
Changes in Estonian Legal Framework and Practices of Accounting and Auditing during 2004-2014

*The Ministry of
Finance*

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Dear Veiko Tali

This report on the “Changes in Estonian Legal Framework and Practices of Accounting and Auditing during 2004-2014“ has been prepared by AS Pricewaterhouse Coopers (“PwC”) for the Ministry of Finance of the Republic of Estonia under the terms of the Ministry of Finance’s Contract with PwC dated 8 September 2015 (the “Contract”).

This report has been prepared for the purposes of analysing the changes in Estonian accounting and auditing framework in order to assess its strengths and weaknesses and make recommendations for improvement. The assignment was carried out from 8 September 2015 to 21 December 2015. Our work included interviews with various related parties in the fields of accounting, auditing and education, analysis of recommendations set forth in the Report on the Observance of Standards and Codes by the World Bank in 2004 (“ROSC report”) and assessment of their level of adoption in Estonia, and presenting suggestions for further improvements.

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We would like to thank you and your staff for pleasant co-operation.

Yours faithfully,
/digitally signed/
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Abbreviations

Abbreviation	Description
AA	Accounting Act
AAA	Auditors' Activities Act
ACCA	Association of Chartered Certified Accountants
AEA	Association of Estonian Accountants
ASBGs	Guidelines of the Accounting Standards Board
BoA	Board of Auditors
CC	Commercial Code
EASB	Estonian Accounting Standards Board
EC	European Commission
EEA	European Economic Area
EQF	European Qualifications Framework
EstQF	Estonian Qualifications Framework
EU	European Union
FEE	Federation of European Accountants
FSA	Financial Supervision Authority
GAAP	Generally Accepted Accounting Principles
GRSA	General Rules for State Accounting
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
IFRS for SMEs	IFRS for Small and Medium-sized Entities
IMF	International Monetary Fund
ISA	International Standards on Auditing
OB	Oversight Board
OQA	Occupational Qualifications Act
ROSC Report	Report on the Observance of Standards and Codes, prepared by the World Bank in 2004
SMEs	Small and medium sized enterprises

1 Introduction

1.1 Background of the Study

Our report provides an overview and analysis of the changes in accounting, financial reporting and auditing legislation and practices in Estonia during 2004-2014, and it also discusses the upcoming changes in the Estonian Accounting Act (AA) and the Auditors' Activities Act (AAA) caused by the adoption of European Union's (EU) new Accounting Directive 2013/34/EU and the new auditing 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 analysis includes comparisons with and benchmarking against Estonia's neighbouring countries and main trading partners Latvia, Finland and Sweden, but also certain comparisons with the leading EU economies Germany and the UK.

This report also serves a function of being a follow up on the Report on the Observance of Standards and Codes prepared in 2004 by the World Bank (ROSC report). The ROSC report from 2004 made an assessment of accounting and auditing practices in Estonia, focusing on the strengths and weaknesses of the accounting and auditing environment and involved a review of both mandatory requirements and actual practice. It used International Financial Reporting Standards (IFRSs), International Standards on Auditing (hereinafter ISAs) and the relevant portions of European Union (EU) law (also known as the *acquis communautaire*) as benchmarks and drew on international experience and good practices in the field of accounting and audit regulation. Our report analyses the policy recommendations made in the ROSC report and compares them to the changes in Estonian legislation and practices during 2004-2014 to assess whether the suggestions are taken into account and if not, what are the reasons behind it.

1.2 Executive Summary

Overall, Estonia has made a remarkable progress in the area of accounting, financial reporting and auditing - not only in comparison with the peer group of countries that transitioned from the plan economy to the market economy at the beginning of nineties, but also from a global perspective. The Estonian regulation in the accounting, financial reporting and auditing is in line with the best international practice. Estonia's progress is evidenced by the 24th position in the area of strength of auditing and reporting standards in the Global Competitiveness Report 2014-2015 by prof. Klaus Schwab, World Economic Forum.

In the area of accounting and financial reporting, all Estonian business entities can choose between IFRS and the Estonian GAAP, the latter being previously based on the full IFRS and since 2013 on the IFRS for SMEs (listed entities and financial institutions are required to use IFRS). The Estonian GAAP is being developed by an independent accounting standard setter and it is regularly kept up to date with the changes in the underlying international standards.

The Estonian public sector accounting and reporting principles are based on IPSAS. Estonia was one of the first countries in Europe to prepare IPSAS-based consolidated financial statements for the whole public sector in 2004. According to a PwC study published in 2014, Estonia was assessed to be one of the most mature countries in Europe in terms of public sector accounting and reporting.

There have been **two major changes** in the area of **financial reporting** since 2004 – firstly, adoption of the XBRL-based electronic system for the submission of the annual financial statements in 2010 (the e-Annual Reporting), and secondly, changing the basis of the Estonian GAAP from the full IFRS (i.e. IFRS as endorsed by EU) to IFRS for SMEs in 2013. Both changes have turned out to be rather successful.

The XBRL-based reporting system that is mandatorily used by all business entities is one of the most advanced in the world. While at the start of the project there was quite a lot of scepticism among the preparers, the system has proved to be user-friendly and efficient. Based on our interviews and informal surveys, both the preparers and users seem to be very supportive to the XBRL-based e-Annual Reporting system. The e-Annual Reporting was honoured as the decade's best project in the category of e-Government&Institutions on the World Summit on the Information Society +10 event held by the United Nations in 2013 (source: www.wsis-award.org). The e-Annual Reporting was also one of the three shortlisted entries in the Improving the Business Environment category in the European Enterprise Promotion Awards in 2012 (source: Europa.eu).

The transfer of the basis of the Estonian GAAP from the IFRS as endorsed by the EU to IFRS for SMEs was a less revolutionary change. In 2009, the IASB published a set of IFRS standards for entities with no public accountability, the so-called IFRS for SMEs. As the vast majority of Estonian GAAP preparers do not have public accountability, it was decided to change the basis of the local GAAP to IFRS for SMEs. Based on our interviews, the transition was seen as a reasonable move and for many companies it did not cause any significant impact on their financial results and financial position.

There has been a **series of improvements** in the area of **auditing**. Based on the ROSC Report from 2004, audit regulation in Estonia was falling short of the international best practice. There has been a significant positive change since then, mainly as a result of the adoption of the new Auditors Activities Act in 2010. The new law has aligned the auditing regulation with the new EU directives and international best practice. Among others, it required that all audit and review engagements should be carried out in accordance with international standards by IFAC (International Federation of Accountants). It also set new qualification requirements in respect of sworn auditors and required that all existing auditors had to pass new exams in order to retain their licences. Certain organisational changes were introduced and mandatory training programmes were established. The problems with the quality of the work of auditors have been acknowledged, the quality control process held by the Board of Auditors has been improved and sanctions in respect of auditors who have failed in the quality control have been effectively put in practice, including the revocation of activity licences of audit firms for those who have failed repeatedly. Public oversight was established by creation of Oversight Board. As a result of those measures the quality of the audit profession and the work delivered has significantly improved.

In recent years, Estonian Board of Auditors has developed an auditing software, E-dok. By the time of preparing this report, the software has been licenced to more than half of the audit firms in Estonia. Also, the software has been licenced to first users in Latvia and the negotiations are ongoing with two additional countries. The software has proved to facilitate the monitoring of the process of assurance engagements as well as to contribute to the quality of the documentation of the engagements.

In 2010, Auditors' Activities Act introduced a requirement for review of annual financial statements to replace the obligation of audit for smaller entities. The reduced scope of the work of auditors has successfully reduced the administrative burden on small entities. Latvia will, following the example of Estonia, replace the requirement for audit with requirement for review for smaller entities starting from 2016. The requirement of review for statutory reporting purposes is unique in the European Union as well as the rest of the world.

As mentioned above, the ROSC Report from 2004 included many recommendations, especially in the area of auditing. The progress in the areas is described in our report. The ability to achieve the necessary changes in such a short period has been largely contributed by the financing from the Estonian-Swiss cooperation programme. Without the financing, the changes could not have occurred in such a pace.

While overall the achievements have been remarkable, we have also noticed some areas of concern or potential for further improvement. This includes:

- Weaknesses in enforcement. Around 15% of all entities have not submitted their annual financial statements to the Commercial Register without any serious consequences. Also, while a relatively large portion of the auditors' reports are qualified or even adverse, there are no consequences to the companies. Thus, there is no real motivation for the companies to improve their financial reporting.
- Sustainable financing. During the last ten years, many of the major developments in accounting and especially in the auditing area were financed by the help of the Estonian-Swiss cooperation programme. As this funding is ending, there is a question about ongoing financing model for the accounting and auditing area.
- Overregulation. The current legislation has a very wide definition of Public Interest Entities, including also entities that do not have any real public accountability (they are included in the PIE definition simply because they exceed certain size thresholds). This causes unnecessary administrative burden for those entities. The authorities have recognised this issue and are considering changing the definition.
- Potentially adverse changes in the regulation. The new Accounting Act introduces a number of new reporting frameworks under Estonian GAAP for small and micro entities. There is a risk that the transparent and simple system that has worked well during the last ten years may get broken.
- Independence of the standard setting body. The new Accounting Act will require that any standards issued by the Estonian Accounting Standards Board need to be approved by the Minister of Finance. Also, the EASB is financially fully dependent on the Ministry and does not have any budget that they could use at their own discretion. That may cause a risk on their independence.
- In order to enhance the quality of the education in the accounting field at vocational and university level, it would be important to have electronic learning environments, including demo versions of databases held by the state. Also, there is currently a lack of accounting-related books in Estonian.
- There still exists data which companies need to submit to more than one state authority, therefore we stress the importance of the continuous efforts by the state to integrate state databases, to critically revise the data being asked from the companies, and to develop the usage of electronic channels to the extent possible. At the same time, it should be monitored that the development will not cause additional administrative burden to micro and small entities, e.g. when implementing e-invoicing with the state, it should be carefully analysed if it should be made mandatory or voluntary for all entities.

2 Accounting and Financial Reporting

2.1 General Overview of Changes in the Legislation

Business activities in Estonia are primarily regulated by Commercial Code (CC), which is based on the *acquis communautaire*. Commercial Code recognizes two types of limited companies: private and public. Public limited companies have a three-tier management structure (shareholders, supervisory board and management board) and most private limited companies, a two-tier management structure (shareholders and management board). An undertaking can also act in a form of sole proprietorship, general partnership, limited partnership or commercial association.

CC sets the responsibility for organising an entity's accounting and preparation of annual financial statements - in private and public limited companies, the management board is responsible for both of the above. CC also provides the requirements for the approval process of the financial statements as well as the deadlines for submission to Business Registry. CC includes references to Accounting Act (AA) as the main act governing the preparation of the annual reports for different types of undertakings. AA is supplemented by Guidelines of the Accounting Standards Board (ASBGs) issued by Estonian Accounting Standards Board (EASB) with the aim to explain and specify requirements of AA.

The procedures for accounting and financial reporting of the Republic of Estonia as a public legal person are described in General Rules for State Accounting (GRSA). GRSA are applicable to the state and state accounting entities.

This section of the report concentrates on the evolution of CC, AA and ASBGs during 2004-2014 and does not particularly concentrate on changes in GRSA.

The accounting reform in Estonia started with the implementation of the new AA, which became effective from 1 January 2003. The new law was accomplished by a new set of ASBGs issued by the Estonian Accounting Standards Board, which also became effective from the beginning of 2003.

The new AA had two main objectives:

- a) Aligning the Estonian accounting regulation with the requirements of the European Union; and
- b) Introducing IFRS-based accounting principles either through direct application of IFRS or indirectly through the application of the local accounting standards that were a simplified summary of IFRS.

In 2003, the financial reporting in the EU was regulated by the Fourth Council Directive 78/660/EEC (in force since 25 July 1978), which governed the preparation of annual financial statements, and the Seventh Directive 83/349/EEC (in force since 13 June 1983), which coordinated national laws on preparation of consolidated financial statements. As Estonia was preparing for the EU accession (Estonia joined the European Union on 1 May 2004), the new AA was aligned with the requirements of those two directives.

The new AA introduced a choice between two accounting frameworks – IFRS (as issued by the IASB) and the Estonian GAAP (as described in the ASBGs) – that was available for all business entities (listed entities and financial institutions were required to adopt IFRS). By doing that, Estonia was one of the first countries in Europe permitting IFRS in both consolidated and standalone accounts for all companies. After adoption of the so-called IAS Regulation 1606/2002 by the European Union (it became effective in 2005), the AA was amended to make a reference to the “IFRS as endorsed by the EU” instead of “IFRS as issued by the IASB”.

The new set of ASBGs (the “Estonian GAAP”) that became effective together with the new AA in 2003 was also based on IFRS. The accounting principles were mostly the same, but it required significantly less disclosure than full IFRS (as a result, the average Estonian GAAP set of financial statements was 2-3 times shorter than a comparable set of IFRS financial statements). Also, in certain areas the ASBGs allowed simplified accounting treatment (e.g. for the calculation of the effective interest rate when applying amortised cost method for financial instruments) or it restricted the choice of accounting treatments allowed by the IFRS (e.g., the revaluation of property, plant and equipment was not allowed under the Estonian GAAP). Thus, the Estonian GAAP could also be called as a simplified version of IFRS.

Since its adoption in 2003, the new AA has been amended several times. However, most of the amendments have been relatively minor and the basic principles (including the choice between two accounting frameworks) have remained the same. Also, the ASBGs have been amended, mainly because of the changes in the underlying IFRS standards and interpretations (for example, as a result of adoption of new standard on accounting for business combinations).

The next major change in the Estonian accounting regulation was introduced in 2013, when the whole set of the ABSGs was amended to change their basis of preparation from the full IFRS to the IFRS for Small and Medium-sized Entities (IFRS for SMEs). IFRS for SMEs was issued by the IASB in 2009 and it was primarily meant for the entities without public interest. The Estonian Accounting Standards Board (EASB) decided that the IFRS for SMEs would be a more appropriate framework for the Estonian GAAP than the full IFRS, as majority of the Estonian companies are SMEs.

The major milestones of the Estonian accounting regulation are summarized in Table 1.

Table 1. Major milestones of the Estonian accounting regulation in 1990-2014

Effective date	Name of the regulation	Major changes introduced
1 January 1991	Regulation of accounting	Introduction a number of new accounting concepts and principals, new terms, and a new set of annual financial statements in the context of transferring from the plan economy to market economy.
1 January 1995	Accounting Act (AA)	Creating legal basis and introducing general requirements for organising accounting and preparing annual accounts, with a reference to international best practice. The AA was supplemented by a number of methodological recommendations. Between 1995 and 2000 the EASB issued 16 ASBGs.
1 January 2003	New Accounting Act accomplished by a new set of ASBGs (based on IFRS)	AA was amended to align the accounting regulation with the EU requirements and to introduce IFRS-based accounting. All companies were allowed to use either full IFRS or Estonian GAAP that was in principle a simplified version of IFRS (listed companies and certain financial institutions were required to use IFRS). The Estonian GAAP consisted of 18 ASBGs that were based on IFRS, but required less disclosure and allowed certain simplifications.
1 January 2013	Amended set of ASBGs (based on IFRS for SMEs)	The whole set of the ABSGs was amended to change their basis from the full IFRS to the IFRS for SMEs (with certain exceptions).

(Source: Composed by the authors)

2.2 Choice of Accounting Frameworks

AA effective since 2003 has provided a choice between two acceptable accounting frameworks:

- a) International Financial Reporting Standards (IFRS) (since 2005 – IFRS as endorsed by the EU); or
- b) Accounting principles generally accepted in Estonia (Estonian GAAP) as described by ASBGs.

Since 2003, using IFRS has been mandatory to credit institutions, financial holding companies, mixed financial holding companies, insurance companies, and companies, whose securities issued are admitted for trading on a regulated securities market of Estonia or another Contracting State of the EEA Agreement. Starting from 2005, investment firms were added to the list above.

Initially, IFRS referred to the IFRS as issued by the IASB. As a result of the adoption of the Regulation No 1606/2002/EC of the European Parliament and of the Council on the application of international accounting standards (“IAS Regulation”), starting from 2005, IFRS referred to those standards and interpretations that had been endorsed by the European Union.

For all other companies, the choice between IFRS and Estonian GAAP has been voluntary. Annual financial statements prepared either using IFRS or Estonian GAAP are used for all statutory purposes. There is no need to prepare any other annual reports for taxation purposes (especially as there is no profit based corporate income tax in Estonia).

Estonian GAAP, as defined by AA, is based on internationally accepted accounting and reporting principles, and supplemented by guidelines issued by the EASB and, in case of the state and public sector entities, by the requirements provided in the GRSA. GRSA is issued by the Ministry of Finance, and it is based on the Estonian GAAP and the International Public Sector Accounting Standards (IPSAS).

Table 2. Applicability of IFRS as adopted by EU

Country	IFRS required	IFRS permitted	IFRS not allowed
Latvia	Consolidated and separate FS of listed companies and financial institutions (banks, insurance commercial companies and other supervised financial institutions).	Consolidated FS of all companies not named in the 1 st column. From January 1, 2016 – separate financial statements of state owned companies which qualify as large companies.	Separate FS of all companies not named in the 1 st column.
Finland	Consolidated and separate FS of listed companies.	All companies if their FS are audited	-
Sweden	Consolidated FS of listed companies and financial institutions (credit institutions, investment firms, and insurance companies).	Consolidated FS of all companies not named in the 1 st column.	Separate FS
UK	Consolidated FS of listed companies. Central and local governments.	All companies.	-
Germany	Consolidated FS of listed companies.	Consolidated FS of all companies.	Separate FS

(Source: IFRS.org)

Although all companies have been allowed to use IFRS, only a small number of companies have used that option. The split between companies using Estonian GAAP or IFRS in the preparation of financial statements is summarized in Table 3.

Table 3. Number of accounting entities using Estonian GAAP or IFRS in their annual reports

	2009	2010	2011	2012	2013	2014
Estonian GAAP	104,234	111,803	118,444	128,072	131,834	122,032
IFRS	268	238	266	304	294	243
Total annual financial statements submitted	104,502	112,041	118,710	128,376	132,128	122,275

(Source: Estonian Ministry of Finance, data as at 15 October 2015)

ROSC report discussed that while two different frameworks exist for preparation of annual financial statements, the dividends available for distribution, legal reserve requirements and other company law issues may be significantly impacted depending on which accounting standards are used and this might raise concerns about whether Estonian companies are on a same playing field. During our conversations with preparers and standard setters, we have not noted that this has been perceived to be a problem.

Firstly, there are very few major differences in acceptable accounting policies between IFRS and Estonian GAAP; therefore, in vast majority of cases, the dividends available for distribution or any other company law matters do not depend on the accounting framework used. Secondly, all entities are free to choose the accounting framework to eliminate the differences, if necessary. Also, the choice between local GAAP and IFRS is available in all the benchmark countries (see Table 2), so this may be regarded as a widespread market practice.

ROSC report also suggested that IFRS would be a mandatory framework for all the public interest entities (PIE). Currently, the requirement does not involve all the PIEs (refer to the list of entities covered by the definition of PIEs in section 2.5.1), as it is not extended to the entities that are PIEs due to their size. As we can see from Table 2, the specific requirement is not in place in any of the benchmark countries as well, although in substance it is in place in countries where the definition of PIE is very narrow (e.g. Germany, where only listed companies are PIEs – see Table 11).

Based on the feedback gathered from the interviews, mandatory usage of IFRS for all PIEs is not supported by the market participants, as it would impose additional burden without bringing clear additional benefits. However, it should also be noted that the Estonian Ministry of Finance is considering reducing the definition of PIE, which may lead to the situation that all or almost all remaining PIEs (under the narrower definition) are required to prepare IFRS financial statements.

2.3 Estonian GAAP

2.3.1 Estonian Accounting Standards Board

Estonian GAAP is, as defined by the AA, an accounting framework that is based on internationally accepted accounting and reporting principles, supplemented by the guidelines issued by the Estonian Accounting Standards Board (EASB). According to the AA effective from 2003, EASB is an independent committee established by the Government of Estonia.

EASB has 7 members who are accounting experts, academics or practicing accountants, and are appointed by the Government of Estonia for a three-year term. The composition of the last five Boards (ie since 2001) has been usually as follows:

- Two auditors (representing also the Estonian Board of Auditors; one of them being the chairman of the Board);
- Representative of the Ministry of Finance (often vice-chairman of the Board);
- Representative of the Association of Accountants;
- Representative of a regulator (Financial Supervisory Authority);
- Representative of the Chamber of Commerce; and
- An academic.

Different backgrounds and experiences of the EASB ensure that the views of all main stakeholders are represented and taken into account. All EASB members have their main jobs elsewhere and contribute to the EASB activities only on a part time basis. Based on our interview with EASB members, the remuneration for the work in the Board is symbolic and the annual remuneration cost for the whole Board is less than 30 000 Euros.

The EASB does not have any administrative staff (they are administratively supported by the Ministry of Finance) and does not own any budget. Any expenditure has to be negotiated and agreed with the Ministry of Finance. In reality, there have been many years when the Board has not incurred any expenses apart from the nominal remuneration costs.

During the period of 2004-2015, the largest externally outsourced projects led by the EASB (amendment of the ASBGs to change their basis from the full IFRS to the IFRS for SMEs – section 2.3.2; translation of ASBGs into English and Russian – section 2.3.3, translation of the IFRS for SMEs into Estonian – section 2.3.3) have been financed by the Estonian-Swiss cooperation programme (section 5). However, the cost of these projects has been relatively minor (not exceeding 10-20 thousand Euros) as compared to annual costs of independent standard setting bodies in other countries.

The main purpose of the EASB is to issue accounting guidelines (ASBGs) explaining and specifying AA and to direct activities in the field of accounting. Most of the guidelines (especially those issued until 2013) have been written by the EASB members themselves. Drafting of the most recent set of amendments (effective from 2013) was outsourced from external parties. Draft guidelines have to be published on the EASB's website for the public discussion and comments for at least two months before approval by the EASB. The final versions of EASB guidelines are published in the Official State Journal (*Riigi Teataja*).

In accordance with the current AA, government authorities (including the Ministry of Finance and the Government of the Republic) are not permitted to interfere into the content of the guidelines issued by the EASB or the process of preparation thereof.

The new draft of AA that is currently discussed in the Estonian Parliament (expected to become effective in 2016, certain provisions in 2017) will change the process of issuance of the guidelines by the EASB. The draft AA would require an approval by the Minister of Finance before any guidelines drafted by the EASB can be published and become effective (with other words, in the future the guidelines of the EASB have to be issued in the form of a regulation of the Ministry of Finance). This change is introduced in order to strengthen the legal validity of the guidelines. Although the draft law states that the Minister is not permitted to change the content of the guidelines prepared by the EASB, it could be seen as a potential threat to the independence of the EASB.

Another potential threat to the independence is caused by the fact that the EASB does not have their own budget and is financially fully dependent on the Minister of Finance. As described above, even the smallest costs have to be pre-approved with the Ministry of Finance.

Based on our interviews with the EASB and other stakeholders, the independence of the standard setter is seen as a very critical precondition for high quality accounting standards. Also, a comparison with other European countries demonstrates that there is a high correlation between the level of independence of the standard setter and the quality of accounting standards. Countries with more developed accounting standards tend to have independent accounting standard setting bodies and vice versa.

