITY OF FINANCIAL REPORTING

42. **While regulatory mechanisms for the enforcement of accounting and auditing standards are weak, there are signs of market incentives to meet user needs.** The existence of, or desire to attract, foreign investors has led to the voluntary preparation of IAS financial statements by over half the registered companies on the current list (even though there is no legal requirement for them to do so), and the quality of IAS financial

statements of listed companies is generally good. Companies preparing IAS financial statements appear willing to adjust their financial statements in order to avoid qualified audit reports, given the negative signals which such reports send to users.

## **VI. POLICY RECOMMEDATIONS**

**43. Oversight of accounting and auditing regulations:** The new ‘Accounting Institute’ called for under the new Accounting Law should be operationalized and organized in a manner that will ensure that, in the public interest, all relevant interested parties participate in the oversight of the accounting and auditing requirements and that such requirements are adopted only with full transparency and participation by the relevant parties.

**44. Accounting Law:** The law on accounting principles, financial statements and consolidated financial statements should conform fully with the EU Fourth and Seventh Company Law Directives as modernized to reflect the proposed requirement for listed companies to publish IAS consolidated financial statements. Maximum advantage should be taken of the accounting and auditing exemptions in the Fourth Directive for SMEs when there is no public interest requirement for the preparation, publication or audit of financial statements.

**45. Audit Law:** The Audit Law should be fully harmonized with the EU Eighth Company Law Directive, the proposed European Commission Directive on auditor independence and other applicable EU legislation on auditing.

**46. Focus of the new accounting standard-setting body:**

- The primary focus of the new accounting standard setting body will be to develop standards for limited liability companies, the substantial majority of which are SMEs. The new standard-setting body should involve participation from interested parties in both the private sector and Government, including appropriate representatives drawn from enterprises, banks and other financial institutions, audit firms and users of financial statements. Adequate funding should be provided to ensure that the standard-setting body is able to carry out its work. Given the private and public benefits arising from sound accounting standards, funding should ideally come from both private and public sources.
- The standard setting body should ensure that its standards are consistent with IAS (for large, listed and financial companies, the standards should essentially be translations/explanations of the IAS standards, and not a local version of IAS), appropriate to the specific circumstances of SMEs and meet the legitimate information needs of external stakeholders such as banks. When developing these standards, the new body should consider the implications of any decision by the International Accounting Standards Board (IASB) to develop financial reporting standards for SMEs.

- The new standard setting body should establish procedures designed to ensure consistent application of IAS in circumstances that arise in Lithuania but which have not been dealt with directly by the IASB or its Standing Interpretations Committee.

47. **Bank of Lithuania:** The BOL should distinguish between:

- the information prepared for prudential supervision purposes which should be prepared in accordance with the BOL's regulations and regulatory accounting standards; and
- financial statements prepared for general purpose reporting to investors and other external users, which should comply fully with IAS (i.e., for regular reporting to outside stakeholders, the BOL should request banks – whether they are listed on the NSEL or not – to prepare fully IAS compliant financial statements and to provide full IAS disclosures, rather than the financial statements drawn up on the basis of the BOL's regulatory accounting standards).

48. **Auditing Profession:**

- The Chamber of Auditors should give urgent priority to: (i) updating Lithuanian auditing standards fully in conformity with the ISA; (ii) updating the auditor's Code of Ethics fully in conformity with EU requirements and the up-to-date IFAC Code of Ethics; and (iii) ensuring that these auditing standards and the Code of Ethics are observed in practice.
- The new Audit Law should establish a comprehensive quality assurance regime that includes independent practice review of the audit firms/auditors, adequate mechanisms of accountability to the public interest and which complies with the recommendations of the European Commission and IFAC and the requirements of the EU Eighth Directive. It is desirable that the Lithuanian Securities Commission and the Bank of Lithuania should be involved in this regime, given their direct interest in the quality of audits of listed companies and banks.

49. **Publication, filing and public inspection of financial statements:** Auditors should be required to review annual reports and financial statements prior to their publication and the filing of those reports and statements with the Lithuanian Securities Commission (LSC). Those reports and statements should be published in full only in the form and text on the basis of which the auditor has drawn up the audit opinion. The full text of the audit opinion should accompany the annual report and financial statements.

50. **Monitoring of compliance with accounting requirements:** The LSC should review the IAS financial statements of all listed and publicly traded companies and take appropriate action against those companies and their auditors when the financial statements do not comply fully with IAS.

51. **Professional Education and Training:** Efforts should be made to improve accounting and auditing capacity by, among other things, reforming the university curricula and examinations and updating accountants in the enterprise sector. Consideration should also be given to amending the Audit Law to add professional education and training in the fields of accounting and auditing as an explicitly allowable activity for audit firms.

*Authorities' response to the assessment:*

- **The BoL argued that the deviations from IAS standards for banks prescribed by the BoL and noted in the assessment are in line with applicable EU Directives** and bank regulatory practice elsewhere, and therefore should not be considered an incidence of non-compliance.
- **The Ministry of Finance has pointed out that the amendment to the Law on Audit currently considered by Parliament envisages transferring the supervisory function for auditors from the Ministry to the Chamber of Auditors and to establish a Quality Committee**, which would consist of representatives of the BoL, the LSC, the State Insurance Supervisory Authority (SISA), the Ministry of Finance, and the Chamber of Auditors. This amendment aims to implement the requirements of the European Commission on control of audit quality.