Table 4. Local accounting standards setters in other countries

Country	Accounting standards setter
Latvia	Local GAAP is drafted by the Ministry of Finance; Latvian Accounting Standards Board has been dissolved.
Finland	Local GAAP is drafted by the Ministry of Employment and Economy. Accounting Standards Board operates under the auspices of the Ministry of Employment and the Economy to provide guidelines and views on the application of the Accounting Act.
Sweden	Local GAAP (K2 and K3) are issued by the Swedish Accounting Standards Board (BFN) which is a governmental body, funded by the state. BFN has delegated to the Swedish Financial Reporting Board (RFR) the authority to (1) develop interpretations of IFRS which are mandatory for all listed companies that prepare consolidated FS and (2) develop standards for the separate FS of a company included in a set of consolidated IFRS FS ("RFR 2 framework").
UK	UK Financial Reporting Council (FRC) is a fully independent regulator that raises funds through a voluntary levy. The levy applies to publicly traded companies, large private entities, insurance companies, pension providers and public sector organisations. FRC issues independently standards for all segments of UK companies (so-called UK GAAP).
Germany	Germany's Accounting Standards Committee (DRSC – Deutsches Rechnungslegungs Standards Committee) is an independent body that finances its activities from membership levies (the membership is on a voluntary basis; members could be for example business entities, accounting and auditing profession). DRSC has a co-operation agreement with the German Ministry of Justice, under which the Ministry has delegated to the DRSC the right to prepare for issuance accounting standards (without interfering into their content).

(Source: Composed by the authors)

From our discussions with the Ministry of Finance, we have understood that maintaining the independence of the EASB is also their intention and priority. Nevertheless, in order to reduce the financial dependency on the Ministry of Finance, we recommend that the EASB should be allocated their annual budget that they could use based on their own discretion. Alternatively, a similar model as in the UK or Germany could be introduced, where the activities of the local standard setter are financed by voluntary or non-voluntary levies of the market participants.

2.3.2 Estonian GAAP - Content

Starting from 2003, the accounting principles in the Estonian GAAP have been based on those of IFRS, with a limited number of differences in the following areas:

- restricting accounting policy choices offered by IFRS in limited areas (e.g. revaluation method for property, plant and equipment was not allowed under Estonian GAAP);
- permitting simplified measurement methods in areas where the impact was expected to be immaterial (e.g. straight-line amortisation of direct cost under effective interest method was accepted for financial liabilities);
- certain accounting areas, which were expected to occur rarely in practice, were not covered by the EASB guidelines; in those areas, the IFRS treatment was recommended (e.g. hedge accounting);
- also, in certain areas, which were not covered by IFRS, but which were relevant for Estonian companies, local guidance was developed (e.g. accounting for common control business combinations);
- the main difference was in disclosure requirements, as Estonian GAAP required significantly less disclosures than IFRS.

As for vast majority of the companies, there were no differences in recognition and measurement methods, the profit and equity were substantially the same regardless whether the company applied Estonian GAAP or IFRS.

During 2004-2012, there were two main waves of amendments to the Estonian GAAP (in 2005 and 2009) when a number of ASBGs were revised in order to reflect developments in the IFRS. In addition, some minor changes were introduced also in the interim years.

From 2013, the basis of the Estonian GAAP has been changed from IFRSs to IFRS for SMEs. In 2009, the IASB published IFRS for SMEs designed to meet the financial reporting needs of entities that (a) do not have public accountability and (b) publish general purpose financial statements for external users. IASB's intention was to make changes to IFRS for SMEs as rarely as possible.

As the IFRS for SMEs was assessed to be incompatible with the European Accounting Directives, the European Commission decided in October 2011 not to endorse IFRS for SMEs in the European Union. Thus Estonia could not offer IFRS for SMEs as an allowed alternative accounting framework in AA (as it was initially planned). However, the EASB decided that IFRS for SMEs is a more appropriate basis than the "full" IFRS for the Estonian GAAP as the entities for which IFRS for SMEs was targeted are of a similar size and nature as most Estonian GAAP preparers. For smaller businesses the accounting principles set out in full IFRS often tend to be too complicated. The IASB also committed to make changes to the IFRS for SMEs as rarely as possible on the contrary to the "full" IFRS, which is continuously evolving. In summary, the EASB decided that the IFRS for SMEs would provide a simpler and more stable basis for the guidelines.

While the new set of ASBGs (effective from 2013) is based on IFRS for SMEs, they are not a copy of it. The overall structure of the ASBGs remained unchanged. One new ASBG (ASBG 15) was added covering all the disclosure requirements (previously, they were included in each ASBG) and some ASBGs that had become redundant were withdrawn (e.g. regarding segment reporting and interim financial statements).

There are a few differences in measurement methods between the new Estonian GAAP and the IFRS for SMEs, mostly to offer a policy choice between a method allowed under IFRS for SMEs and under full IFRS. The reason for offering such a choice was that companies that need to report on a "full" IFRS basis to their parent companies, could use the same accounting policies also under the Estonian GAAP (that is otherwise based on IFRS for SMEs). Examples of such policy choices granted by the ASBGs include:

- development costs – could be expensed as required under IFRS for SMEs or capitalised as required under full IFRS;
- government grants – could be recognised in income immediately as required under IFRS for SMEs or accounted for using the net method allowed under full IFRS;
- investment properties – could be measured at fair value, if determinable with due cost and effort (IFRS for SMEs requirement) or at cost less depreciation (allowed under full IFRS). This policy choice was introduced in 2014 based on the feedback from the preparers and users.

In addition to some differences in accounting policies, the disclosure requirements of the EASB guidelines somewhat differ from those in IFRS for SMEs (however, the overall disclosure volume is roughly the same). In the areas not specifically covered by the guidelines, the treatment in the IFRS for SMEs is recommended, but not mandatory.

According to the IASB (source: <http://www.ifrs.org/ifrs-for-smes/Pages/IFRS-for-SMEs.aspx>), the IFRS for SMEs framework is either required or permitted in 73 countries over the world. However, after the decision of the European Commission not to endorse IFRS for SMEs in the European Union, the interest of most European countries has been rather low. The local GAAP in most EU countries is either locally developed (in the framework of EU accounting directives) or based on full IFRS. The most remarkable exception is the UK where a similar approach to Estonia has been chosen – the new UK GAAP (effective from 2015) is largely based on the IFRS for SMEs, with certain exceptions (in similar areas as in the Estonian GAAP, e.g. government grants), and reduced disclosure requirements for small and micro entities.

Table 5. Basis of local GAAP in other countries

Country	Relations between local GAAP and IFRS/ IFRS for SMEs
Latvia	Latvian GAAP is based on the EU Accounting Directive, with its main principles similar with IFRS.
Finland	Local GAAP in Finland is not directly related to either of those.
Sweden	Swedish GAAP for larger entities, K3, is based on IFRS for SMEs with a number of exceptions (policy choice to capitalise or expense development expenditures, intangible assets such as goodwill have to be amortised over a period no longer than 10 years (with some exceptions), accounting for pensions can follow applicable tax laws, revenue for services and construction contracts can be accounted for at the completed contract method in the standalone accounts). Local GAAP for small entities, K2, is not built around IFRS for SMEs, instead it is very much based on the Swedish tax law.
UK	New UK GAAP effective from 2015 has introduced 5 different accounting frameworks: 3 frameworks for standalone companies (micro-entities regime, small entities regime and FRS102 for entities that are not micro or small) and 2 additional reduced disclosure frameworks for companies that are part of a larger group that prepares publicly available consolidated financial statements. While micro-entities regime and small entities regime are mainly based on the requirements of the new EU Accounting Directive, the primary regime FRS 102 is based on IFRS for SMEs, with certain exceptions (e.g. in the areas of government grant and investment properties).
Germany	German GAAP is written in the context of the German Commercial Code (HGB). IFRS principles are followed as long as practicable and assuming they are not in conflict with the German Law.

(Source: Composed by the authors; <https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Overview-of-the-financial-reporting-framework.pdf>;
https://www.drsc.de/service/ueber_uns/organe_und_gremien/hgb_fa/index_en.php)

Based on our discussions with the users and preparers, they were generally very satisfied with the quality of the Estonian GAAP guidelines. The general view was that no significant change has been perceived by the market participants when the basis of the Estonian GAAP was changed from the full IFRS to IFRS for SMEs. We have seen a small number of entities that have transferred from the Estonian GAAP to IFRS because they wanted to keep IFRS-based accounting principles (mainly because they wished to avoid amortisation of goodwill that was introduced by the new Estonian GAAP in line with IFRS for SMEs requirements). On the other hand, there have been preparers who have welcomed the amortisation of goodwill and relief of not preparing annual impairment tests. Overall, as indicated in Table 3, the number of IFRS preparers has rather decreased since the basis of the Estonian GAAP was changed from full IFRS to IFRS for SMEs in 2013.

Based on our interview with the EASB, there could be additional policy choices made available in the future (to enable the preparers to comply either with the requirements of the IFRS for SMEs or full IFRS, whichever is more relevant for the particular entity), but moving back to the full IFRS framework as a basis for the Estonian GAAP is currently not considered.

Overall, the users and preparers seem to be satisfied with the current version of the Estonian GAAP. Therefore, we would recommend not making any radical changes to the current accounting framework, apart from those that are required by the new EU Accounting Directive.

2.3.3 Availability of Guidance Materials

Guidance Materials

ASBGs are available at EASB's website www.easb.ee. The ASBGs are available in Estonian, English and Russian. IFRS for SMEs to which current ASBGs refer to, are available in English on IASB's website www.ifrs.org. Translations of ASBGs into English and Russian, and translation of IFRS for SMEs into Estonian have been financed by the Estonian-Swiss cooperation programme (section 5).

On an ongoing basis, the questions from the preparers are handled through several channels:

- Ministry of Finance answers the calls for accounting questions; the number of these calls is not very large, amounting to 40-50 per year.
- EASB responds to any written questions submitted to them, which is generally less than 10 in a year.
- The state's Shared Service Centre has 4 people to answer questions coming from the public sector.
- Members of Association of Estonian Accountants turn to their representative in EASB.
- Other business organisations also have a hotline available should their members seek advice.
- Preparers turn to the audit profession.

On a more infrequent basis, EASB issues interpretations or explanations to the ASBGs on its website.

Training

During 2010-2011, Ministry of Finance organised seven 4-day IFRS training courses in Estonia, financed by the Estonian-Swiss cooperation programme (section 5). On an ongoing basis, Association of Estonian Accountants organises seminars, summer training and other events to its members. In addition, several auditing and consulting companies provide trainings on accounting topics.

Based on our interviews, the general feedback from preparers was that the guidelines are well written and generally well understandable due to the examples. On the other hand, some proposed that an EASB's commentary page would be useful with comments and additional examples by EASB on frequently arising questions. In our view the direct channel for asking questions directly from EASB would be useful, and would avoid the risk of different interpretations which inherently exists if multiple channels for consultation exist.

We recommend considering how to finance the area in the short- and long-term. The largest projects in this area during 2004-2014 have been financed by Estonian-Swiss cooperation programme, but the guidelines and their translations will most likely require updating in the future.

2.4 Obligation to Prepare and Submit Annual Reports

2.4.1 Submission Deadlines

In Estonia, all legal persons in private or public law have to submit annual financial statements within 6 months after the end of the financial year, except for listed companies, credit institutions, financial holding companies, mixed financial holding companies, investment funds, investment firms and insurance companies, which are required to submit their annual financial statements within 4 months after the end of the financial year. The above requirements have been in force throughout the whole period under review in this report. The general requirement is included in the Commercial Code; the specific requirements are included in respective acts applicable only for certain type of entities (for example Securities Market Act).

Table 6. Submission deadlines

Country	Annual financial statement submission deadline after the end of the financial year
Estonia	Listed companies, credit institutions, financial holding companies, mixed financial holding companies, investment funds, investment firms and insurance companies: 4 months. All other entities: 6 months.
Latvia	Companies which exceed two out of the following criteria: BS total EUR 1.4 million; revenue EUR 3.4 million, average number of employees 250: 7 months. Parent companies who prepare and submit consolidated financial statements: 7 months. All other entities: 6 months.

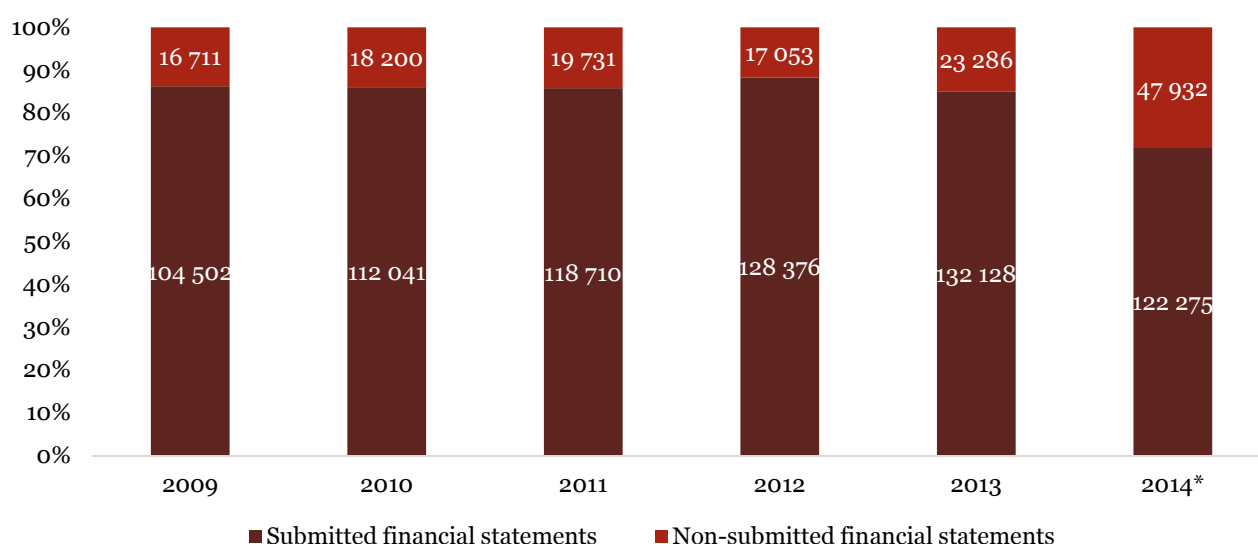
Country	Annual financial statement submission deadline after the end of the financial year
Finland	All entities: 6 months.
Sweden	All limited liability companies: 7 months.

(Source: Composed by the authors)

Preparers of ROSC report recommended to bring the submission deadline forward to 3 months after the end of the financial year. As we can see from the comparison with reference countries, Estonian deadline of 6 months is in line with many countries. Based on our interviews, the preparers and users did not find it beneficial to introduce the deadline of 4 months to all PIEs (and leave 6 months for all other entities), as general statistical data would still not be available until all entities will have presented their annual financial statements.

As we can see from the statistics, there is a problem with timely submission and even non-submission of the annual financial statements. Ca 15% entities fail to submit their financial statements at all; by 1 October 2015, 28% of entities have failed to submit their 2014 financial statements (based on information received from the Ministry of Finance, it is common that ca 70% of the entities have submitted their financial statements of the previous year by the beginning of October, and percentage of submitted financial statements increases to 85% by the end of the year).

Figure 1. Submitted and non-submitted annual financial statements



*Data as at 15 October 2015, when approximately 72% of annual reports in 2014 had been submitted.

(Source: Composed by the authors based on data received from the Ministry of Finance)

As the non-submission of financial statements appears to be an issue in Estonia, the authors have investigated whether this is an issue also in other countries and if so, what are the possible sanctions created to penalise late submission or the rewards granted to entities to encourage timely submission.

- In Latvia, financial statements must be submitted to State Revenue Service together with the corporate income tax return. Penalties may be imposed for failure to submit the annual reports on time. If the problem persists, there can be harsher consequences, e.g SRS may suspend the activities of the entity.
- In Finland, there are sanctions, but this has not been regarded as a problematic area as most companies tend to submit their annual reports in time.
- In Sweden, non-submission or non-timely submission of annual financial statements is also not a problematic area.

Many of the interviewees shared the view that non-submission of financial statements is a very serious problem in Estonia and they suggested the state should take measures to solve it, either by putting into effect the existing sanctions included in the law, by imposing new sanctions, or by any other means.

Several ideas for amended/additional sanctions were expressed:

- When opening a company's information in e-Business Register, the first page would disclose whether the entity has submitted financial statements timely (and also, if the auditor's report is unmodified or modified) – knowing that the information is emphasized, would motivate preparers submit financial statements in time.
- Prohibition to participate in public sector tenders.
- Prohibition to apply for government grants from Enterprise Estonia.
- Prohibition to sell the shares of the entity.
- Prohibition from claiming VAT.
- Mandatory audit/review.

During our work, we found out that the state has not yet analysed the impact of the unsubmitted financial statements, or impact of late submission of financial statements. For instance, entities with deteriorating financial results may be inclined to submit the financial statements as late as possible, thus not providing their creditors timely and relevant information, and ultimately, causing the financial reporting in Estonia perceived less credible and transparent.

We recommend the Ministry of Finance to investigate the reasons behind non-submission or late submission, the share such entities form of the whole economy, and based on the above the necessity and nature of an effective sanction system. Also, it maybe useful to study some bankruptcy cases to understand if timely submission of the financial statements would have helped creditors/investors to capture the problems earlier. It should also be analysed whether in cases where non- or late submission is caused by high administrative burden, the diminished requirements to the reporting by micro entities would solve the problem. Effective sanction system should be implemented to motivate entities to submit their financial statements in time.

2.4.2 *Public Availability of Financial Statements*

All annual financial statements submitted to business register are available for a fee for the public, which is two Euros per annual report. Credit institutions are obliged to publish their financial statements at their website and make them available at the location of the entity. The annual and interim financial statements of listed entities are available on the website of the stock exchange; listed entities are obliged to ensure that their financial statements are publicly available for at least five years.

In Latvia, the entities submit annual reports to State Revenue Service, and submitted reports are transferred by SRS to the Enterprise Register. Annual reports are available electronically through a fee-based online databases of Latvian enterprises, including www.lursoft.lv, www.crediweb.lv, and www.firmas.lv. The fee of reviewing the annual report depends on the service provider and on the information one wants to review. For example, reviewing the company's annual report in format as submitted to State Revenue Service can cost 6.83 Euros in lursfot.lv.

In Finland, all annual statements that are submitted to Trade Register are available for reviewing online for a fee of 6.20 Euros.

In Sweden, annual financial statements of limited liability companies are available to the public free. The annual reports of other companies can be reviewed for a fee of 50 Swedish kroons (approximately 5.50 Euros) from the webpage of Swedish Companies Registration Office.

Based on the feedback we gathered during our interviews, the availability of the annual financial statements is considered to be good, although several suggested that primary statements could be available for free. We therefore recommend the state to consider making certain financial information, e.g. primary statements available without a fee. The same recommendation has also been made by the Institute of Baltic Studies, who recommended enhancing the Commercial Register in a way that it would be possible for everyone to look up and download the annual reports of any company free of charge. Enabling the access to the annual reports free of charge with the aim to compare and analyse the financial statements of companies would enhance the quality of decisions users make based on these reports both in private and public sector.

2.4.3 E-Annual Reporting Using the XBRL Format

Since 1 January 2010, Estonian entities, except those who prepare consolidated financial statements or report under IFRS as endorsed by the EU, are required to submit their annual financial statements electronically, using the standardised reporting forms (XBRL-format reporting) based on financial reporting taxonomy provided in the Accounting Act. Entities who prepare financial statements in accordance with IFRS, or prepare consolidated financial statements can use XBRL format on a voluntary basis and may continue submitting financial statements in .pdf format. In summary, there are three options available for submission of annual reports: inserting data manually into electronic system (which is based on XBRL-format reporting), transferring data directly from accounting software by using XBRL-format file, or submitting the financial statements in pdf-format. A summary of how the financial statements have been submitted since the standardised reporting forms were taken into use considering the three options available is included in Table 7.

Table 7. Submission of annual reports using XBRL files, .pdf and electronic system

Format	2009	2010	2011	2012	2013	2014
XBRL file	770	554	435	504	471	517
.pdf	6,240	3,449	1,678	1,194	1,007	816
Electronic system (manual insertion to XBRL format)	97,492	108,041	116,615	126,725	130,736	121,418
TOTAL	104,502	112,044	118,728	128,423	132,214	122,751

(Source: Ministry of Finance, information as at 4 December 2015)

The requirement to submit financial statements electronically does also not apply to state, state accounting entities (public and private limited state companies may use XBRL voluntarily), local government, legal persons in public law registered in Estonia, sole proprietors, and the financial statements of foreign companies which are submitted by the director of the branch. When looking at the costs and benefits of the XBRL reporting, a survey conducted by the Estonian auditing company BDO Eesti AS showed that after Estonia started using the electronic e-filing system for compiling annual reports, the average time spent on composing of the financial statements decreased approximately 25% (BDO Eesti AS, 2011: 49). On the other hand, based on the information from the preparers gathered in our interviews, the accounting software of micro-sized entities still often lacks an XBRL interface and the taxonomy is not compatible with the chart of accounts. Despite that, the general view was still that administrative burden has been reduced, and quality, especially in terms of comparability, of financial statements has been enhanced by adopting the XBRL reporting.

In Latvia, XBRL format is not used. In Finland, during 2016 it will be possible for the entities to submit their annual financial statements electronically, using standardised electronic forms (XBRL-format reporting). In Sweden, it has been possible to submit annual financial statements in XBRL format, but due to low demand from the entities the service has been closed down. There are, however some indications that this or similar service may be introduced in the future.

Based on our experience with preparers of IFRS financial statements, using XBRL format does not provide flexibility to structure the financial statements in a company-specific way, e.g. there is no possibility to rename the line items in the primary financial statements, or re-order the notes to emphasize the most relevant information. We therefore recommend keeping XBRL format mandatory only for those entities who prepare financial statements in accordance with Estonian GAAP.

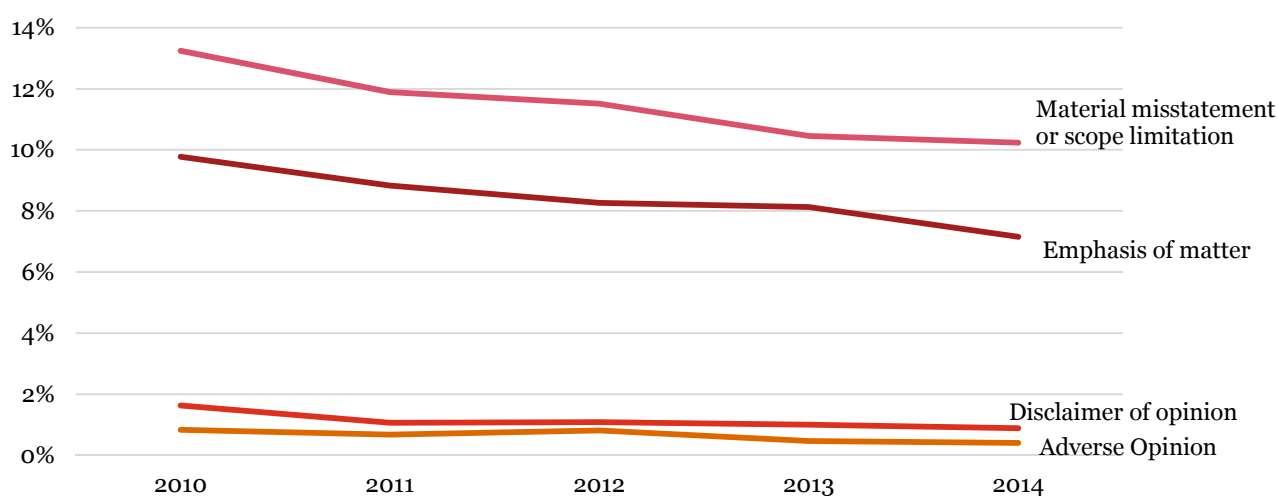
2.4.4 Quality of Financial Statements – Modified Auditors Reports

In 2014, out of all auditor's reports issued on the annual financial statements, approximately 83% were unmodified – i.e. were not an adverse opinion or disclaimer of an opinion, did not include any qualifications, and did not include an Emphasis of Matter paragraph. The trend has been positive over the last years, improving from 77% unmodified reports in 2010. More information is included in Figure 2.

In 2014, the split of modifications by the type of modification, and the main reasons was as follows:

- Approximately 10% included a qualification, either material misstatement or scope limitation. The main three areas where qualifications were issued were the valuation of receivables, inventories and investment properties.
- Less than 1% included an adverse opinion. Main areas: consolidation, going concern, receivables.
- Approximately 1% included a disclaimer of opinion. Main areas: receivables, consolidation, investment properties.
- Approximately 7% included an emphasis of a matter. 65% of the emphases were issued due to going concern.

Figure 2. Modifications to auditors' report (%) of total amount of reports issued



(Source: compiled by the authors based on data received from the BoA)

Although the share of unmodified auditor's reports is growing, the interviewees shared the concern that the number of modified reports is still too large. Main reasons were considered to be:

- Lack of consequences – in a situation where recognising impairment loss on assets would decrease equity to a level below criteria set in CC, it is simpler for a company to accept qualification rather than correct the financial statements.
- Auditor's report is considered only a compliance issue rather than reputational issue, so some entities are not keen on improving their financial statements to obtain unmodified auditor's report.

Based on our interviews with representatives of banks who use the financial statements of entities as part of their credit risk management process, modified reports cause additional information queries from the entities to understand the reasons behind the modification.

Representatives of Board of Auditors were on an opinion that the key is to motivate entities to improve their financial reporting to obtain unmodified auditor's reports, rather than to sanction the entities which have modified reports. This can be achieved by enhancing public awareness that unmodified report by an auditor means high quality reporting by the company, and the companies with better reporting quality are more likely to be trustworthy business partners and employers. One of the examples how the public perception can be educated is, when any public or private parties organise a competition or selection of "top" companies, they would involve only those companies that have impeccable financial reporting. Another example would be for the state to offer some simplifications or advantages to the entities with unmodified auditor's report, e.g. considering areas discussed in section 2.4.1. Also, as mentioned in 2.4.1, it may be useful to disclose in e-Business Register, on the front page of a company's information, whether the entity has submitted financial statements timely and whether the auditor's report was unmodified or modified.

In cases of qualifications for items which would, if corrected, lead to inadequacy of capital, it may be necessary to introduce procedures to take the impact of the qualifications into account when measuring the conformity of net asset position against the minimum thresholds set by regulation.

We recommend the state to consider possibilities to increase the public appreciation of high quality reporting and motivate entities to enhance the quality of their financial reporting.

2.4.5 Quality of Financial Statements – Oversight by Financial Supervision Authority

Financial Supervision Authority (FSA) examines the reporting quality, reliability and comparability of issuers whose shares have been listed for trading on the regulated securities market operated by NASDAQ OMX Tallinn Stock Exchange. The obligation arises from Securities Market Act. Annually, FSA examines a selection of interim and annual financial statements issued by the listed entities. FSA has the power to enforce actions to achieve an appropriate disclosure and correction of a misstatement, if necessary.

In 2014, FSA examined 8 interim financial statements and 10 annual reports (FSA Yearbook, 2014), paying special attention to the following areas in the financial statements: correctness of calculations of earnings per share, disclosures regarding incompliance with loan covenants and disclosures on impairment testing of goodwill and fair valuation of assets.

In addition, FSA needs to approve ex-ante the prospectuses, including the financial statements included thereto, before registering a public offering and listing prospectus.

Activities of the FSA are financed through supervisory fees and procedural fees that are paid by entities subject to financial supervision. FSA publishes its yearbook annually, describing the activities undertaken and issues identified. FSA staff receives theoretical and practical training. In 2014, employees of the FSA participated in both national and international supervision-focused training events. Also, in-house professional training sessions were organised.

FSA has not discovered any material non-conformities in the financial statements. This indicates that the financial statements of listed entities have a good quality.

2.4.6 Expected Changes in AA Effective from 1 January 2016

Changes in AA that will become effective starting from 1 January 2016 are influenced by the adoption of Accounting Directive 2013/34/EU and incorporation of requirements included therein.

Estonia brought an action against to the European Court of Justice regarding to the Accounting Directive, as it considered the reductions to the content of annual reports to be contrary to principles of proportionality and subsidiarity. By adopting maximum harmonization regime, the Accounting Directive sought to avoid disproportionate administrative burden being inflicted on small-sized entities, but its impact assessment failed to account for reduction of administrative burden Estonia had already achieved by introducing electronic XBRL-based reporting, while overstating anticipated positive effects by an order of magnitude. For instance, it was estimated that by introducing every reporting simplification the Accounting Directive made available for micro-entities, Estonia could reduce their administrative burden by up to 38 million Euros. However, local independent study assessed total administrative burden related to financial reporting of all Estonian entities to be 10.5 million Euros in 2010 (source: BDO Eesti AS). The court, however, rejected Estonia's arguments in its ruling, noting that since the Accounting Directive needs to take into account situation in every Member States, its impact on a particular Member States does not render it disproportional.

According to the Draft of the changes to the AA, the requirements on the content of annual reports will depend on the size of the entities, and the Draft of changes to the AA proposes the definitions of the following size groups of companies included in Table 8.

Table 8. Size categories of micro-, small and medium-sized entities based on the Draft of changes to the AA

	Micro-Sized Entity	Small-Sized Entity	Medium-Sized Entity
Estonia (draft law, expected to be effective from 2016)	Private limited companies (<i>OÜ</i>) which are <u>in compliance with all of the following criteria:</u> <ul style="list-style-type: none"> • BS total¹ does not exceed EUR 175 thousand; • Revenue² does not exceed EUR 50 thousand; • Total liabilities¹ < total equity¹; • One shareholder who is also member of the Management Board. 	Entities which <u>do not exceed the limits of two of the following three criteria:</u> <ul style="list-style-type: none"> • BS total¹: EUR 4 million; • Revenue²: EUR 8 million; • Employees³: 50. 	Entities which <u>do not exceed the limits of two of the following three criteria:</u> <ul style="list-style-type: none"> • BS total¹: EUR 20 million; • Revenue²: EUR 40 million; • Employees³: 250.
Latvia (draft law, expected to be effective from 2016)	Entities which <u>do not exceed any of the limits:</u> <ul style="list-style-type: none"> • BS total¹: EUR 350 thousand; • Revenue²: EUR 700 thousand; • Employees³: 10. <p>Reduced reporting requirements apply to companies which do not exceed two of the following <u>three criteria:</u></p> <ul style="list-style-type: none"> • BS total¹: EUR 50 thousand; • Revenue²: EUR 100 thousand; • Employees³: 5 	Entities which <u>do not exceed the limits of two of the following three criteria:</u> <ul style="list-style-type: none"> • BS total¹: EUR 4 million; • Revenue²: EUR 8 million; • Employees³: 50. 	Entities which <u>do not exceed the limits of two of the following three criteria:</u> <ul style="list-style-type: none"> • BS total¹: EUR 20 million; • Revenue²: EUR 40 million; • Employees³: 250.
Finland (draft law, expected to be effective from 2016)	Entities which <u>do not exceed the limits of more than one of the following criteria:</u> <ul style="list-style-type: none"> • BS total¹: EUR 350 thousand; • Revenue²: EUR 700 thousand; • Employees³: 10. 	Entities which <u>do not exceed the limits of more than one of the following three criteria:</u> <ul style="list-style-type: none"> • BS total¹: EUR 6 million; • Revenue²: EUR 12 million; • Employees³: 50. 	Entities which <u>do not exceed the limits of two of the following three criteria:</u> <ul style="list-style-type: none"> • BS total¹: EUR 20 million; • Revenue²: EUR 40 million; • Employees³: 250.
Sweden	Not known yet, expected to be effective from 2017.	Entities which <u>do not exceed the limits of two of the following three criteria:</u> <ul style="list-style-type: none"> • BS total¹: EUR 4.3 million; • Revenue²: EUR 8.8 million; • Employees³: 50. 	N/A

¹ At the end of the financial year² Of the financial year³ Average during the financial year

(Source: Draft of changes to the AA, 65 SE III)

The following table (Table 9) illustrates how many companies will fall under each category defined in Table 8, based on financial data available for the financial year of 2014. The table also includes information about how much of total revenues, assets and number of employees of all the entities will fall under each category.

Table 9. Classification of companies in Estonia

Category	Micro	Small	Medium	Large	Total
Total number of companies	35,331	83,916	465	144	119,856
Total number of companies (%)	29.5%	70.0%	0.4%	0.1%	100%
BS total (mln EUR)	606	44,085	6,475	17,188	68,354
BS total (%)	0.9%	64.5%	9.5%	25.1%	100%
Revenues (mln EUR)	393	28,270	6,761	16,130	51,554
Revenues (%)	0.8%	54.8%	13.1%	31.3%	100%
Number of employees	15,255	264,979	47,926	86,041	414,201
Employees (%)	3.7%	64.0%	11.6%	20.8%	100%

(Source: Ministry of Finance)

The requirements on the extent and content of annual report will depend on the size-group of the entity:

Table 10. Requirements on annual report

Country	Micro	Small	Medium&large
Estonia	<ul style="list-style-type: none"> Two primary statements: abridged balance sheet and income statement; Specified information in limited amount of notes (up to 3 notes); No management report has to be prepared. 	<ul style="list-style-type: none"> Two primary statements: long or abridged balance sheet, and income statement (if chooses abridged primary statements; certain additional disclosure requirements apply); Specified information in limited amount of notes (up to 9 notes); Management report. 	For medium-sized and large entities, Estonia is going to incorporate into the new accounting law the requirements from Accounting Directive 2013/34/EU without major changes. Estonia will not adopt any exemptions allowed by the Accounting Directive (for example starting the income statement with gross profit (loss)).
Latvia	<p>If a company does not exceed two of the following three criteria – total assets EUR 50 thousand, revenue EUR 100 thousand, 5 employees:</p> <ul style="list-style-type: none"> Can submit only balance sheet and profit and loss account; Notes not required, but need to provide information on off-balance sheet liabilities, contingencies, advances, loans, guarantees etc. provided to the management, average number of employees and transactions with treasury shares. <p>Other micro entities:</p> <ul style="list-style-type: none"> No management report has to be prepared if they disclose in the notes transactions with treasury shares during the year. 	<ul style="list-style-type: none"> Two primary statements: balance sheet and income statement; Less extensive note disclosures– e.g., does not need to disclose information about the subsidiaries and the parent company, information on related party transactions, allocation of revenue by type of activity or by geographic region, and fees paid to the statutory auditor. Management report. 	Little differences between medium and large entities – medium size entities are not required to include the allocation of revenue by type of activity or by geographic region, and fees paid to the statutory auditor.

- Shorter notes – not required to include the movement schedules of non-current assets and disclosure about the events after the balance sheet date.

Finland	<ul style="list-style-type: none"> • Two primary statements (balance sheet, income statement); • Specified information in limited amount of notes; • No management report (“board of directors’ report”) has to be prepared (not applicable for public companies or if the entity prepares consolidated financial statements). 	<ul style="list-style-type: none"> • Two primary statements (balance sheet, income statement); • Specified information in limited amount of notes; • No management report (“board of directors’ report”) has to be prepared (not applicable for public companies or if the entity prepares consolidated financial statements). 	<ul style="list-style-type: none"> • In addition to balance sheet and income statement, also cash flow statement, if the company is large-sized or PIE. • Management report (“board of directors’ report”) has to be prepared by both large sized and medium sized entities.
Sweden	<ul style="list-style-type: none"> • Two primary statements: abridged balance sheet and income statement; • Specified information in limited amount of notes (less information than for small-sized entities); • No management report has to be prepared, except for limited liability companies (Swe: Aktiebolag) and Economic associations (Swe: Ekonomiska föreningar). 	<ul style="list-style-type: none"> • Two primary statements: long or abridged balance sheet, and income statement (the adoption of the Accounting Directive 2014/34/EU implies no changes in this respect); • Specified information in limited amount of notes (fewer information will be required); • Management report. 	N/A – no split between medium and large entities. Swedish GAAP (K3) will be applicable.

(Source: Composed by the authors)

As can be seen from the comparison with other countries, the company size criterias are largely similar in the reference countries. Estonia is the only country where qualitative indicators are used to define Micro-entity. Also, the balance sheet limit in Estonia for micro-entities is the smallest in comparison with the other countries, meaning that several entities which based on the size criteria would be small entities in Estonia, would be Micro entities in other countries, thus they would have larger administrative burden in Estonia. We recommend the state to monitor the impact of the size criteria, and weigh the benefits of having more information against administrative burden. The analysis should be done in conjunction with assessment, what size-group entities and for which reason fail to submit their financial statements in time, and whether including more entities into Micro-entity group with reduced reporting obligations would attract more entities to submit their annual reports. On the other hand, multiple reporting frameworks may hinder the quality and transparency of the financial reporting environment in Estonia. We recommend the state to monitor the actual impact of the new requirements to ensure the right balance has to be achieved.

The requirements on the content of the annual reports of Micro and Small entities is largely similar in the given countries.

Based on our interviews with users (banks), changing the structure of primary statements will bring along a necessity for additional investments. They have not yet assessed the impact on the credit risk analysis processes, e.g. if additional information would be needed from clients with abridged primary statements.

2.5 Governance

2.5.1 Definition of Public Interest Entity

AAA effective from 2010 introduced the definition of public interest entities (PIEs). PIEs include entities listed below:

1. Listed companies;
2. Credit institutions;
3. Insurance companies;
4. Companies whose consolidated indicators exceed at least two of the following indicators: revenue of the financial year 66 million Euros, assets as of the balance sheet date 33 million Euros, average number of employees during the financial year 1,000 persons;
5. Companies, foundations, non-profit associations or other persons, in which a public sector entity has a majority holding or which is under the dominant influence of the public sector entity, whose consolidated indicators exceed at least three of the following indicators: revenue of the financial year 14 million Euros, assets as of the balance sheet date 7 million Euros, average number of employees during the financial year 200 persons, number of members of the supervisory board 8 persons;
6. Local governments with more than 10,000 people living in their administrative territory as of the balance sheet date or whose consolidated assets at the balance sheet date exceed 20 million Euros; and
7. Ministries as state accounting entities within the meaning of the Accounting Act.

Table 11. Examples of definition of PIE

Country	Extent of the EU definition				Other designated entities on national level						Number of PIEs and listed entities		
	Listed entities	Credit institutions	Insurance undertakings	Other designated entities	Pension funds	Investment companies	Size criterion	State owned companies	Government	Asset management companies	Number of PIEs	Number of listed entities	GDP 2013 EUR bn)
Estonia	X	X	X	X			X	X	X		149	13	18
Latvia	X	X	X	X	X	X				X	75	33	23
Finland	X	X	X	X	X	X					600	120	193
Sweden¹	X										450-500	450-500	421
UK²	X										2,300	2,300	1,899
Germany³	X										1,600	800	2,738

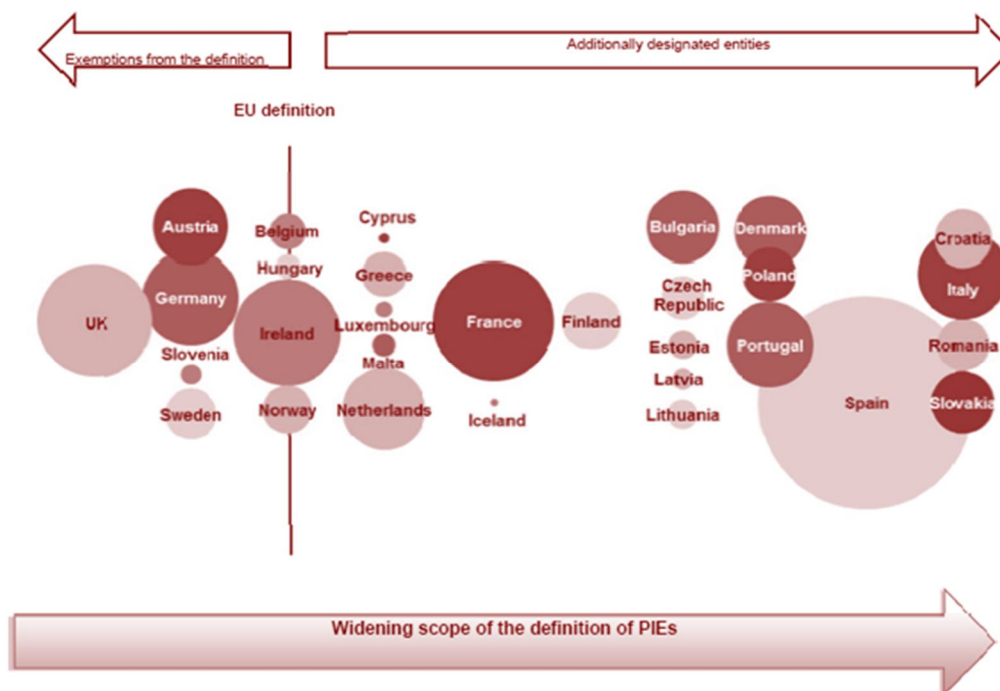
¹No single definition has been put in place when implementing the Directive 2006/43/EC. With the option included in Article 39 of the Directive 2006/43/EC, the rules set for PIEs currently apply to listed entities only.

²The option to only impose the more demanding EU PIE requirements on listed entities (Article 39 of the Directive 2006/43/EC) is applied. Additional requirements similar to those placed upon PIEs under the Directive 2006/43/EC are applied on other entities (for instance credit and insurance companies) by respective national laws and regulations.

³No single definition has been put in place when implementing the Directive 2006/43/EC. With the option included in Article 39 of the Directive 2006/43/EC, the rules set for PIEs currently apply to listed entities only.

(Source: FEE Survey "Definition of Public Interest Entities (PIEs) in Europe", October 2014)

Figure 3. Overview of the definition of PIEs across Member States, Iceland and Norway reflecting the actual number of PIEs



(Source: FEE Survey “Definition of Public Interest Entities (PIEs) in Europe”, October 2014)

It can be seen from the data above that the PIE definition is relatively narrower in the UK, Germany and Sweden. The scope of the definition is much wider in Italy and Slovakia, whereas Spain has by far the largest number of PIEs in the European Union.

Compared to the other reference countries, Estonia has the most expanded definition of PIE, and as a result, the largest number of PIEs compared with its GDP or number of listed entities.

PIEs are required to establish an audit committee (see 2.5.2); also, the auditors of PIE entities are subject to stricter rules in relation to e.g. rotation and supervision, and obligation to publish a transparency report. In addition, when EU Auditing Regulation No 537/2014 will become into force, the auditors will need to disclose starting from 2017, in accordance with ISA 700 (revised) and ISA 701 much more detailed information in the auditor’s reports on the financial statements of PIEs compared to the auditor’s reports to other entities – including description of most significant assessed risks, auditor’s response to the risk and key observations arising.

During our interviews, the recurring view was that PIE definition should be narrowed. If any size criteria will remain, they should be described as “rebuttable”, and e.g. FSA would be granted the right to remove entities from PIE status.

In other countries, no changes to PIE definition are anticipated, except for Latvia where it is planned to extend the PIE definition to pension funds.

During the preparation of this report, the pre-work for changing PIE definition in AAA has started. Based on the initial information, PIE definition is planned to be harmonized with the definition in EU directives. Information gathered in our interviews supports the initial approach taken.

Table 12. Division of public interest entities (PIE) according to the annual reports of 2013

	Credit institutions and listed entities	Share of total economy	Insurers	Share of total economy	Total Estonian economy
No of companies	91	0,08%	31	0,03%	115,128
Revenue ¹ (mln EUR)	16,794	37,12%	2,263	5,00%	45,244
No of employees ²	98,956	24,25%	23,545	5,77%	408,144
Assets ³ (mln EUR)	29,982	59,79%	5,911	11,79%	50,142
	Local government*		Ministry		
No of local governments	24	No of ministries	11		
No of people	897,579				
Total assets (mln EUR)	2,391				

*Data as of October 2015

¹ Of the financial year

² Average during the financial year

³ At the end of the financial year

(Source: compiled by the authors based on data received from the Ministry of Finance)

2.5.2 Obligation to Establish an Audit Committee

AAA effective from 2010 introduced the requirement of establishing an audit committee by public interest entities (PIEs). Obligation to establish audit committee is applicable to entities listed in 1-5 in 2.5.1. In entities listed in 6-7 in 2.5.1, the functions of the audit committee are performed by the revision committee.

In Latvia and Sweden, only listed companies are required to establish audit committee. In Finland, the Corporate Governance Code established in October 2015 includes a recommendation which allows entities to form audit committee. If the size of a company's operations requires that matters regarding financial reporting and supervision have to be managed in a smaller assembly than the whole Board of Directors, forming audit committee is recommended.

According to AAA, an audit committee is an advisory body of the body or person that elected, approved or appointed its members in matters involving accounting, auditing, risk management, internal control and audit, exercising of oversight and budget preparation and legality of the activities. The members of an audit committee shall be elected or removed by the supervisory board or, in the absence thereof, by the highest management body (the members of the audit committee of a ministry shall be appointed or removed by the minister). An audit committee shall have at least two members, at least two of whom shall be experts in accounting, finance or law. In order to elect a member of the audit committee, his or her written consent is required. An internal auditor, a member of the management board, a procurator, an assistant minister or a secretary general of a ministry or a person performing an audit shall not be a member of an audit committee; the chairman of the supervisory board shall not be the chairman of an audit committee. AAA sets requirements for the activities of audit committees and for communications between sworn auditors and audit committee.

Master thesis published by Tiiu Lauri in 2015 analyses the actual practices by PIEs in establishing audit committees (Lauri, T. 2015). Based on her study, not all PIEs have formed an audit committee, and in case the audit committee has been established, in many cases the members largely overlap with members of supervisory boards. The activities of audit committees are varying and the usefulness and achieving of the purpose by the audit committee are quite differently perceived by different entities. Her study indicates that audit committees are established by all listed companies, but the extent of activities varies in different companies.

Establishment of an auditing committee is not monitored by the state, and there are no sanctions prescribed by the law in case an entity fails to meet the requirement.

Based on our interviews, the respondents were on the view that PIE definition is too extensive and burdens many entities with the obligation to establish audit committee.

As pointed out in 2.5.1, the initial plan to narrow the definition of PIE is in line with the feedback we gathered during the interviews. We also recommend that when the definition of PIE is revised, the obligation to establish audit committee should be supported by establishing an oversight system to ensure the interests of public are protected by adequate management system in the entity.

2.5.3 Preparation and Approval of Annual Financial Statements

According to the CC, the management board of private and public limited company is responsible for organising the accounting. The management board is also responsible for preparing and approving the annual report – the date of completion of the annual report is considered to be the date when the management board has approved the report. By approving the annual report, the management confirms the correctness and completeness of the information set out therein. At least one member of the management board signs the annual report immediately after approval, specifying the date of completion. Prior to April 2012, all members of the management board had to sign the annual report after the approval. The change in the law does not move the responsibility of preparing a correct and complete annual report to the person who signs the annual report; instead the responsibility of the management board is ensured by the approval process prior to signing.

Members of the management board who cause damage to the private or public limited company by violation of their obligations shall be solidarily liable for compensation for the damage caused. A member of the management board is released from liability if he or she proves that he or she has performed his or her obligations with due diligence.

After approval by the management board, the annual report is presented to the auditor, if audit or review is necessary. If an entity has a supervisory board (in case of a public limited company), the annual report and profit distribution proposal are presented to the supervisory board who prepares a report to the shareholders' meeting stating whether the supervisory board approves the annual report. Then, annual report and profit distribution proposal are submitted to the shareholders for approval. Thereafter, the management board submits the approved annual report together with the proposal for the distribution of profit or the covering of loss, the division of revenue by activity and the sworn auditor's report, if audit or review is compulsory, to the commercial register.

2.5.4 Requirements on the Management Report

On 1 December 2005, AA was changed and started to require more information in the management report, such as the description of the main fields of activity as well as products and services and also the main financial ratios. If an entity prepared financial statements in accordance with IFRS, those disclosures were made also in the earlier period within the notes to the financial statements.

From 2007, listed entities have been required to disclose information of different nature, e.g. regarding their shares, voting rights of the shares, rules in relation to appointment of management and supervisory boards, provisions and rules for amendment of the articles of association of the company etc.

Starting from 2008, AA required that the annual report of an entity should disclose the entity's main field of activity pursuant to the Classification of Business Activities used in Estonia. According to the explanatory memorandum, such amendment provided for quick identification and processing of registers maintained by the court.

In 2009, new requirements became into force for listed entities who were obliged to include Corporate Governance Report (CGR) as part of their management report. CGR has to include reference to corporate governance code implemented by the accounting entity, profound and substantiated explanations if the accounting entity does not comply with corporate governance code, description of managing and supervisory bodies and the panels of the committees thereof and the organisation of their work, and description of the main features of internal audit and risk management systems in connection with the process of the preparation of the annual accounts.

Planned amendments to AA, expectedly effective from 2016 will include additional requirements to the management report of large listed entities who will have to disclose their diversity policies, and the results of application of the policies during the financial year. If no such policies exist, an explanation should be included. Also, large entities which are PIEs and have more than 500 employees as at the balance sheet date, will need to disclose the business model, and environmental and social impacts of its activities, management of human resources, monitoring of human rights and anticorruption risk management procedures. Also, as stated in 2.4.6, micro entities will not have to publish a management report.

2.6 Profession of Accountants

In Estonia, a professional qualification framework has been worked out for accountants¹, including description of requirements for accountants in a 7-level hierarchy (for examination of sworn auditors and internal auditors please refer to chapters 3.3.2 and 3.4 respectively). Passing the level tests is voluntary both in public and private sector, and is not very wide spread (about 3,000 accountants have taken a test, out of ca 12,000-15,000 accountants in total). The tests have no linkage to the auditor's examination tests, nor to any international tests (e.g. ACCA).

On the basis of the Professions Act of 2001, Estonian occupational qualifications were divided into five levels, with level I the lowest and level V the highest. In relation to accounting, three standards were specified: Accountant assistant I, Accountant II, and Accountant III.

Taking into account the Lisbon strategy (2000) and its aim to develop the European Union into the most competitive and dynamic economy, all member states were encouraged to link its qualification standards with the European Qualifications Framework (EQF). As a result, an 8-level Estonian Qualifications Framework (EstQF) was established and included in the new Occupational Qualifications Act (OQA) passed in 2008.

The development and implementation of the framework took place in 2008-2013, with new accounting qualification standards in effect since 1 January 2014. The respective EQF standards for accountants are Accountant level 5, level 6 and level 7. The linkage of former qualifications to EQF framework has not brought any substantial modifications to the curriculum, and the official awarding body for accountant's qualifications remains to be the Association of Estonian Accountants (AEA). To a large extent, the profile of knowledge, skills and competencies required on each respective qualification level has remained the same. However, the test of level 5 accountants now also includes managerial accounting, in addition to financial and tax accounting. The transition from former standards to the EQF framework is depicted in Table 13.

¹ An accountant in the context of this report is as defined according to ESTERM of Eesti Keele Instituut. "Accountant" is someone who performs accounting services. Accountants prepare financial statements and tax returns, financial records for auditing, and develop financial plans. The term "Accountant" in this report does not cover external and internal auditors, and is therefore much narrower compared to how this term is used in international practice.

Table 13. Changes in professional standards of accountants in Estonia

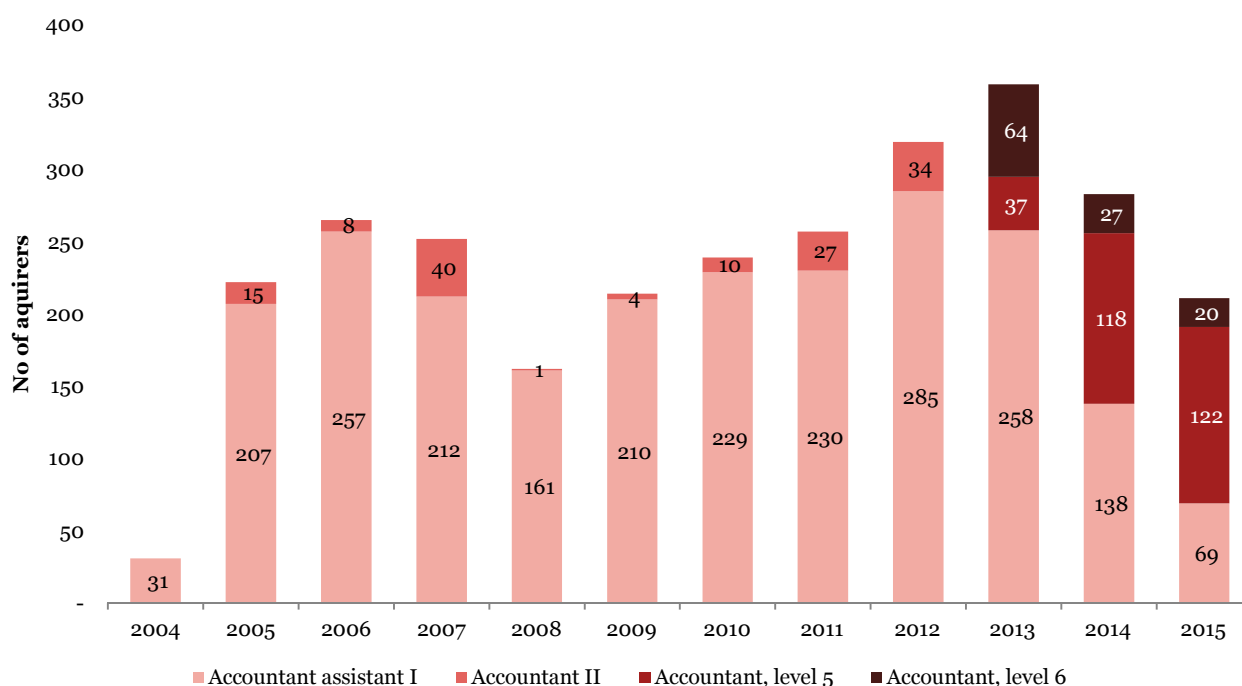
Former professional standard (valid until 31 December 2013)	EQF standard (effective since 1 January 2014)	Work requirements	Competencies	Occupations accessible	Qualification validity
Accountant assistant I	Accountant, level 5 ¹	Cooperation with other members of the team and taking responsibility. Tasks are normally carried out under supervision.	Financial accounting, accounting for taxation purposes, management accounting.	Accountant, accounting assistant, payroll accountant, cashier, data entry clerk.	Valid indefinitely
Accountant II	Accountant, level 6	Considerable amount of independence and responsibility, as well as assisting others where appropriate.	Financial accounting, accounting for taxation purposes, management accounting, analysis of financial reports, budgeting, cost accounting.	Accountant, senior accountant, head accountant.	Valid for 5 years
Accountant III	Accountant, level 7	Considerable personal responsibility and independence, cooperation with the team, and responsibility for the work of subordinates.	Financial accounting, accounting for taxation purposes, management accounting, cost accounting, analysis of financial reports, estimates and audits.	Finance director, head accountant, senior accountant, accountant, controller.	Valid for 5 years

¹To receive qualification Accountant, level 5, the person having Accountant assistant I qualification from prior system effective until 31 December 2013 has to take additional exam covering questions about management accounting. If this exam is not taken, the Accountant Assistant I is equalised with Accountant level 4.

(Source: Composed by the authors based on the webpage of Estonian Qualifications Authority found at www.kutsekoda.ee)

The professional examinations are organised by the AEA Qualifications Committee. None of the qualification levels are currently linked with the examination of becoming a sworn auditor despite some topics (e.g. Estonian GAAP and IFRS) are the same.

As a private organisation, the AEA has not received any funds from the Estonian-Swiss cooperation programme. However, AEA receives funds from membership fees, from carrying out different conferences and information days, from conducting preparatory trainings to pass Accountant qualification exams, etc. AEA also has an exclusive right to organise professional examinations and charge fees for exams, based on an agreement with the Estonian Qualifications Authority.

Figure 4. Accounting qualifications issued in period 2004-2015

In the reference countries, exams of accountants are not compulsory as well, refer to Table 14 below for more information.

Table 14. Summary of examinations to accountants in other countries

Country	Summary
Latvia	Profession of accountants is not regulated in Latvia. To work as an accountant, the person must either have completed the required professional education, or alternatively – obtained certificate of professional competence or have obtained professional experience in the accounting field. There are several professional organisations of accountants in Latvia who issue their own certificates. In addition to them, there is a limited liability company who issues competence certificates to the accountants. However, this certification is voluntary.
Finland	In Finland, a highly respected professional examination in the field of accounting is called the KLT accounting examination. The examination is voluntary, but the job descriptions of certificated accountants are more versatile and involve more responsibility than usually in the field. Currently, there are around 2,700 KLT-accountants in Finland. Candidates must have relevant degree and several years of working experience in the accounting field before attending the test. After passing the test, KLT-accountants must constantly sustain their professional expertise and it is monitored every three years.
Sweden	There are no compulsory tests for accountants. There are voluntary tests for accountants who sell their accounting services to different companies. After the test the accountant receives an authorisation as accountant in public practice.

(Source: Composed by the authors)

Based on our interviews, we can conclude that it has proved difficult to introduce the professional level examination system in the private sector. AEA believes that having a professional certification as an Accountant is proof of quality, therefore, they made a recommendation that some companies should be obliged by law to have this certification - for example companies, whose main field of activity is providing accounting services to other companies. However this idea was not supported by all interviewees, as respondents were generally on an opinion that the quality of accountants is regulated by the business environment and the level of accountants is generally tested by companies who hire them.

AEA is working together with the Board of Auditors on the possibilities to harmonise tests of higher level accountants with the tests of sworn auditors.

It can be concluded from the interviews carried out that no quality control system is currently in place. The only indication to a “quality control” is the fact that the Accountant level 6 (and 7) qualification is valid for five years and after that, the person has to be recertified.

There have been discussions lately whether a common body for regulating the profession of accountants (including sworn and internal auditors) is necessary. In our interviews, none of the parties expressed the need for such an “umbrella” organisation. As already mentioned above, in respect of professional exams, the auditors’ and accountants’ organisations already cooperate. The professional standards used by sworn and internal auditors to carry out their services are different, and there is little to no regulation for accountants in that respect. Also, the quality control system over sworn auditors’ is very regulated and not applicable to accountants, where the quality is rather managed by the business environment. Therefore, there was no necessity found for coordinating other activities (standards, quality control, oversight, etc.). Based on the feedback, we recommend that no such “umbrella” organisation needs to be considered at this point.

2.7 Other

2.7.1 Current “E-projects” by the State

“Zero-Bureaucracy” project:

In our interviews, several interviewees suggested that the databases of the state (Business Register, E-land Register, Register of Construction Works, databases of Statistics Estonia and Estonian Tax and Customs Board) should be integrated better. Still there are some data which an entity needs to submit to both the Estonian Tax and Customs Board and to Statistics Estonia. Also, the nature of information gathered should be critically revised.

In 2015, the Ministry of Economic Affairs and Communications has initiated a project of zero-bureaucracy to gather ideas from the public how to reduce administrative burden of companies, change the reporting procedures, or change the data that is being currently required. Based on the feedback, it has been suggested to create a so-called “one-stop-shop” i.e. one single reporting environment where the entities of private sector can enter all the data required by the state, or furthermore, where the entities could transfer the data automatically, directly from their business software. The working group set by Association of Estonian Accountants and Statistics Estonia has been analysing whether all the state required data could be gathered using XBRL Global Ledger standard. One single reporting environment would considerably reduce the administrative burden of the entities of private sector, as no double-entering of data would be needed; the environment would be user-friendly, as the entity would have the full overview of all the data required from the state, as well as upcoming deadlines.

Based on the information gathered on the interviews and the feedback received by the ministries from the zero-bureaucracy project, we recommend putting continuous effort in the integration of the state databases and usage of electronic channels to the extent possible.

“Digi-Turn” project:

The Ministry of Finance is currently working on the draft of changes to the AA to introduce e-invoicing. By the preliminary wording of the draft, accounting source documents should generally be machine readable. Furthermore, if an invoice is presented to a state accounting entity, a local government, a legal person in private or public law registered in Estonia, or an entity over which the abovementioned entities have significant influence or control, the source document must be machine readable – meaning that the invoicing to the public sector can only occur electronically.

Based on our interviews, all supported the initiative to start using e-invoices when settling accounts with public sector. However, starting to use the e-invoicing on a mandatory basis would impose additional administrative burden to smaller entities, but may also create problems for the public sector entities.

We therefore recommend that before implementing the change, the impacts should be thoroughly assessed, especially the impacts to micro and small entities. If maintaining both, the electronic and paper invoicing, systems will be expensive to the state, we recommend considering to give an extended period to the private sector entities to implement the electronic invoicing systems.

2.7.2 Public Sector Accounting and Budgeting

Estonia was one of the first countries in Europe to implement IPSAS based accounting in the public sector. The first consolidated accrual and IPSAS based financial statements for the Estonian government and public sector were prepared for 2004 and they have been prepared since then. According to a global PwC survey carried out in 2013, the Estonian public sector accounting and reporting was one of the most advanced in the world.

Table 15. Accounting maturity by country and government sector

	Central	State	Local	Social Fund
Austria	73%	12%	12%	61%
Belgium	67%	67%	73%	60%
Bulgaria	56%	-	56%	63%
Croatia	34%	-	34%	55%
Cyprus	14%	-	75%	17%
Czech Republic	75%	-	75%	77%
Denmark	72%	-	65%	58%
Estonia	92%	-	92%	86%
Finland	72%	-	90%	92%
France	89%	-	84%	92%
Germany	22%	29%	58%	42%
Greece	12%	-	12%	12%
Hungary	66%	-	66%	55%
Ireland	54%	-	71%	57%
Italy	31%	-	30%	14%
Latvia	73%	-	73%	55%
Lithuania	88%	-	88%	72%
Luxembourg	19%	-	31%	15%
Malta	22%	-	94%	-
Netherlands	31%	-	58%	78%
Poland	66%	-	66%	68%
Portugal	55%	-	80%	70%
Romania	63%	-	63%	38%
Slovakia	75%	-	75%	34%
Slovenia	62%	-	62%	19%
Spain	70%	61%	68%	58%
Sweden	81%	-	81%	71%
United Kingdom	96%	-	95%	-

(Source: PwC (2014). Collection of information related to the potential impact, including costs of implementing accrual accounting in the public sector and technical analysis of the suitability of individual IPSAS standards 2013/S 107-182395.)

The procedures for accounting and financial reporting of the public sector entities are set out in the General Rules for State Accounting (GRSA). GRSA is based on IPSAS and in most areas prescribes similar accounting treatments for the public sector as Estonian GAAP for business entities.

In 2015, the Ministry of Finance commenced a process of adopting accrual based budgeting in the public sector. The current plan is to approve the first accrual-based budget for the Estonian government for the financial year 2017. However, the final political decision to introduce accrual-based budgeting has not been taken yet.

We would strongly recommend implementing accrual based budgeting in the public sector as it would help to increase the efficiency of managing the public funds and fully utilise the benefits of high quality of public sector accounting.

2.7.3 *Terminology*

Currently, there are differences in some terms as used by different sources of accounting legislation – i.e by the AA, AAA, and CC; by ASBGs; and by the translations of IFRSs as endorsed by EU. There are also differences of terms in some of the educational books in the field of accounting/financial reporting.

As the inconsistent terminology may have negative impact on the development of the accounting field, in 2015, the Ministry of Finance has formed a temporary terminology committee whose task is to revise the accounting and financial reporting terms used in the legislation, align them to the terms used in translations of international financial reporting standards (IFRS, IFRS for SMEs), and agree on the terms that will be used in the future. The committee consists of six members, including two members from EASB, two from universities, one from the Institute of the Estonian Language, and a lawyer from the Ministry of Finance. Owing to differences in opinion between members, the terminology committee has been able to achieve only very limited progress in aligning terminology between domestic legislation, IFRS translations, and EASB guidances and a number of basic terms remain without consistent, agreed-upon Estonian translation.

Based on our interviews, majority of the interviewees shared the view that there is no substantial problem with terminology. Indeed, different terms may be applicable for several items, but as their substance is understood, different terms are not misleading. We therefore recommend revisiting whether the unification of accounting terminology is critical at this point of time.

2.7.4 *Disclosure of Auditors' Fees in Financial Statements*

Since 2010, AA includes requirement to disclose an overview of the amount of fees under audit firm client contract calculated during the accounting year and divided as follows: 1) audit fees; 2) fees for review service; 3) fees for other assurance services; 4) fees for related services; 5) fees for other business activities, including fees for tax advisory services.

In our experience, entities in Estonia do not always disclose their auditors' fees in their financial statements and the users have appeared to be disinterested in such disclosure.

While the disclosure may serve a purpose to help a user of the financial statements to understand whether the audit fee is large enough to enable conducting a quality audit or whether the fees can impact the independence of a sworn auditor, during our interviews we did not identify that any party would particularly value such a disclosure.

Estonian Board of Auditors does not monitor whether the total fees charged to the client have been disclosed. It can be seen from the OB yearbook 2012-2014 that there is a positive correlation between higher fees and better quality. For instance, audit firms where the quality of services was of highest standards (classified as “green”), charged 2.2 times larger audit fees than those, that were classified as red.

As a summary, there has been an improvement in the area since 2004; the respective requirement in the EU directive has been transposed to AA in 2010.

3 Auditing

3.1 General Overview of Changes in the Legislation

The changes in the field of auditing in Estonia can be roughly divided into two periods governed by: (1) first Auditor's Activities Act issued in 1999, and (2) new Estonian Auditor's Activities Act issued in 2010, introducing audits based on International Standards on Auditing.

The organisation governing the auditing practice in Estonia is Estonian Board of Auditors (BoA), which was created in 1999 with the Auditor's Activities Act (hereinafter AAA) of the Republic of Estonia. BoA is a legal person in public law and is a self-governing professional association of Estonian auditors, which organises the audit activities in accountancy in private and public interests and protects the professional rights of its members. The members of BoA are sworn auditors and audit firms with activity licence; only the audit firms with activity licence have the right to provide auditor's services.

During 2004-2010 there were no major changes to the AAA. The AAA was supplemented by Auditing Rules, which were adopted in 2000 and formed the code for auditing practice. It explained the ethical principles of auditing, the function and purpose of auditors and fundamental ideas of auditing. It also defined the relationship between the auditor and the client and provided instructions, how to plan and conclude the audit and also included the requirements for the audit documentation and auditor's report. The Auditing Rules were a very abbreviated substitute for ISAs.

The need to amend and update the AAA significantly was also pointed out in the ROSC report of 2004. According to their analysis, the differences in technical proficiency of Estonian auditors resulted in significant differences in audit quality. High-quality audit delivery could be expected from select audit firms representing approximately 25 percent of profession. Furthermore, the research stated that although there was a significant improvement in the quality of audits of public interest entities, the audit quality in SMEs lagged behind. The reason behind it was that most sole practitioners and auditors employed in small audit firms did not have access to an audit practice manual. Thus, at that time, lacking knowledge about how to apply ISAs made many Estonian auditors only to use Estonian auditing guidelines, albeit not properly.

In May 2006, the European Union adopted the Audit Directive 2006/43/EU (amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC) that required the use of international auditing standards adopted by the European Commission for all statutory audits to be performed in the European Union, allowing for applying of national auditing standard until the Commission has adopted an international standard. The Audit Directive pointed out that audit qualifications obtained by statutory auditors on the basis of this Directive should be considered equivalent. Also, knowledge of auditors should be tested before a statutory auditor can be approved. In order to protect third parties, all approved auditors and audit firms should be entered in a register which is accessible to the public and which contains basic information concerning statutory auditors and audit firms. In addition, Member States should organise an effective system of public oversight for statutory auditors and audit firms on the basis of home country control.

The changes in the European Union level brought along changes in Estonian AAA to reflect the requirements included in the Audit Directive 2006/43/EU. The new AAA became effective in March 2010. The act included regulations in respect of sworn auditors (e.g. professional examination, qualifications and qualification levels, activity through audit firms, rules for activity licence, rotation, auditor's liability etc.), BoA (e.g. activities of BoA, public oversight, auditors' register etc.), internal auditors (e.g. activities, professional examination, qualifications etc.), and entities subject to audit or review (e.g. thresholds for audit and review obligation, definition of PIE, obligation to establish audit committee, etc.).

In accordance with the AAA, sworn auditors are obliged to comply with standards for professional practice of sworn auditor, consisting of (1) the international standards transposed by the European Commission and established by the Commission Regulation; (2) the standards prepared on the basis of the principles of the International Federation of Accountants (hereinafter IFAC) and international standards in the part which is not covered by the standards provided for in clause (1); and (3) other standards.

For the purposes of AAA, international standards are the following approved by IFAC:

1. International standards on auditing;
2. International standards on review services;
3. International standards on assurance services;
4. International standards on related services;
5. International standards on quality control;
6. Code of ethics;
7. Other documents regulating the activities of sworn auditors.

AAA set the objectives of the BoA to be as follows: (1) high quality of the professional activities, good reputation and reliability of the members of the Board of Auditors, (2) development and harmonisation of good practice of professional activities of the members of the Board of Auditors, (3) organisation of oversight of the members of the Board of Auditors, (4) organisation of in-service training for the members of the Board of Auditors, and (5) protection of the professional rights of the members of the Board of Auditors. AAA also sets the bodies of BoA to be the General Meeting, the President (being also a member of the management board), the management board, the revision committee and the Oversight Board, and lists the competence and functions of each of the bodies.

The AAA adopted in 2010 has been changed 11 times until the end of 2014 (including the last changes becoming effective starting from 1 January 2015). The most substantial was the latest change effective from 2015 which among others, added or modified regulations in the following areas:

- Clarified the requirements for third-country sworn auditor;
- Amended the obligation of sworn auditor to undergo in-service training;
- Introduced an additional service called accountancy revision, which is a part of internal control;
- Explained in which circumstances can the audit firm be voluntarily dissolved;
- Included additional information about the quality control and respective teams carrying out the work.

The next significant changes to the AAA are expected in 2017, when Estonia has to adopt the new auditing Directive 2014/56/EU amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts. The most significant changes are expected in areas of auditor's rotation (see section 3.3.8) and prohibition to provide other services (see section 3.3.9). Also the definition of PIE will be revised (see section 2.5.1). Until now, there are no specific rules around provision of other services, in addition to the independence rules from IFAC's code of ethics.

3.2 Entities Subject to Audit or Review

In accordance with CC, the annual financial statements of public limited companies are to be audited; the annual financial statements of private limited companies are subject to audit or review if:

- During 2004-2010: if the share capital exceeds 25,564 Euros; if stipulated so in the articles of association of the company, or required by other laws. AA stipulated company size limits as presented below.
- Starting from 2010: stipulated so in the articles of association of the company or required by AAA.

During 2004-2010, the quantitative thresholds of companies, to whom AA mandated the audit of the annual financial statements, are described in Table 16. Audit was obligatory if an entity exceeded two out of three indicators.

According to the effective AAA, an audit of the annual report is compulsory for all public limited companies, state accounting entities, local governments, legal persons in public law, foundations and political parties receiving allocations from the state budget and for company in which the state has at least the discretion for the purposes of the State Assets Act. In 2010, the foundations were removed from the list of compulsory audit, unless they meet a more specified criteria (for example are established by the state).

Limits of compulsory audit or review also depend on quantitative criteria. Starting from 1 of January 2010, audit or review is compulsory for companies exceeding quantitative thresholds included in Table 16. These thresholds have not changed significantly over the years (i.e. during 2010-2014).

Table 16. Limits of compulsory audit for 2004-2015

	2004	2005-2010	2010-2015	
	Audit	Audit	Review	Audit
	2/3	2/3		2/3
Revenue ¹ (mln EUR)	> 0.38	> 0.64	> 1	> 2
Employees ²	> 5	> 10	> 15	> 30
Assets ³ (mln EUR)	> 0.19	> 0.32	> 0.5	> 1
			1/3	
Revenue ¹ (mln EUR)			> 3	> 6
Employees ²			> 45	> 90
Assets ³ (mln EUR)			> 1.5	> 3

¹ Of the financial year

² Average during the financial year

³ At the end of the financial year

(Source: Composed by the authors based on AA effective from 2004-2010 and AAA effective since 8 March 2010.)

The limits of audit and review are being changed from 1 January 2016. AAA will be amended together with amendments to AA discussed in 2.4.6. The draft of changes to AAA proposes the following limits for audit and review:

Table 17. Limits for compulsory audit or review included in the Draft of changes to the AA 65 SE I

	Review	Audit
	2/3	2/3
Revenue ¹ (mln EUR)	> 1.6	> 4
Employees ²	> 24	> 60
Assets ³ (mln EUR)	> 0.8	> 2
	1/3	
Revenue ¹ (mln EUR)	> 4.8	> 12
Employees ²	> 72	> 180
Assets ³ (mln EUR)	> 2.4	> 6

¹ Of the financial year

² Average during the financial year

³ At the end of the financial year

(Source: explanatory note to Draft of changes to AA no. 65 SE I)

Based on data of 2013, under the current law, 6,496 entities were subject to audit and review. By the thresholds of the Draft law, the number would have been 5,161. As explained in the explanatory memorandum to the Draft law, Ministry of Finance has determined that approximately 80% of the assets and revenues of the total economy should be audited or reviewed by sworn auditors to ensure the overall quality of financial reporting in Estonia. Based on 2013 data, the new thresholds would meet the objective.

More detailed information about entities, revenues and assets covered by assurance engagements is provided in Table 18 and Table 19.

Table 18. Number of companies having compulsory audit and review obligation under current AAA, using 2013 information

	Review	Audit	Total	Share of total number of companies	Number of companies
Total amount	1,452	5,044	6,496	5.58%	116,403
Revenue (mln EUR)	1,697	39,789	41,486	82.37%	50,368
Employees	16,320	235,892	252,212	63.31%	398,395
Assets (mln EUR)	1,963	64,226	66,189	85.30%	77,597

(Source: Draft of changes to the AA no. 65 SE I)

Table 19. Number of companies having compulsory audit and review obligation based on the Draft of changes to the AAA, using 2013 information

	Review	Audit	Total	Share of total	Sum of all companies
Total amount	1,302	3,859	5,161	4.43%	116,403
Revenue (mln EUR)	3,601	36,301	39,903	79.22%	50,368
Employees	25,203	211,483	236,686	59.41%	398,395
Assets (mln EUR)	5,151	59,221	64,372	82.96%	77,597

(Source: Draft of changes to the AA no. 65 SE I)

In Finland, auditing is compulsory to all companies whose main area of business is holding securities and has significant influence on managing another company's operations and financing. In addition, audit is compulsory if an entity exceeds size criteria below.

Table 20. Size criteria for audit (and review) in other countries

Million EUR	Latvia			Sweden		Finland
	Until 31/12/2015	From 1/1/2016		Limited Liability Companies	Economic Associations	
	Audit	Review	Audit	Audit	Audit	Audit*
	2/3	2/3	2/3	2/3	2/3	2/3
Revenue for the year ended	> 0.8	> 0.8	> 1.6	> 0.3	> 8.6	> 0.2
Average number of employees	> 25	> 25	> 50	> 3	> 50	> 3
Assets at the BS date	> 0.4	> 0.4	> 0.8	> 0.16	> 4.3	> 0.1

* Finland has a 2-tier auditors' system: KHT auditors (approved by the Central Chamber of Commerce) and HTM auditors (approved by local Chamber of Commerce). A KHT auditor must be appointed by all listed companies, and by other companies if at least 2 of the 3 indicators are met: total assets EUR 25 million, revenue EUR 50 million, average number of employees 300.

(Source: Composed by the authors)

As can be seen in the table above, Latvia is one of the few countries to follow Estonia's lead to introduce statutory review. In addition to Latvia and Estonia, review has also been introduced in Switzerland starting from 2008. Scandinavian countries are working on Nordic standard of auditing for audits of small entities. The Nordic standard is based on general auditing principles and uses a risk-based approach. Since the standard is principles based, the auditor's professional judgment will have a more prominent role. Use of the Nordic standard is limited to audits of entities below the thresholds for small entities in the EU Accounting Directive. The Nordic standard has been developed by the Nordic Federation of Public Accountants (NRF) and was released for consultation by the institutes of public accountants in Sweden, Denmark, Finland, Iceland and Norway with the deadline in October 2015.

Based on our interviews, people generally shared the view that the thresholds should be increased. Different parties (e.g. organisations of enterprises, Board of Auditors, Association of Accountants etc) were also asked to provide their views to the Ministry of Finance in the process of compiling the Draft of changes to AAA. Some users expressed the view that for them, increasing of thresholds means additional work with the financial statements of a smaller entity, because without having a sworn auditor's review or audit performed on these statements, it is more difficult to rely on them.

We recommend the Ministry of Finance to continually monitor, how big share of the total economy is covered by assurance engagements on the annual financial statements to ensure the quality of financial reporting in Estonia while balancing the administrative burden for small entities.

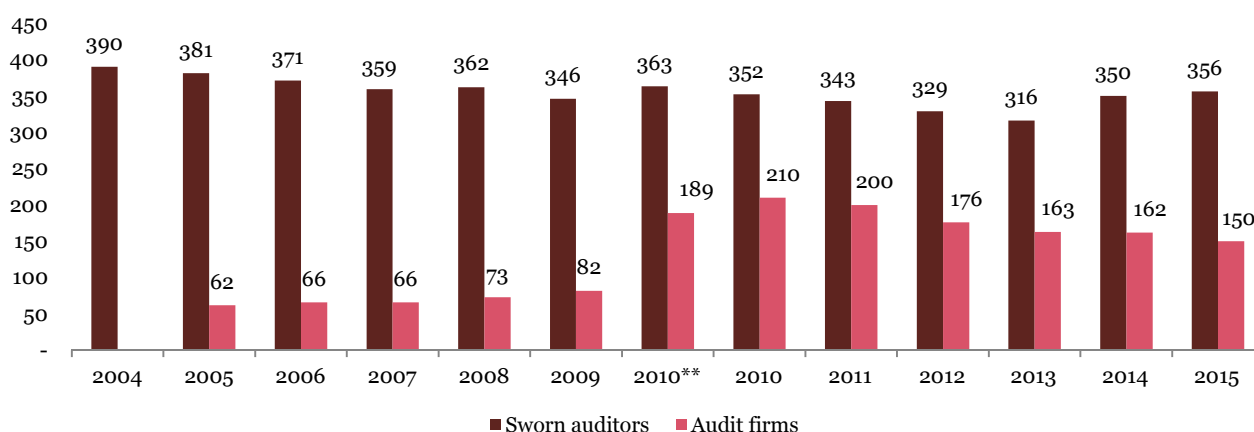
3.3 Board of Auditors

The members of BoA are sworn auditors and audit firms with activity licence; only the audit firms with activity licence have the right to provide auditor's services. During 2004-2015 the number of sworn auditors has decreased from 390 to 356.

When the new AAA became effective in 2010, all existing certified auditors were obligated to pass the special part of sworn auditor of the auditor's exam in order to have a right to apply for activity licence. The exam had to be passed by July 2011; later the deadline was postponed to October 2012. The fact that a lot of certified auditors decided not to take the exam, explains the decrease in the number of auditors during 2010-2013 – during these years, total of 63 auditors left the profession, most due to the abovementioned reason.

Decreasing number of audit firms during 2010-2015 is largely due to consolidation within the profession – smaller audit firms are combining together. The main reason behind the consolidation are significantly increased requirements for the auditor, therefore working together enables to share the workload in establishing proper procedures and policies.

Figure 5. Estonian Board of Auditors members in period 2004-2015*



*Data presented as of the end of the financial year on 30.06 in each respective year.

**As at 8 March 2010 (at the moment when new AAA entered into force)

(Source: Estonian Board of Auditors)

The total turnover of auditing firms in 2014/2015 amounted to 25.1 million Euros, increasing from 23.3 million Euros a year before. As can be seen from Table 21, the largest 5 entities have 54.8% of the market share. Also, large and medium audit firms have been able to increase their revenues while there has been a reduction in the small audit firm segment.

Table 21. Summary data about the market of auditing services

Segment	Number of audit firms	Sum of revenue (in million EUR)	Market share	Average revenue growth
2013/2014				
Large audit firms	5	12.8	54.9%	6.9%
Medium audit firms	25	6.1	26.32%	13.8%
Small audit firms	131	4.4	18.78%	-3.4%
Total	161	23.3	100%	4.5%
2014/2015				
Large audit firms	5	13.7	54.75%	7.4%
Medium audit firms	25	6.6	26.37%	7.9%
Small audit firms	122	4.7	18.88%	16.2%
Total	152	25.1	100%	14.1%

(Source: Oversight Board Yearbook 2014/2015)

3.3.1 Oversight

Supervision over the Board of Auditors (including supervision of the quality control) is done by the Oversight Board (OB). Oversight Board consists of 7-9 members, appointed by the Minister of Finance. Proposals concerning the appointment of members can be made by Financial Supervision Authority (1), the National Audit Office (1), the Ministry of Justice (1), the Board of Auditors (2).

The Oversight Board is an independent supervisory body of the Board of Auditors established on the basis of AAA, and whose function is to organise oversight in the public interest and take measures for facilitating the development of audit activities, the achievement and protection of the quality of the professional activities of the sworn auditors. In accordance with AAA, the members of the Board of Auditors, and registered 3rd country sworn auditors, are subject to oversight. Oversight includes, among other, the internal quality control of the professional association of auditors, disciplinary proceedings and the proceeding and investigation of complaints. The competence of OB includes organising and directing oversight; approval of important documents of the Board of Auditors, taking certain decisions listed in AAA in respect of professional examination, exercising oversight over quality control, disciplinary proceedings, processing of complaints and in-service training of sworn auditors. Also, OB administers the sworn auditor's oath, establishes the amount of the membership fee and the rate of the licence fee and takes decisions regarding deprivation of the qualification.

Oversight Board is financed from state budget and not from membership fees of Board of Auditors.

Table 22. Buildup and financing of supervisory system**Country**

Latvia	<p>Public oversight system over the activities of the auditors is composed of three bodies:</p> <ul style="list-style-type: none"> • The Ministry of Finance through its Audit Oversight Commission, • Latvian Association of Sworn Auditors (LASA), and • The Audit Advisory Council established by the Minister of Finance. <p>LASA is an independent professional body of the auditors. LASA certifies statutory auditors, provides licences to audit companies, and maintains statutory audit register. LASA also organises quality reviews that are performed by peer reviewers who are members of LASA. LASA has established a Quality Committee that monitors the quality control procedures and reviews disciplinary cases of certified auditors. The Ministry of Finance oversees the activities of LASA through its Audit Oversight Commission (AOC). AOC regularly inspects or supervises the quality reviews performed by LASA, either on-site or off-site. The Audit Advisory Council has been established for the purpose of promoting the increase of quality of audit services. The decisions of the Audit Advisory Council have recommendation status and its main contribution has been raising public awareness of issues in the field of auditing, and defending the public interest given the many functions delegated to LASA.</p> <p>LASA is financed mainly by the membership fees. State oversight activities performed by the Ministry of Finance are financed from the State Budget. The activities of the Audit Advisory Council are financed through State budget, however to date the people involved in the council have not been remunerated.</p>
Finland	<p>New Auditing Act in Finland will become effective on 1 January 2016. From that date, the supervision function will be transferred from the Central Chamber of Commerce of Finland over to the Finnish Patent and Registration Office, from private sector to the public sector.</p> <p>As of the year 2016 the Auditor Oversight Unit within the Finnish Patent and Registration Office will be the competent authority. The Auditor Oversight Unit will also authorise auditors and audit, organizes the professional examination, keeps the audit register and performs many other statutory functions related to auditing. The functions of the Auditor Oversight Unit will be financed by statutory fees, which will be collected from auditors and audit firms. Also, an hourly rate of 130 Euros will have to be paid for the quality control inspection. Those auditors and audit firms that audit public interest entities will have to pay an annual quality control review fee (instead of the hourly rate for the inspection). The amount of the fee will be calculated on the basis of the yearly income of the auditor/ audit firm.</p> <p>In addition there are individual fees being collected for example for taking part in the examinations etc.</p>
Sweden	<p>Swedish Supervisory Board of Public Accountants (Revisorsnämnden - RN) is a governmental authority with a mandate to supervise Swedish auditors. Approved and authorised auditors, as well as registered audit firms, are subject to supervision. RN is a governmental authority under the Ministry of Justice.</p> <p>The tools available for RN's oversight are recurring quality control inspections as well as risk based inspections, disciplinary investigations, and the power to impose disciplinary sanctions. RN has the sole responsibility for the system for inspections of audit firms and auditors. For inspections of auditors and audit firms that do not audit listed companies, RN relies on the inspections carried out by the professional organisation FAR. The activities of FAR are monitored by RN. Under an agreement between RN and FAR, the organisation has a duty to report to RN material breaches of auditing standards or professional ethics.</p> <p>RN is organised in an office, a disciplinary board and an exam committee. RN is led by a director, who is the head of the authority and who has the full decisive power in all administrative matters and all matters connected to investigations and other duties of the authority. The director is appointed by the government and reports to the Minister of Justice. All matters concerning exams, issuing of authorisation or registration, opening investigations and closing investigations without disciplinary action are decided by the director or the staff member to whom the director has delegated his powers of decision. He may also, by powers delegated to him, decide in disciplinary matters.</p> <p>Investigations, in which disciplinary action is imposed on a public accountant or an audit firm, are decided by the disciplinary board. It consists of nine persons, all appointed by the government. The chairman and the deputy chairman are judges. The other members represent various professions and central governmental authorities such as the National Tax Board and the Financial Supervisory Authority, all selected for specific competence in audit related matters. Two members are auditors in public practice. Beside disciplinary matters, the disciplinary board is also responsible to decide on the issuance of such formal regulations that relates to the authority of RN and in matters of principle.</p> <p>RN is funded entirely by fees levied on auditors and registered audit firms. The government decides by means of regulation the size or the specific grounds on how to calculate most fees, e.g. the different annual fees levied on auditors and registered audit firm. Failure to pay an annual fee is an immediate ground for withdrawal of an auditor's approval or the registration of an audit firm. RN sets its own annual budget according to the expected influx of fees, but is obliged to keep costs and incomes in balance over time. Fees for taking part in professional exams arranged by RN are decided by RN itself. All fees are paid directly to RN.</p>

(Source: Ministry of Finance, the authors, <http://eng.lzra.lv>, <http://siteresources.worldbank.org/EXTCENFINREPREF/Resources/4152117-1232359743213/Latvia-ROSCAA-final.pdf>, <https://www.prh.fi/fi/tilintarkastusvalvonta.html>, <http://www.revisorsnamnden.se/rn/english/english.html>)

There have been discussions, as a part of preparations for making changes to AAA effective from 2017, about the future split of responsibilities over and financing of the supervision activity. Among other, it is discussed whether OB will continue the supervision activities over all the auditors, or will the supervision over the auditors of PIE clients move to be governed by the Financial Supervision Authority (FSA). Also, whether the financing of supervision would continue to be through state budget or should supervision be financed through activity fees of auditors.

In our interview with the representatives of BoA, they expressed a concern that financing supervision by auditors may create independence questions. Also, no allocations from the state budget would raise a question as to whether the state values the role of auditors of working in the public interest in the enhancement of financial reporting and auditing in Estonia.

As can be seen from the practice in countries where the audit profession has a long history and the role of the auditors in the society has been well recognised by the public, the financing of oversight activities can be fully conveyed to the profession itself. Based on the practice in Latvia where, similarly to Estonia, the role of the audit profession is perhaps not so well established yet, the oversight activities are partially financed by state budget. In establishing the future financing model for the oversight activities in Estonia, we recommend the state to assess prudently whether the public awareness of the role of the auditors is at the same level as in countries with long history of auditing practice, and whether the companies are ready for increased audit fees for the reason of passing the financing of the whole oversight system to the profession itself or would they perceive this as an additional administrative burden imposed by the state.

3.3.2 *Examination for Becoming a Sworn Auditor*

AAA in 2010 changed significantly the examination system for becoming a sworn auditor. Previously, the examinee had to pass one written exam covering various subjects from how to conduct an audit to financial reporting and business management. Prior to taking the exam, the applicant had to practice auditing under the supervision of a certified auditor for three years.

According to the new law effective from 2010, the professional examination is built up as follows:

- Prior to submitting an application for taking the professional exam, an examinee has to have practiced at least three years under the supervision of a sworn auditor. The examinees have to submit practice reports upon start and finish of the practice period. The practice report submitted on the completion of the practice period must include, among other, a description of trainings passed and;
- Examinee has to take the professional exam. The professional examination program is established by a regulation of the Minister of Finance. The sections of the professional examination are:
 1. Special part of accounting;
 2. Special part of a sworn auditor;
 3. Special part of public law.

The sections are divided into sub-parts. Also, examinees are required to write an essay on a subject specified by the Oversight Board. On the basis of the essay the suitability of the personal characteristics of an examinee for the sworn auditor's professional activities is assessed.

The tests are web-based.

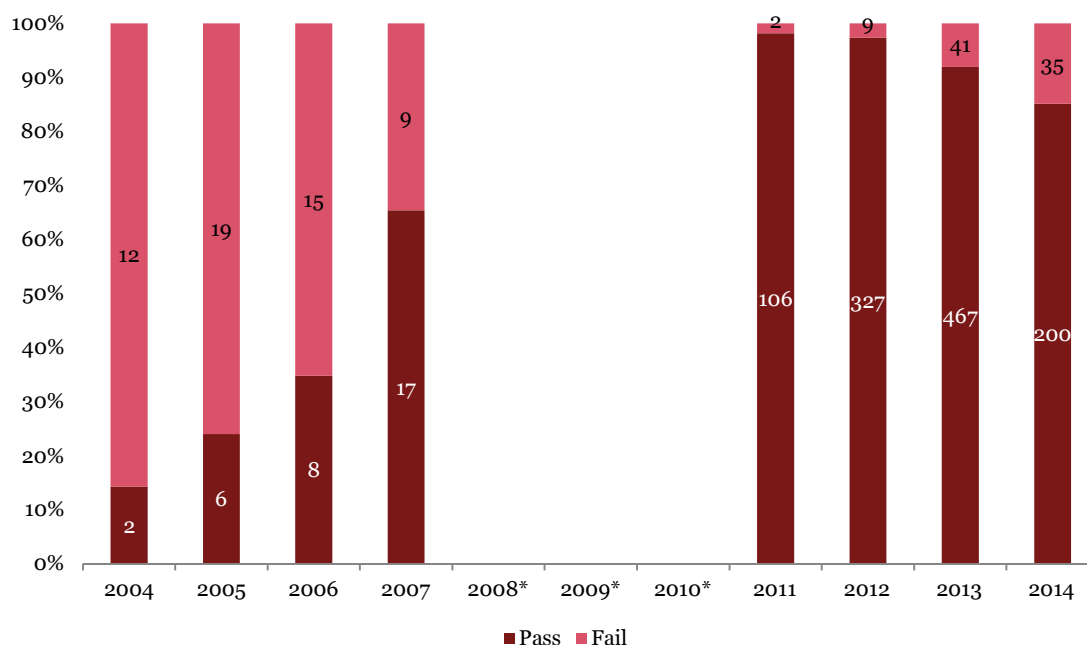
The results of the tests are assessed by examination board which consists of at least five members appointed and removed by the OB. To ensure objective assessment, the personal data of the examinee shall be used in a coded form at the professional examination, except in an interview organised for the assessment of the suitability of personal characteristics.

The tests are organised on an ongoing basis, to the contrary of the exam programme before 2010, when the test was organised only once a year.

Professional examination is funded by examination fees charged from the examinee. The fees are determined by AAA. BoA also organises training courses for examinees on various topics, funded by the participation fees.

The questions for the professional examination tests were created during 2009-2010, and 2015 using the funding by Estonian-Swiss programme (refer to section 5).

Figure 6. Auditor's professional examination statistics in period 2004-2014



**No professional examinations were held in 2008-2010 and no certificates were awarded.*

The number of examinations taken prior to and after 2010 are not directly comparable: prior to 2010, the exam consisted of one test; after 2010, the exam consists of 10 different modules. Also, the figures include repetitive exams – i.e. exams taken once more when failed. Additionally, examinations held in 2004-2007 are also incomparable since the content and passing thresholds determined were different each year.

The test questions are available for the examinees for preparation to the exams. About 50% of the test questions are available with answers. OB's yearbook 2012-2014 includes an analysis which shows that there is correlation that when an exam includes more questions with published answers, it is more likely that the exam is passed by examinee (OB's yearbook 2012-2014).

Representatives of BoA, expressed the view during the interview that having so big share of published answers seems to lead many examinees just memorising the questions and answers.

We recommend expanding the question base, and considering not to publish neither the questions nor answers – so the examinee will have at least some questions in the exam which cannot definitely be answered by memorising the published question and answer.

3.3.3 Quality Control

In accordance with AAA effective from 2010, quality control of auditors is performed by the Board of Auditors every six years (for auditors of PIEs, every three years). The procedure of quality controls is approved by the OB. Quality controls and internal disciplinary proceedings of the professional association are carried out, and the facts of the complaint and investigation are ascertained by the quality control team formed by the management board of BoA. The team consists of at least two members, but the size and composition of the control team are determined by the management board of BoA on the basis of the risk analysis, objective, schedule and object. The head of a control team shall have completed special training in quality control

organised by the Ministry of Finance. A member of the control team shall have experience in the preparation of reports on the professional activities of a sworn auditor and financial reports or be an expert in accounting, finance or law. The members are elected in a way that conflicts of interests between a member of the control team and the object of the control or proceedings or persons associated therewith would be avoided.

At least one person appointed by the OB participates in the quality control carried out or disciplinary proceedings conducted by the BoA.

OB approves the list of auditors subject to the quality review during the next financial year.

The management board of BoA has the right to increase the nominal frequency of quality control up to the frequency of at least once a year if material violations are ascertained as a result of the work of the control team or disciplinary proceedings which, however, are not sufficient to make a proposal to the Ministry of Finance for the suspension or termination of an activity licence. In other words, where significant shortcomings have been detected during the quality control, the auditor will be subject to quality control on the next year as well.

If significant shortcomings have been detected during the quality controls over two consecutive years, the Ministry of Finance may revoke the activity licence. Any other disciplinary penalties are imposed by the decision of the management board of BoA as a result of disciplinary proceedings; the decision is pre-approved with OB.

As a result of quality reviews, the activity licence of one audit firm has been revoked in 2013/2014, and the activity licences of three audit firms have been revoked in 2014/2015.

The actual performance of disciplinary proceedings by the management board of BoA has been improved year-on-year; as stated in the OB's yearbook 2014-2015, since the financial year of 2013/2014, the management board's actual practice has been fully compliant with the requirements of AAA.

Table 23. Frequency and procedure of quality controls in other countries

Country	Frequency and procedure of quality controls
Latvia	Every 5 years; for PIE auditors every 3 years. Quality control is performed by the Latvian Association of Certified Auditors and supervised by the Ministry of Finance. Authorised representatives of Ministry of Finance participate in the quality control visits of PIE auditors.
Finland	Every 6 years, for PIE auditors every 3 years. Quality controls for PIE auditors are performed by the independent full time employees of the Auditing Board of the Central Chamber of Commerce; other quality controls are performed by practitioners who are coordinated, monitored and reviewed by the quality assurance team of the Auditing Board. Inspection results are approved by the Auditing Board of the Central Chamber of Commerce and the Auditing Committee of the regional Chamber of Commerce.
Sweden	Every 6 years, for auditors of listed companies: 3 years. Quality reviews of the auditors of listed companies are carried out by the Supervisory Board of Public Accountants (RN). For other auditors, RN relies on inspections carried out by the professional organisation FAR; RN monitors its activities.

(Sources: Composed by the authors; <http://tilintarkastuslautakunta.fi>)

In the World Bank's ROSC report from 2004, based on empirical evidence rather than research, high-quality audit delivery could be expected from select audit firms representing approximately 25% of profession. The results from the recent quality controls prove a decent improvement in this area:

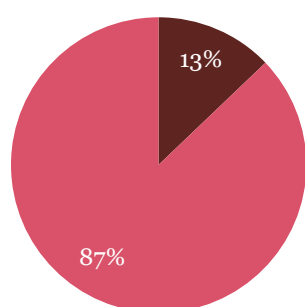
During 2014/2015, 41 quality control procedures were held, out of which:

- 15 (36.6%) were classified as "green" - the quality of services met the standards; improvement is possible;
- 13 (31.7%) as "yellow" – the quality is acceptable, however shortcomings detected and improvement required;
- 13 (31.7%) as "red" - significant shortcomings detected, improvement mandatory.

However, there are some critical factors which impact the interpretation of the results. The “yellow” and “red” results are aggregated to small and medium audit firms only, thus the impact of the “yellow” and “red” auditors to the auditing market is much less significant than the numbers above seem to indicate. Also, within “red” results, some are repetitive. The impact of the results of the quality controls is analysed below.

2014/2015 was the fifth year of the cumulative first 6-year cycle since the new AAA became effective in 2010. During that five years, 87.2% of the total audit market (by revenue of audit firms of 2014/2015) has been covered by the quality controls.

Figure 7. Distribution of audit firms' total revenue of 2014/2015 in relation to the quality control coverage during 2010-2015

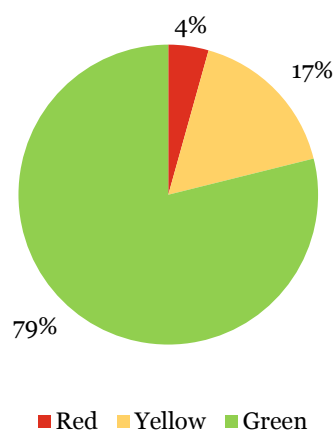


- Audit firms' total revenue not covered by quality control
- Audit firms' total revenue covered by quality control

(Source: Oversight Board yearbook 2014-2015)

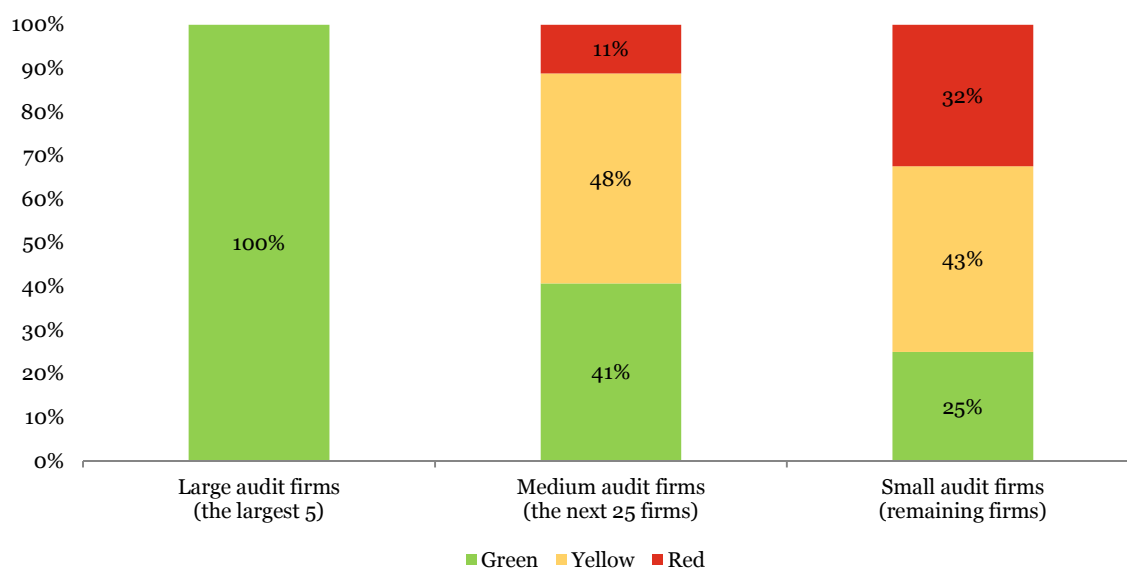
Out of the tested audit firms, the results of “green”, “yellow” and “red” are split by revenue (of 2014/2015) as follows:

Figure 8. Distribution of audit firms' total revenue of 2014/2015 according to the quality control results of 2010-2015



- Red
- Yellow
- Green

(Source: OB yearbook 2014-2015)

Figure 9. The results of quality controls by segments of the audit firms

Some audit firms have been subject to quality control twice or three times – due to repetitive control as a result of “red” result in the first year, or due to being an auditor of PIE client.

(Source: OB Yearbook 2014-2015)

In ROSC report, the problem areas surfaced that adversely impact the average quality of auditing practices in 2004 were determined to be lack of documentation, fraud, internal control system, related parties, lack of audit evidence (inventory stock takes, external confirmation letters).

The significant shortcomings detected in the quality reviews of 2010-2015 are in the following areas (OB Yearbook, 2014-2015):

1. Engagement has not been conducted in accordance with appropriate framework.
2. Auditor is not compliant with requirements on ethics, incl independence.
3. Auditor has not performed risk assessment procedures in accordance with a standard; and the extent and nature of planned procedures is not in compliance with the risk assessment.
4. Auditor has not planned and performed the engagement with professional scepticism and has disregarded circumstances that may cause the financial statements to be materially misstated.
5. Documentation of the engagement is inadequate and does not provide the purpose, description and conclusion of a procedure, or the details proving the performance of the procedure.
6. Auditor has not obtained sufficient appropriate audit evidence regarding the appropriateness of management’s use of the going concern basis of accounting in the preparation of the financial statements, and has not concluded, whether a material uncertainty exists about the entity’s ability to continue as a going concern.
7. Appropriately signed management representation letter is missing, or the letter is signed later or significantly earlier than the auditor’s report.
8. In an audit of group financial statements, the auditor has not communicated its requirements to the component auditor, or has breached the requirements of ISA 600 in another way, as a result of which the evidence in relation to components is inadequate.
9. Auditor has issued an auditor’s report of an incorrect type.

The representatives of the management board of BoA expressed a view that the consolidation within the auditors has had a positive impact on the quality of audits. Based on our interviews with users of financial statements, their perception is that the existence of auditor’s report adds credibility to the financial statements. We acknowledge the improvement in enhancing the quality of auditors in recent years, and we recommend the above described practice be continued in the future to further improve the quality and to aim to achieve that no audit firms will fall under the “red” or even the “yellow” category as a result of the quality reviews.

3.3.4 Continuing Professional Education

In accordance with AAA effective from 2010, a sworn auditor is required to enhance their knowledge and expertise pursuant to the in-service training program. During 2010-2014, auditors were required to participate in the in-service training organised by the Board of Auditors for at least 16 academic hours a year, and in the in-service training recognised or organised by the Board of Auditors for at least 24 academic hours a year.

Effective from 2015, the training hours are calculated on a 3-year cumulative basis, and now the sworn auditors are required to participate in trainings for at least 120 academic hours within 3-year calculation period; and at least 48 academic hours should be trainings organised by the BoA.

In accordance with AAA effective from 2010, a sworn auditor has to submit an activity report to the BoA annually, within 50 days after the end of the period (1 July to 30 June) included in the activity report. Failure to submit the report in time may cause sanctions to the sworn auditor. Failure to comply with the requirement of continuing professional education, may bring along admonition, reprimand, a fine or a fine together with referral to an additional professional examination.

Prior to 2010, sworn auditors had to submit an activity report once every three years. There were no requirements to the minimum amount of in-service training to be participated in.

3.3.5 Complaints

The management board of BoA conducts processing of the complaints received with respect of members of the BoA and investigation thereof pursuant to the procedure approved by the Oversight Board. Oversight Board exercises oversight over processing of complaints in the management board of the BoA. The management board has prepared a procedure how a complaint can be filed with BoA; the procedure is available at the webpage of BoA.

The number of complaints has been relatively small. In 2014/2015 and 2013/2014, one disciplinary proceeding a year has been started as a result of a complaint (OB Yearbook 2014-2015).

3.3.6 Dismissal of Auditors

In accordance with AAA effective from 2010, a contract between client and auditor may be cancelled only with good reason, and the differences in opinions in the issues concerning accounting or in the activities of a sworn auditor cannot be considered as a good reason. Audit firm and the client have obligation to notify OB of the cancellation through the information system of the register and provide its explanations concerning the reasons for cancellation of the client contract. The audit firm shall submit a report concerning the work performed immediately after notification of the OB. The client is obliged to pay immediately to the audit firm for all the works agreed upon in the client contract which were performed before the cancellation of the client contract.

3.3.7 Auditor's Responsibility

AAA effective from 2010 sets that an audit firm shall bear proprietary liability for the direct proprietary damage wrongfully caused to a client or third party by provision of audit service. The maximum liability limit is ten times the client contract fee which was agreed upon in the client contract in connection of which the damage was caused. AAA also imposes mandatory professional liability insurance to the audit firms and sets limits for insurance coverage and excess.

Also, AAA sets a minimum limit to the amount of share capital of an audit firm which is a private limited company.

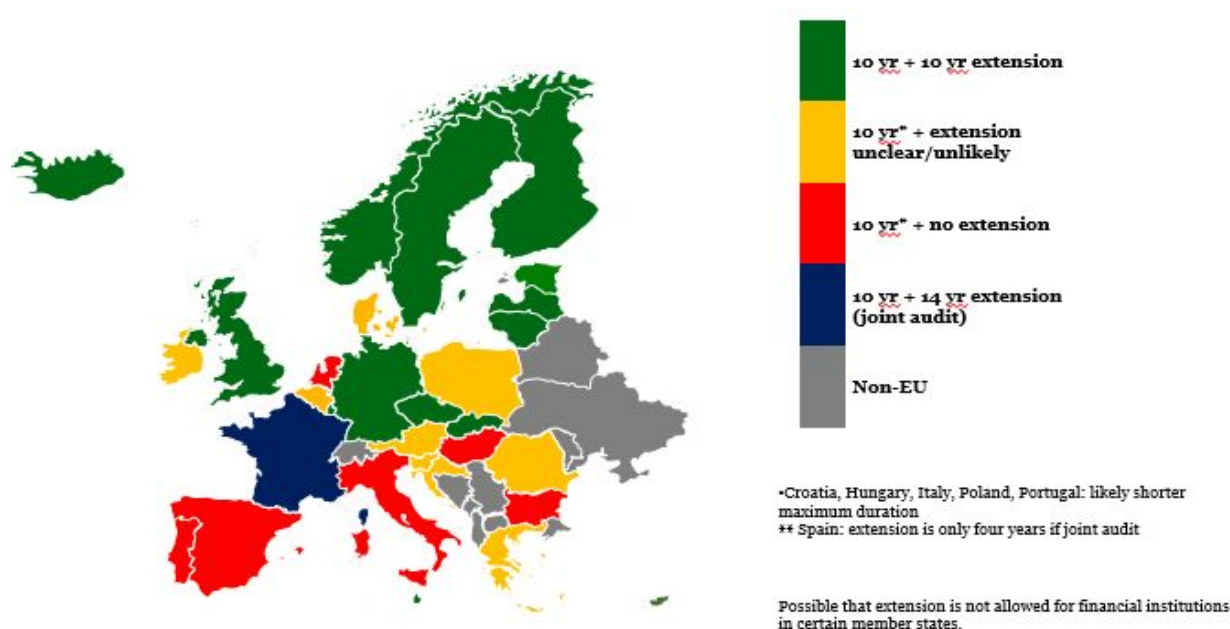
Prior to 2010, the liability was not limited, and it was also obligatory to have a professional liability insurance.

3.3.8 Rotation rules

In accordance with AAA effective from 2010, a sworn auditor (i.e. person) representing an audit firm of a PIE, may be the signatory of the client contracts or of a sworn auditor's report for up to seven consecutive years. There were no rotation rules in the AAA prior to 2010.

Changes to the AAA are expected in 2017, when Estonia has to adopt the new auditing Directive 2014/56/EU amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts. Although the legislative procedures are on preliminary stages in Estonia as well as in most other countries, the graph below provides a very preliminary assessment on the direction which the countries are likely to take, but the actual result may differ from the preliminary assessment.

Figure 10. Potential outcome of member state options regarding mandatory firm rotation



(Source: PwC study, November 2015)

In our view it is important that the approach taken by Estonia will be the same or at least similar to the approach taken by the countries from where the largest share of the foreign investments in Estonian companies have originated, or by the countries where Estonian companies have made the largest share of investments. As at 30 September 2015, 54.1% of foreign investments are originated by Scandinavian countries; and 39.6% of investments to abroad by Estonian companies are made to Latvia and Lithuania.

(source: <http://statistika.eestipank.ee>). Similar rules across the countries where the consolidation group is spread would facilitate the process of appointing an auditor by the companies.

3.3.9 Independence – Prohibition to Provide Other Services

Neither current AAA, nor the version effective prior to 2010 provided any specific restrictions for an auditor to provide other services. Rather, the auditors should follow the IFAC's Code of Ethics in determining which services can or cannot be provided.

Changes to the AAA are expected in 2017, when Estonia has to adopt the new auditing Directive 2014/56/EU amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts. Although the legislative procedures are on preliminary stages in Estonia as well as in most other countries, the graph below provides a very preliminary assessment on the direction which the countries are likely to take, but the actual result may differ from the preliminary assessment.

Figure 11. Potential outcome of member state options regarding tax and valuation services



(Source: PwC study, November 2015)

3.3.10 Financing

The activities of Board of Auditors are financed mainly from membership fees and allocation from state budget. The latter is used to finance oversight activities. In 2014/2015, the membership fee of sworn auditors was 64 Euros, and the fee for activity licence was 1% of revenue from auditing services of an audit firm.

Table 24. The split of income of the BoA in 2014/2015 and 2013/2014

	2014/2015	2013/2014
Membership fees	40%	34%
Allocations for state budget for oversight	22%	15%
Grants from Estonian-Swiss programme: E-dok	13%	27%
Grants from Estonian-Swiss programme: arrangement of professional examination	9%	11%
Training fees	12%	11%
Professional examination fees	2%	2%
Other grants for operating costs or special projects	1%	0%

(Source: Annual report of BoA 2014/2015)

The future of financing of the oversight activities is discussed under 3.3.1. As can be seen from the Table 24 above, significant part of the income has originated from the Estonian Swiss cooperation program. The finances have been granted in relation to specific projects that have been completed. However, as the current strategy of BoA foresees investments to improve the webpage of BoA and to develop further the E-dok software. The latter will largely depend on whether the additional funds will be received from the Estonian-Swiss cooperation programme. Considering the above, the further financing of the activities of BoA will require continuous focus and attention of the Ministry of Finance and BoA, to ensure BoA will be able to adequately fulfil its tasks to ensure maintaining and improving the quality of auditors' profession in Estonia.

3.3.11 Availability of Guidance Materials, E-dok Software

Guidance materials for auditors are available at the website of BoA, and include:

- International standards issued by IAASB and IFAC's Code of Ethics (translated into Estonian by using financing from the Estonian Swiss cooperation programme (see section 8)).
- Best practice templates and guidelines issued by the Methodology Committee. Methodology Committee consists of experienced practitioners, and has currently seven members. The committee analyses the methodology related to professional services offered by auditors, issues templates and guidelines, participates in developing the laws and advises sworn auditors.

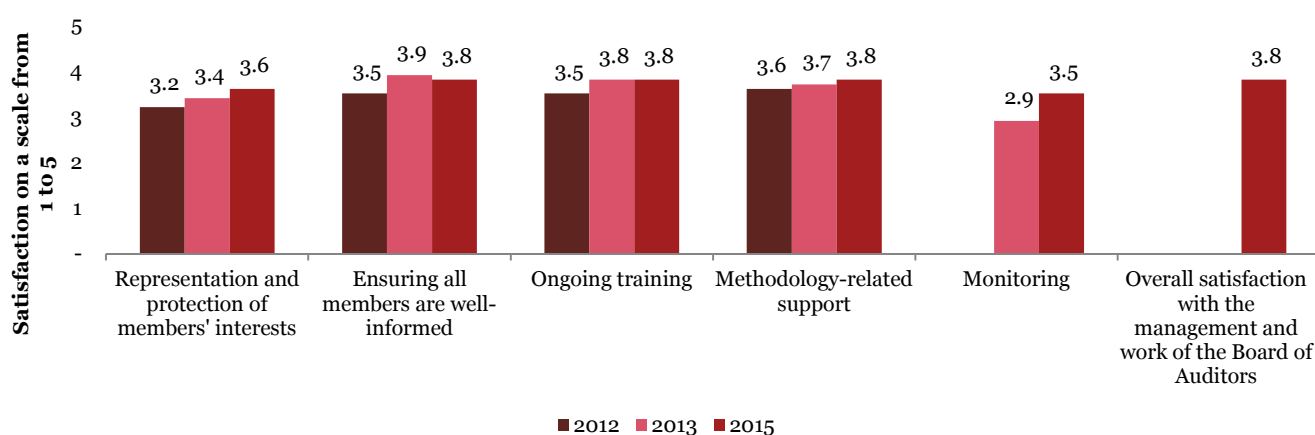
BoA has hired a methodology specialist who answers questions of the auditors, and directs any recurring or more complex issues to the Methodology Committee.

BoA organises regular in-service trainings to auditors, as well as pre-qualification trainings to persons planning to take professional examination; the trainings are funded by participation fees. During 2010-2011, BoA and Ministry of Finance organised nine trainings on ISAs, financed by the Estonian-Swiss cooperation programme (see section 8).

In couple of recent years, the main development project of the BoA has been developing and implementing of auditing software E-dok. E-dok is licensed to auditors for a fee. Based on the annual report of BoA of 2014/2015 financial year, during 2014/2015 more than half of the audit firms in Estonia have started to use E-dok; the software has already been licensed to first users in Latvia, and the negotiations are ongoing with two additional countries, Lithuania and Georgia. The software has proved to facilitate the monitoring of the process of assurance engagements as well as to contribute to the quality of the documentation of the engagements. The development was financed from the Estonian-Swiss cooperation programme (see section 8). The software will need further developments, and will need additional financing in the future. The financing model in the future is yet unclear.

The management board of BoA has gathered feedback from auditors in respect of availability of materials and help. The results show positive trend:

Figure 12. Board of Auditors feedback trends in years 2012, 2013 and 2015



(Source: BoA)

Based on the information gathered by us, the processes appear to be well established and sufficient financing has been in place during the period under review, especially due to the funds available through the Estonian-Swiss cooperation programme. There are some concerns raised by the interviewees in regard to financing of the area in the future, in case larger new projects or necessity for extensive revision and updating of existing materials would appear.

3.3.12 Other Engagements of Auditors

In addition to AA, several other laws place obligation on sworn auditor to perform specific engagements other than audits and reviews. For example, the Commercial Code (CC) states that in cases, where the non-monetary contribution to share capital exceeds a pre-determined threshold, the value of the non-monetary contribution has to be verified by an auditor. Or the Electricity Market Act (EMA) states that an electricity undertaking has to arrange the auditing of its activities, including whether the annual accounts of the electricity undertaking and its annexes comply with the specific requirements of the EMA. One of the most recent requirement placed on auditors by the state is included in the Packaging Act. The latter states that the reports submitted to the Packaging Register have to be audited/verified by a sworn auditor and reports presented to a recovery organisation also have to be reviewed by sworn auditors.

In most of the cases the law itself does not specify the scope of the work of the auditor, the level of assurance expected and the structure of a report, if any, presented by the entity. In many cases, the requirement in a law is so vague that it does not provide much basis for an auditor to determine, under which applicable standard (ISA, ISRE, ISAE, ISRS) the procedures should be performed or what is the level of assurance needed from the procedures. For example, different laws may require that the auditor has to "evaluate", "review" or "perform procedures". Therefore, the feedback from our interviews suggests that it is an important area for the state to consider in the future – to involve BoA in the early stages of preparation of a law which would require an auditor to perform procedures, to prescribe the basis of work performed by the auditor, and the format of any related reporting by an entity.

The problem is not as serious in cases the auditor's report is directed to one party only (e.g National Audit Office of Estonia, FSA) – in those cases the party receiving the report can prepare guidelines to specify the framework, or the auditor can negotiate the framework directly with the intended user. However, it would still be preferable if more accurate requirements would be included directly in a law that requires procedures to be performed by an auditor.

Based on our interviews, the interviewees expressed some ideas about areas where the state could use the expertise of sworn auditors and require them to control a specific subject matter, e.g. in areas related to environment, energy etc. One of the areas where the state could consider if the auditors' expertise could be used for the benefit of the public interest – in case of companies who have not submitted their annual reports timely or not at all after number of reminders, the state should consider if an appropriate measure would be imposing a mandatory review or audit. The most appropriate measure should be certainly weighed thoroughly, but in case the late submission or non-submission is more prone to companies that are in financial difficulties, it would be for the interest of their creditors to receive the financial information as soon as possible.

3.4 Internal Auditing

Internal auditing in Estonia was first established in 1993 with only 10 to 15 practitioners at the time. By 2005 there were in total about 170 internal auditors working in the central government sector in Estonia. There were also 135 members of the Institute of the Internal Auditors (IIA) in Estonia (Eesti Siseaudiitorite Ühing) (as of June 2006). During the next five years, the membership of the IIA Estonia had risen to 200 members (as of April 2010) (Linnas, 2012).

Although the number of internal auditors have increased during the year, the development of internal audit practice in Estonia has been a long process and still includes room for improvement. During 2004 - 2014 the internal audit practice has been more regulated and improved in public sector.

The standard setting for public sector internal audit started in March 2000, when the government appointed the Ministry of Finance the ministry in charge of the public sector internal control and internal audit. In the same year, the parliament adopted the Government of the Republic Act under which the heads of authorities with executive power (AEP) are obliged to ensure the application of an internal control system and the organisation of internal audit activities. It imposed the obligation on governmental authorities and state authorities under the administration of governmental authorities to appoint a person responsible for internal audit and, if necessary, to establish an appropriate structural unit to perform internal audit duties by 1 January 2001. (Public Internal Control in Estonia)

In July 2006 the Estonian Government asked the Minister for Finance to develop additional competence requirements and activity quality criteria for internal auditors. The Ministry of Finance had to ensure (Ibid.):

- The Transfer from using the recommended national best practices to applying international internal audit standards in the professional activities of internal auditors;
- Improved quality of internal audits to comply with national and international requirements;
- The development of a professional certification and quality monitoring system for internal auditors and the establishment of the legislative framework needed to implement this system.

By the end of 2009, the system for internal auditor professional certification and quality monitoring had been developed and the legal framework for the implementation of the system prepared. The Auditors Activities Act (AAA) adopted in January 2010 specifies, among other things, the requirements for internal auditors, legal basis for the activity of internal auditors, internal auditors' right to professional practices, and the basic principles for monitoring the quality of internal auditors' professional practices. It covers the activity of internal auditors in public sector entities and in companies and private sector entities that are classified as public interest entities. According to the AAA, internal auditors in Estonia are subject to the oversight of the Ministry of Finance, who is also the standard setter of internal audit regulation in Estonia. The AAA introduced the International Professional Practices Framework's mandatory guidance (definition of internal auditing, ethics code, international standards for the professional practice of internal auditing) that already existed as customary law in the Estonian legal system. (Ibid.) In cooperation with the Ministry of Finance and the IIA Estonia, the professional activities standards for internal auditors (including International Standards for the Professional Practice of Internal Auditing) were fully accepted at the end of 2011 (Linnas, 2012).

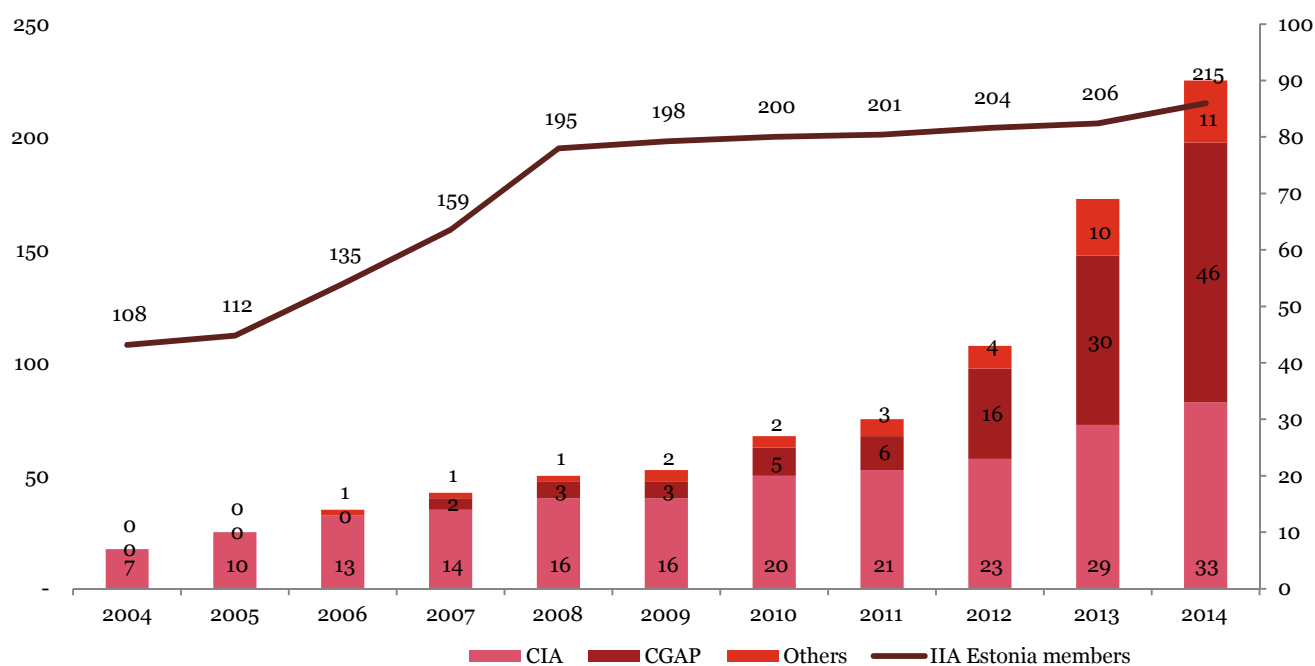
In April 2010 the Minister for Finance also established the Professional Qualifications Committee for Auditors as an advisory committee to address issues relating to the professional practice of internal auditors and quality monitoring. The purpose of the Committee is to help develop the professional activity of internal auditors and maintain and uphold high quality in the profession.

Since autumn 2011 it has been possible to take an examination in Estonian, prepared in cooperation with IIA Estonia, to receive an international certificate Certified Government Auditing Professional (CGAP). A person looking for the CGAP has to pay a professional examination fee. Furthermore, at the professional examination, the examination board shall verify, beside personal characteristics, the level of training, knowledge, skills and experience of the examinee required for the commencement or continuation of professional activities. There are also some preconditions and restrictions for persons who are going to enter the CGAP in Estonia. The AAA prescribes sections and sub-parts of the professional examination and the fields and subjects covered by the professional examination program (Linnas, 2012). After being certified the internal auditors must enhance their knowledge, skills, and other competencies through continuing professional development. They are also obliged to undergo regular periodic in-service training in Estonia. Similarly to sworn auditors, the internal auditors are also required to prepare and submit through the information system of the register an internal auditor's activity report within two months following the end of the internal auditor's activity report period.

In public sector auditing, on 1 January 2013, an amendment to the Local Government Organisation Act entered into force, under which:

- A council must ensure the implementation of an internal audit system and the organisation of the professional activity of an internal auditor in the local government;
- A rural municipality or city government must implement an internal audit system and bear responsibility for its productivity;
- A local government unit has a right to establish an appropriate position or structural unit for the performance of the professional duties of an internal auditor;
- The local government must apply the provisions set down in the Auditors Activities Act when organising the professional activity of an internal auditor and as the base for his/her professional activity;
- If a local government has created for the performance of the professional duties of an internal auditor a corresponding position or corresponding structural unit, the corresponding official or head of the structural unit shall submit an internal auditor's report prior to the approval of the annual report to the rural municipality or city government.

Figure 13. IIA Estonia members and certified members in period 2004-2014



(Source: IIA Estonia)

4 Education

Vocational education (*kutseharidus*) serves the purpose of fostering the knowledge, skills and attitudes, occupational know-how and the social readiness required for working, participating in social life and participating in the lifelong learning process. Vocational training is organised by vocational educational institutions and professional higher education institutions.

Vocational education system in Estonia is regulated by the Vocational Educational Institutions Act (VEIA). In 2013, the parliament passed new VEIA that fundamentally changed the regulation of the vocational education system. The most notable aspects are the following:

- Defining new categories of vocational training directly linked to the Estonian Qualifications Framework;
- Extensive use of outcome-based principles in the evaluation and establishing of qualification criteria for types of vocational training, curriculums and for personnel working in the teaching and pedagogical profession;
- Establishing the right to provide instruction;
- Defining and implementing the use of the new unit (Estonian vocational education credit points) for measuring study volumes.

Uniform requirements for vocational training are regulated by the Vocational Education Standard. Formal vocational training curricula is divided between national and school curricula.

The Estonian higher education system is binary and consists of universities (*ülikool*) and professional higher education institutions (*rakendusõrgkool*). Some vocational schools also have a right to offer professional higher education programmes. Based on the form of ownership, institutions of higher education can be divided into state, public and private institutions.

Higher education is primarily regulated by the Universities Act, the Institutions of Professional Higher Education Act and the Private Schools Act. Since the academic year of 2002/2003, the general structure of the higher education system is based on two main cycles, following the undergraduate-graduate model. The first cycle is the bachelor level; the second cycle is the master level. For some specialities, the study programmes have been integrated into a single long cycle, leading to a master level qualification. The highest stage at universities is doctorate studies. Professional higher education programmes constitute the first stage of the higher education system and correspond to bachelor level programmes. Since 2012/2013 academic year, higher education is free of charge in Estonia for those studying full-time and in Estonian.

4.1 Accounting Education in Estonia at Vocational, Higher Professional and University Level

The chapters below concentrate on accounting education in Estonia at vocational, professional higher education institution and university level. This chapter analyses the accounting education syllabuses of the following institutions:

- Vocational schools – Tallinn School of Economics, Lääne-Viru College;
- Professional higher education institutions – Tallinn College of Tallinn University of Technology (TUT), Lääne-Viru College;
- Universities – University of Tartu, Tallinn University of Technology, Estonian Business School.

4.1.1 Vocational Level

Tallinn School of Economics has *Accountant* curricula, which comprises of 120 EKAP (Estonian Vocational Education Credit Points), where 1 EKAP is equal to 26 hours of study, including lectures, individual work, internship, online learning and tests. Modules in the *Accountant* curricula include: Financial Accounting, Cost Accounting, Managerial Accounting, and Corporate Finance.

Lääne-Viru College also has *Accountant* curricula, which comprises of 120 EKAP. Modules in the *Accountant* curricula include: Financial Accounting, Tax Accounting, and Managerial Accounting.

Graduates of both schools shall have the practical and theoretical knowledge required of the Accountant level 5 qualification candidate (see also Chapter 2.6).

4.1.2 Professional Higher Education Level

Tallinn College of TUT has *Accounting and Business Management* curricula, which has the following main specialisations available: accounting, business administration, service marketing and management. The study programme is 210 ECTS (European Credit Transfer and Accumulation System) in total, out of which the chosen specialisation makes up 98 ECTS (including internship). Accounting specialisation includes modules such as Consolidated Financial Statements, Cost Accounting, International Financial Reporting Standards, Compilation and Analysis of Annual Report, Auditing and Accounting Softwares.

Lääne-Viru College has *Accountancy* curricula, which comprises of 180 ECTS. Subjects related to accounting forms up to 132 ECTS. Modules included in the syllabus are Financial Accounting I and II, Financial Analysis, Managerial Accounting, Cost Accounting, Financial Management.

4.1.3 University Level

The analysis on university curricula is divided between undergraduate-graduate level.

Estonian bachelor's programmes (undergraduate level) provide a broad-base business education. The syllabus is usually composed by the university and includes compulsory base subjects such as accounting and managerial accounting. Until recently, only one university covered by our study offered the possibility to specialize in accounting at bachelor (undergraduate) level.

Table 25. Accounting curriculum at undergraduate level in selected Estonian universities in academic year 2014/2015

	University of Tartu	Tallinn University of Technology	Estonian Business School
Title of curriculum	Economics and Business Administration	Business Administration	International Business Administration
Specialisation into accounting available	Yes (since 2013)	Yes (since 2002)	No
Name of the specialisation	Corporate finance and accounting	Accounting	Entrepreneurial Finance
ECTS covered by specialisation	24 ECTS	21 ECTS	18 ECTS

(Source: Composed by the authors based on the information available at universities web-pages)

Estonian Business School's curriculum *International Business Administration* curriculum has no specialisation in accounting per se, however students majoring in Entrepreneurial Finance (covering 18 ECTS) read Intermediate Financial Accounting and Corporate Finance. University of Tartu's specialisation *Corporate finance and accounting* includes 12 ECTS worth of accounting subjects and 12 ECTS worth of corporate finance subjects.

Estonian master's programmes (graduate level) provide more specialized knowledge in the field of accounting compared to undergraduate level, including more IFRS related courses, etc.

Table 26. Accounting curriculum at graduate level in selected Estonian universities in academic year 2014/2015

	University of Tartu	Tallinn University of Technology	Estonian Business School
Title of curriculum	Economics and Business Administration	Finance and Accounting	International Business Administration
Specialisation into accounting available	Yes (since 2014) ²	Yes (since 2005)	No
Name of the specialisation	Accounting	Accounting, Auditing	Finance Management
ECTS covered by specialisation	36 ECTS	42 ECTS	30 ECTS

(Source: Composed by the authors based on the information available at universities web-pages)

Both at University of Tartu and at Tallinn University of Technology accounting specialisation includes obligatory subjects as well as elective subjects. Estonian Business School offers majoring in Finance Management (not directly in Accounting), where subjects include International Accounting Standards, Financial Statement Analysis and Advanced Topics in Managerial Accounting.

In Tallinn University of Technology the accounting curricula includes subjects such as Group Accounting, International Accounting, Accounting for Non-Profit Organisations etc. Subject International Accounting covers general understanding about IFRSs as well as other financial reporting standards used in countries worldwide. At Tallinn University of Technology, changes in the curriculum are first initiated by the Department of Accounting and then reviewed by curriculum-specialised work group followed by the faculty (Tallinn School of Economics and Business Administration). The final decision maker is the University Council.

Since 2009, higher education quality has also been assessed by Eesti Kõrghariduse Kvaliteediagentuur (Estonian Higher Education Quality Agency), an independent agency. Quality assessment involves assessment of the compliance of study programmes, teaching and study-related development efforts based thereon with legislation, national and international standards and developments of the study programme. Quality assessment takes place once every seven years, unless the Agency has established a term of up to three years based on the results of quality assessment.

At Tallinn University of Technology students have also additional specialisation available since 2011. Namely, they can specialise in auditing. This curricula was created using the funds of Estonian-Swiss co-operation programme and according to the representative of Tallinn University of Technology, the initiative to create the curricula came from National Audit Office of Estonia (*Riigikontroll*).

² Curricula covered in this research is offered starting from 2014. Until 2013, the master level students had the chance to take accounting subjects for 18 ECTS.

Table 27. Number of graduates

Vocational education	Course	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total
Tallinn School of Economics	Accountant	49	87	79	73	68	67	78	110	61	71	77	820
Lääne-Viru College	Accountant	N/A	N/A	N/A	29	17	21	12	19	25	22	18	163
Professional higher education													
Tallinn School of Economics	Accountant	70	113	87	100	117	98	105	123	130	75	90	1,108
Lääne-Viru College	Accountancy	109	97	97	63	96	81	98	79	74	93	89	976
Tallinn College of TUT	Accounting and Business Administration	71	61	47	78	50	57	52	63	42	30	44	595
Higher education													
Tallinn University of Technology	BA Business, MA Finance and Accounting ³	N/A	14	28	38	35	49	48	67	48	32	52	411

(Source: Composed by the authors based on information received from institutions)

In terms of statistics about graduates entering the job market, institutions have their own monitoring processes. Unfortunately, the data available is often incomplete or based on the institution as a whole, making it difficult to draw conclusions on the level of specific department or programme. Similarly, the grounds on which a graduate is classified as working in his or her field or speciality are considerably different. Some interviewees estimated that approximately 85% of graduates are employed in the field directly related to their studies.

³ Data includes BA Business graduates, who chose a specialisation in Accounting. Other main specialities include Finance, Marketing, and Management and Organisation of Work. Also included are MA Finance and Accounting programme graduates, where main specialities include Finance, Accounting and Auditing.

4.2 Content and Efficiency of Accounting Internships as Part of Curriculum

At vocational schools, the internship is an integral part of the curricula. Both in Tallinn School of Economics as well as in Lääne-Viru College, the internship in the workplace comprises of 30 EKAP and makes up 25% of the total capacity of the curricula.

At professional higher education schools, the amount of internship differs among schools. For example, at Tallinn College of TUT, students have to go through internships for 32 ECTS out of 210 or 15%. At Lääne-Viru College, the internship makes up 46 ECTS out of 180 or 25%.

At universities, less emphasis has been put on internship. On bachelor's level the internship is assigned 6 ECTS at University of Tartu, 5 ECTS at TUT, and 7.5 ECTS at EBS out of total 180 ECTS (i.e. between 3%-4% of total curricula). Since 1 ECT equals 26 hours of study, the length of internship is normally 4 weeks and takes place in summer. In some universities, the student is assigned a supervisor at the workplace, who is in turn assisted by the internship coordinator from the university faculty. At master's level, even less emphasis is put on internship (6 ECTS at University of Tartu and 1 ECTS at TUT out of total 120 ECTS). No internship is required at PhD level.

According to the interviews carried out with the representatives of vocational as well as professional higher education schools, for accountant position the company's prefer students graduating from higher vocational schools over universities due to the fact that the studies are more practical in nature and include more internships.

Based on the interviews with representatives of Estonian Association of Small and Medium Enterprises (EVEA), Estonian Traders Association, Estonian Chamber of Commerce and Industry, employers are more inclined to recruit vocational school graduates, who have accumulated a considerable amount of work experience throughout their studies. In the field of accounting and auditing, practical experience is highly valuable and the government should more aggressively promote vocational training in that industry. An interviewee from Estonian Traders' Association, on the contrary, believes that economics graduates from higher education institutions (universities) do not necessarily need to have work experience when entering the labour market.

It is normally the case in Estonia that each company's recruitment process consists of various practical tests, enabling them to determine the competency level of each candidate and select the most suitable one. Thus, candidates who have obtained a professional certification do not necessarily have an advantage, although, from the point of view of recruiters, the certification does give additional assurance. There are also many concerns related to internships raised by vocational as well as professional higher education schools. Firstly, there are not enough internship positions available for students. Therefore, companies should more actively cooperate with schools to offer internship positions. However, the lack of interest by company's side could be caused by the fact that no/limited remuneration is offered to company and/or its employees supervising the interns. Thus, interns are seen as a liability rather than an opportunity to find good and qualified workforce. Secondly, the tasks carried out by interns during the internship are not always as prescribed in the syllabus, i.e. they are not the everyday responsibilities of an accountant. Thus, interns are unable engage in the common daily work of an accountant and get the experience and actual know-how of accounting matters.

As a recommendation the Estonian Government should consider, whether the state itself could implement an internship system in state-owned enterprises. As the state of Estonia has holdings in 32 private legal entities and owns 67 foundations and 115 non-profit organisations⁴, then the state is in a unique position to create a system, where there is a limited number of internship positions available in those undertakings.

⁴ <http://www.fin.ee/state-assets>

Another recommendation made by the interviewees of vocational and higher education schools on how to make the learning experience more “real-life” was that it is important to have electronic softwares and learning environments. Students could massively benefit from the experience of filling in tax declaration forms for the Estonian Tax and Customs Board, and the submission of information required by Statistics Estonia. Additionally, a demo version shall be created for the Centre of Registers and Information Systems (RIK), allowing students to practise the compilation and submission of annual reports.

4.3 Linking Curricula with Professional Qualification Standards

Schools of vocational and professional higher education have built up their curricula in a way that it is linked to the requirements of the accountant qualification standards (see chapter 2.6). Thus, the following links should exist between levels of study and accountant occupational qualification exams:

- A graduate from the *Accountant* curriculum of a vocational school shall be able to undertake the Accountant level 5 exam.
- Upon graduating from *Accountant* curriculum from a professional higher education school or obtaining a bachelor’s degree from a university, the option of taking Accountant level 6⁵ examination should be available if the candidate also meets the requirement of having sufficient work experience. If no work experience exists, it has to be obtained before taking the exam.
- Owners of postgraduate degree should be able to take the Accountant level 7 examination, providing the candidate fulfils the work experience requirement. However, no level 7 exam currently exists.

It can be concluded from the interviews that additional funding is needed to work out the Accountant level 7 examination. Some of the interviewees supported the idea of linking the Accountant level 7 exam with the examination for becoming a sworn auditor, because the latter already has modules that could be used in Accountant level 7 exams, such as special part of accounting (including IFRSs and Estonian GAAP) and special part of public law (including Company’s Act). This would enable developing an integrated professional qualification examination system in the field of accounting and auditing and helps to eliminate additional costs from keeping up two separate systems.

According to the interviews carried out with the representatives of vocational as well as professional higher education schools, the professional examination for accountants should become electronic (currently it is a written exam on paper), making it easier to collect statistical information about exam questions that are most commonly answered incorrectly. Currently, statistics is provided about the parts of the exams that are mostly failed, so that teachers as well as students could in the preparation phase pay more attention to these topics. The electronic exam system is, for example, implemented in the case of becoming a sworn auditor. Also, information is available in the annual report of BoA about how many people have passed/failed the exam of becoming a sworn auditor including statistical information by each exam.

A more serious point of concern raised by the representatives of vocational and professional higher education schools is the fact that accountant’s professional certification is not recognised in the society, more specifically by companies, resulting in no or limited benefits in the job market. Consequently, many graduates decide not to take the examination. AEA believes that having a professional certification as Accountant is a proof of quality, therefore they made a recommendation that some companies should be obliged by law to have this certification - for example companies, whose main field of activity is providing accounting services to other companies. However this idea was not supported by all interviewees, as some of them believed that as in other jobs, the actual work of the person shows the quality and just having a certification is of secondary importance.

⁵ When applying for the Accountant level 6 qualification, a bachelor’s degree or professional higher education diploma is normally required, as well as 2 years of work experience in the field of accounting.

The interviewees also supported the idea of creating of an electronic platform (webpage) that would allow storage and usage of various study materials in Estonian, such as e-books, summaries, presentations, case studies, etc. Such a source should also provide access to interactive and disciplinary learning software, such as practice firms and accounting/financial software demo versions.

All interviewees also emphasized the need for additional accounting related books in Estonian. It would be helpful to have some of the internationally recognised accounting (text)books translated into Estonian.

Interviewees did not consider necessary to have an expert panel coordinating the curricula of the universities. Rather, the universities should decide their curricula on their own; vocational schools have already taken a direction to link their curricula to the content of the exam program of accountants.

4.4 Quality and Emphasis of Thesis and Research Papers

Based on the interviews with the representatives of vocational and professional higher education schools the thesis have more a practical orientation and they are often based on a case of a certain company. The topic could be, for instance, how to create a cost accounting model for a firm, or the comparison of efficiency indicators in two different competing companies. The majority of students at higher education schools often work and study simultaneously, and therefore, their employers have an incentive to support company-specific thesis since this could address and solve company's real issues.

At university level, the emphasis of science and research papers is more diverse - there are both purely theoretical as well as practical papers written. The students are provided a list of topics to choose from that are of more importance to the faculty that year and/or where the professors are readily available to supervise a thesis. However, students always have the opportunity to pick their own topic and then find a professor who agrees to supervise.

4.5 Government Quotas

Following the education reform in Estonia, higher education is- since academic year 2012/2013- free of charge for those studying full-time on either traditional or distance learning programmes taught in Estonian. However, based on their strategic goals, universities are allowed to apply the free of charge principle to courses taught in languages other than Estonian. As long as the total amount of credits (dependent on respective programme and institution) are completed each semester, no fees are applicable throughout the course. This is different from previous system, where both government funded (*Riigieelarveline (RE)*) and student funded (*Riigieelarveväline (REV)*) study places existed. Additionally, students are no longer able to take part in coursework or sit for examinations during academic leave.

When merit-based scholarships were awarded to high achievers prior to the reform, financial aid is now need-based, distributed to students according to their individual requirements.

Higher education institutions also saw a change in the principles of funding. Universities are now entitled to operating grant, which is determined on the basis of the scope of activities, as well as the quality of teaching and performance of its applicants and graduates. Accordingly, factors such as the number of students and lecturers on different degree levels, lifelong learning, cooperation with companies and recruiters in the region, results of national examinations of prospective students, international programmes, average time spent studying for a degree and PhD thesis are taken into account. Consequently, the quantity of graduates is no longer the only factor determining the size of the grant.

In addition to higher education, the vocational education system was fundamentally changed in 2013, when the parliament passed the Vocational Educational Institutions Act. As a result, new categories of vocational training were defined, linking directly to the Estonian Qualifications Framework. Estonian vocational education credit points were implemented for measuring study volumes, and for the purposes of evaluating the qualification criteria for types of vocational training, syllabus and personnel, outcome-based principles are now more extensively used.

As a result, higher education institutions and vocational schools are only allowed to accept a pre-determined amount of students onto their programmes. This has led to a significant drop in student enrolment compared to years before the reform took place. Before 2013 students had the possibility to self-finance their studies, whereas the number of places is now also determined by government quotas.

Tallinn School of Economics, for instance, is no longer able to offer a degree in accounting on higher education level since the government has decided not to let a vocational education provider engage in teaching higher education.

Representatives of vocational and higher education schools find that the government quotas are currently too low. In their opinion, there should be enough places funded by the government to allow those who graduate from a vocational school to continue their studies on a professional higher education level.

Table 28. Study places for accountancy programmes at selected institutions in academic year 2015/2016

Institution	2015/16
Tallinn School of Economics	90
Lääne-Viru College	148 ⁶
Tallinn College of TUT	55
Tallinn University of Technology	153 ⁷
University of Tartu	113 ⁸

(Source: Composed by the authors based on the information available at institutions web-pages)

4.6 Financing of Accounting Education from Estonian-Swiss Cooperation Programme

From 2009 till 2015, resources have been allocated from Estonian-Swiss cooperation programme to finance the accounting education and related activities. Approximately 305 thousand Euros has been allocated to the following activities described below. Organisations and individuals who have been granted these funds appreciate it very much and hope that in the future similar programmes will continue to be carried out.

Tallinn University of Technology has been granted funds to develop academic curriculum for the master degree program in the field of audit. This also included popularizing the graduate studies in the field of accounting (providing tuitions for students applying for master degree in auditing). According to the interview with the representative of Tallinn University of Technology they will continue teaching auditing at master degree level even if the cooperation programme between Estonian and Switzerland ceases to exist when there is interest among students to study it.

⁶ Accumulated data for vocational and professional higher education programmes in Accounting, including VÕTA programme (recognition and accreditation of prior and experiential learning) study places

⁷ Accumulated data for BA Business and MA Finance and Accounting programmes

⁸ Accumulated data for BA and MA Economics and Business Administration programmes, excluding courses taught in English

Estonian-Swiss cooperation program has also supported research studies in the field of accounting. For example, various activities have been carried out to support audit and accounting studies from educational institutions side (TTU audit master degree) and also activities to motivate PhD students in the field (4 scholarships).

Resources have been allocated from Estonian-Swiss cooperation programme also to Accounting Teachers' Association with the purpose of developing the Accounting Teachers' Association's website. The Association is the only organisation representing Accounting teachers in Estonia. The aim of this website is to gather and share information through one reliable source to all Estonian Accounting teachers and their students and through that advance the quality of teaching in this field.

Financial support has also been provided to organize a large scale international European Accounting Association conference in Tallinn in May 2014 and establish and carry out Accounting Teachers' Association seminars.

4.7 International Cooperation

Estonian universities are moving towards getting accreditation from the Association of Chartered Certified Accountants (ACCA). The goal is to have curricula taught in university to cover the same subjects that are tested in the ACCA examination. This would later allow students graduating from the curriculum aligned with ACCA requirements to claim exemptions from ACCA exams (maximum of nine exemptions out of total 14 exams a person has to take to get ACCA qualification). Some Estonian universities are currently drawing up comparison tables to determine to what extent their postgraduate syllabus is compatible with the ACCA examination.

The ACCA accreditation would be an indicator of high quality and possibly increase the attractiveness of the curricula. Students then have the option of complete the assessments for the remaining 5 modules through respective institution organising ACCA exams in order to become ACCA certified.

In terms of international cooperation with other vocational schools, higher education institutions and universities, each school has their own list of partner schools, but the level of cooperation is at one point more active and in another point there is less communication. This lack of communication and cooperation is often determined by the lack of resources (i.e. it takes money to visit other schools or have professors and teachers from other institutions to come to Estonia). Therefore, most of the interviewees supported the idea that more funds should be directed to that section. For example, more active cooperation with partner universities would help Estonian lecturers and professors to get international experience. Another idea is to invite foreign colleagues to teach in Estonia.

In terms of cooperation among institutions in Estonia, the Estonian universities locally do not have significant collaboration, however vocational education providers do have.

5 *Estonian-Swiss Cooperation Programme*

In 2004, Switzerland allocated 1 billion Swiss francs to then 12 new European Union member states with an objective to reduce economic and social disparities within the enlarged EU.

The Framework Agreement of the cooperation programme was signed in Bern in December 2007 between the Government of the Republic of Estonia and the Swiss Federal Council. Among the projects to be financed stood the “Financial Reporting Technical Assistance Project” with the duration of 5 years starting in 2009.

The main objective of the project was to enhance the implementation of *acquis communautaire* as it relates to financial reporting, with an aim to result in a business environment conducive to sustained economic growth that is less prone to financial systems crisis.

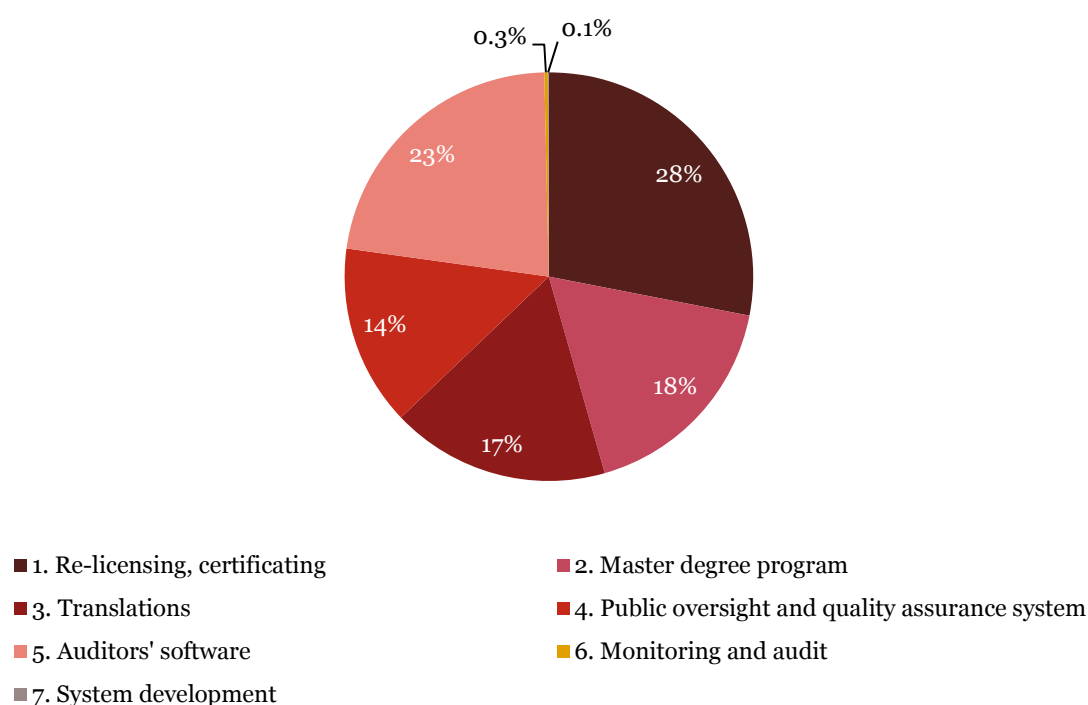
Five different focus areas were specified, including the improvement of the financial sector with a budget allocation of 1 800 000 CHF.

Table 30 illustrates how the funds allocated to the financial sector have been used to finance seven groups of activities.

Table 29. Usage of funds in financial sector

Budget breakdown	Agreed financing, CHF	Total eligible expenses as of 31.07.2015, CHF	Progress to 31.07.2015
1. Re-licensing, certificating	485,500	485,395	99.98%
2. Master degree program	302,997	302,850	99.95%
3. Translations	312,000	299,168	95.89%
4. Public oversight and quality assurance system	247,645	247,336	99.88%
5. Auditors' software	388,200	388,050	99.96%
6. Monitoring and audit	62,000	4,641	7.49%
7. System development	1,658	1,657	99.96%
Total	1,800,000	1,729,096	96.06%

(Source: Composed by the authors based on data received from the Ministry of Finance)

Figure 14. Estonian-Swiss programme budget allocation in the financial sector

(Source: Composed by the authors based on the data received from the Ministry of Finance)

A detailed breakdown of the activities involved in each of the activity title are presented below:

Table 30. Activities funded

Activity title	Activities involved	Section in this report covering the topic
1 Re-licensing of Auditors and certifying the internal auditors and accountants	1.1 Sworn auditors examination program's development	3.3.2
	1.2 ISA and IFRS training methodology and materials' development	3.3.11
	1.3 Carrying out ISA and IFRS trainings	
	1.4 Development of examination test questions	
	1.5 Carrying out examinations	
	1.6 Relicensing of sworn auditors	
2 Development of master degree program in the field of audit	2.1 Developing academic curriculum for the master degree program	4.1.3
	2.2 Popularizing the graduate studies in the field of accounting (providing tuitions for master degree)	0
	2.3 Research studies in the field of accounting	
	2.4 Cooperation with other local universities and professors in the field of accounting to apply the training program and tests of ISA and IFRS developed in Activity 1, to the master degree curriculums	
3 Translation of IFRS, ISA and IIA standards	3.1 Translation and review of new and improved IFRS	2.3.3
	3.2 Translation and review of new and improved ISA	3.3.11
	3.3 Translation and review of new and improved IIA	
	3.4 Translation of IFRS, ISA and IIA tests	
	3.5 Publishing of translations	
4 Public oversight and quality assurance system (POS and QAS)	4.1 Induction training for new members of national public oversight systems and new members of national quality assurance systems, drawing on EU and international experts and facilitating the exchange of views and insights between members from different Member States;	3.3.1 3.3.3

- 4.2 Follow-up training for POS and QAS members, including through study tours, secondment (emphasis on German and Austrian POS), and/or twinning, technical assistance
- 4.3 Development of a public oversight methodologies, process manuals and work programs as set in the Auditing Act, for POS and QAS
- 4.4 Update of a regional template for quality assurance process manual – ISA checklist
- 4.5 Trainings for POS and QAS members related to local legislation and carrying out the inspections
- 4.6 Two to four quality control specialist candidates will be found and from following will be financed from this activity:
- a) training program (2-3 month program) intensive IFAC standards training
- intensive accounting standards training
 - local legislation (accounting act, audit act, commercial code, administrative act)
 - local oversight guidelines, best practices etc.
 - written and verbal communication skill enhancement
 - study tours (both short and middle term) to other oversight bodies for methodological or practical training
 - trainings from Big4 internal quality controllers
 - practical quality control along with current quality controllers
- b) allowance for the candidates for training program period

5	Developing audit software	5.1 Developing audit software	3.3.11
6	Interim monitoring and project's audit	6.1 External experts will conduct an Accounting and Audit review (A&A) in 2015 6.2 Project reviews/audits will be carried out every second year plus the final audit.	Overall
7	Enhancement to the existing system whereby accounts are published timely and are readily available	7.1 The translation of XBRL taxonomy based on IFRS	2.4.3

(Source: Ministry of Finance)

See the conclusion of the funding from Estonian-Swiss cooperation programme introduced in “Executive Summary” and recommendation for sustainable financing in here “Summary of the Most Significant Recommendations”.

6 Assessment of Progress of Recommendations in ROSC Report





As part of the report, we analysed recommendations set forth in the ROSC report of 2004, outlining the most important recommendations for improvement and assessing their level of adoption as of the end of the reference period.

The table below divides recommendations into three sections as follows: auditing, accounting, and education. The ROSC suggestions can be found in the first column, followed by an assessment of the respective recommendation's level of accomplishment. We have assigned either "fully accomplished", "partially accomplished" or "not accomplished" status to each suggestion, followed by the comments and reasoning for doing so. The legend can also be found at the bottom of the table.



Table 31. ROSC recommendations and level of progress

Recommendation in ROSC report	Level of progress	Reference to the section in our report where the topic is discussed + reference to the section of our recommendations, where applicable
AUDITING		
<i>THE AUDIT PROFESSION</i>		
Statutory auditors and audit firms must be subject to the IFAC Code of Ethics for Professional Accountants.		3.1
Ensure that audit firms incorporated as a limited liability company have sufficient share capital and professional indemnity insurance, which offer adequate protection to claimants.		3.3.7
Ensure the Estonian Board of Auditors formally endorses and follows its mandate to serve the public interest.		3
Ensure the Estonian Board of Auditors has adequate resources to perform its education, training, technical development, research, professional regulation, and other duties.		3.3.10, 3.3.1– the resources during the period have been adequate, comprising of financing from membership fees, state budget and Estonian-Swiss cooperation programme. Sustainable financing of BoA, including the oversight activities, in the future periods needs to be worked out – refer to section 7.
Ensure that the legal provisions regarding the dismissal and resignation of statutory auditors provide adequate safeguards for his/her independence. The law could introduce that dismissal is only possible in case of a significant reason.		3.3.6




AUDIT QUALITY

Ensure the Estonian Board of Auditors develops its quality assurance system to ensure that auditors comply with applicable auditing and ethical standards, and independence requirements.		3.3.3
The cycle to achieve full coverage of all statutory auditors is too long.		3.3.3
Ensure that Estonia has an effective system of investigations and sanctions to detect, correct and prevent inadequate statutory audits.		3.3.1, 3.3.3, 3.3.5
Take increased advantage of the auditing exemption in the 4 th and 7 th EU Company Law Directives for SMEs when there is no public interest requirement for the audit of financial statements.		3.2



EXAMINATION AND TRAINING

The Estonian Board of Auditors inadequately monitors the pre-qualification work experience and training by individuals (trainees) within audit firms.		3.3.2
Continuing professional education (CPE). BoA should make it a priority to at least implement the IFAC guidelines on continuing professional education.		3.3.4



OVERSIGHT

Quality assurance systems should have adequate public oversight.		3.3.1
Require that statutory audit fees are disclosed.		There is a requirement in the law, but market seems not to perceive it an important matter – see section 2.7.4.
Ensure statutory auditors communicate audit matters of governance interest arising from the audit of financial statements with the members of the company's supervisory board.		3.1, 3.3.3










AUDITING STANDARDS

The Estonian auditing guidelines should follow International Standards on Auditing (ISAs); development of audit guidance related to individual ISAs.		3.1
The authorities should ensure that official translations of ISAs and the Code of Ethics are readily available.		3.3.11

ACCOUNTING AND FINANCIAL REPORTING*ACCOUNTING STANDARDS*

Accounting standards. Issuance of implementation guidelines on individual IFRSs that should link into IFRIC.	 /  /N/A	2.3.1, 2.3.3– the guidelines issued by the EASB have been considered to be good and the channels to get information exist; the ability of EASB issue ongoing guidance depends on the financing – refer to section 7.
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OBLIGATION TO PREPARE AND SUBMIT ANNUAL REPORT

All public interest entities (PIEs) should use IFRSs in preparation of annual report.	 /N/A	2.2– refer to the list of entities obliged to use IFRS, extension of the obligation to non-listed and non-financial entities is not a practice in any of the reference countries.
The final deadline for disclosing an annual financial report, including the statutory audit report, to the public should be three months after fiscal year end.	N/A	2.4.1 – deadlines in Estonia are in line with the practice in the reference countries.
The interim reports of listed entities should follow IAS 34, Interim Financial Reporting, and should contain a management report on the company activities. They should be published within 2 months after quarter end.		2.4.1
Increase accountability of preparers of financial statements.		2.5. There is a large number of entities who do not submit their financial statements or do it late, and a large number of entities to whom auditors have issued a modified report – see section 7.
OVERSIGHT BY FSA		
Compliance. The FSA should monitor compliance of the financial information presented by its licensees with IFRS, and take appropriate measures in case of infringements discovered in the course of enforcement.		2.4.5
Necessary powers. The FSA should be provided with resources to establish and carry out an effective monitoring system.		2.4.5
Issuers and documents. Enforcement should apply to financial information provided by the licensees of the FSA, including listed companies, banks and insurance companies. Financial information should include annual and interim financial statements and reports (individual and consolidated), as well as prospectuses.		2.4.5
Methods of enforcement. Prospectuses: ex-ante approval; other financial information: ex-post enforcement. Enforcement of all financial information is normally based on selection of issuers and documents to be examined.		2.4.5
Actions. Where a material misstatement in the financial information is detected, FSA should take appropriate actions to achieve an appropriate disclosure and, where relevant, public correction of misstatement. Non-material departures will trigger other actions, e.g statement from FSA to the issuer.		2.4.5
Reporting. The FSA should periodically report to the public on their activities (enforcement policies adopted, decisions taken).		2.4.5

EDUCATION

EDUCATION AND TRAINING

Universities: The accounting major curriculum should include IFRS training, more business administration and case studies at the undergraduate level in universities.		4.1.3. Only few universities offer specialisation in accounting at undergraduate level (including accounting related subjects, IFRS training). More thorough programmes are available at graduate level.
Universities: a panel of experts should review and update the accounting curriculum.		4.1 and 4.3
Regulators: Provide theoretical and practical training to the staff of the FSA and other regulators so they can enforce accounting, financial reporting, and auditing standards as recommended.		2.4-5
Professional accounting education program. The Estonian Board of Auditors should prepare a syllabus of the program's courses and textbooks with up-to-date technical information.		3.3.11. The textbooks have not been prepared, but guidance materials are available online at AoB's webpage. The lack of textbooks in Estonian, and lack of demo versions of electronic databases of the state is perceived as a problem – see section 7.

	Fully accomplished		Partially accomplished		Not accomplished	N/A	Not applicable
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7 *Summary of the Most Significant Recommendations*

This section contains the summary of the most significant recommendations, chosen from the recommendations provided throughout the report. Our recommendations in this report are based on the combination of the information collected from the interviews (refer to section 8.2), the background information gathered from different sources (refer to section 8.1), the practices of other countries and the knowledge and opinions of the experts involved in the team of authors of this report (refer to page 3).

1. Late Submission or Non-submission of Annual Reports; Quality of Financial Statements.

As described in section 2.4.1, ca 15% of entities fail to submit their annual reports, and many of the entities submit their annual reports long after the 6-month deadline. We recommend the Ministry of Finance to investigate the reasons and the impact of those entities to the whole economy, and understand how the issue impacts public interest of obtaining the financial information and state's interest to collect statistical data of the economy, and, if necessary develop a more effective sanction system.

Also, section 2.4.4 shows that 17% of financial statements have received modified auditor's reports which indicates there is a problem with the quality of financial reporting as well as the perceived impact of the auditor's report. We therefore recommend considering measures which would educate the public and emphasize the importance of auditor's report.

More detailed information and some suggestions are included in sections 2.4.1 and 2.4.4.

2. Sustainable Financing

During the period under review, many of the larger developments in the accounting and auditing area were financed with the help of the Estonian-Swiss cooperation programme – refer to the list of areas financed in section 5. There is a question about a sustainable financing model in the future in respect of many areas within accounting and auditing field. To list a few:

- There are currently discussions about the future financing model of supervision over auditors, and one of the ideas has been that the supervision activity should be financed by auditors themselves. This may create questions about the independence; and there is also a perceived connection between the importance of the role of auditors working in the public interest, and allocations from the state budget to support their activities. (Refer to section 3.3.1)
- The auditing software E-dok developed by the BoA and proved to be a very usual tool for the auditors, will need further developments in the future; there are also other areas where developments are needed by BoA (e.g. updating/adding questions to the auditor's exam, updating guidance materials to auditors etc). However, the financing model is still not clear. (Refer to section 3.3.11)
- The state has undertaken projects regarding e-invoicing and integration of state databases that collect information from the private sector. These projects will require one-off investments by the state. (Refer to section 2.7.1)
- Further improvements in the university level will require stable financing by the state. (Refer to section 4.1.3)

As the funding from Estonian-Swiss cooperation programme has proved to be crucial in implementing important changes in recent years, we recommend the state to consider if renewing the measure or obtaining funding from another similar programme would be achievable.

3. Narrowing the Definition of PIE

As illustrated in section 2.5.1, Estonia has one of the most expanded definition of PIEs in the EU, and all the PIEs are subject to increased requirements, e.g. obligation to establish auditing committee. The additional requirements create excess administrative burden also to many entities which would not be defined as PIEs in other countries and would not be exposed to these requirements. Based on the interviews, comparison with the practice in other countries, and review of analysis in a master thesis about actual practices by PIEs (refer to section 2.5.2), we recommend the definition of PIE be narrowed and brought in line with the practice in most of the EU countries.

4. Increase in the Number of Reporting Frameworks

The draft of changes to the AA introduces a number of new reporting frameworks under Estonian GAAP for small and micro entities (refer to section 2.4.6). While the purpose is to reduce the administrative burden of those entities, the transparent and simple system will be replaced by considerably more complex system. We recommend the state to monitor the actual impact of the new requirements, to achieve a proper balance of reduced administrative burden and clarity and transparency of the reporting system.

5. E-development

As described in section 2.7.1, the state has commenced the projects of reducing bureaucracy, by analysing how different state databases where entities of private sector submit their data can be integrated, and of introducing e-invoicing with the state. Based on the interviews and feedback gathered by the state in respect of these projects, we recommend continuous effort should be put to the integration of the state databases and usage of electronic channels to the extent possible. In developing new projects, e.g. e-invoicing, the impact to all market participants, especially micro and small companies, should be monitored, to ensure the developments will reduce, and not add to the administrative burden.

6. Educational Materials in the Field of Accounting and Auditing

Based on our interviews with representatives of the vocational and university level education, referred to in section 4, there is a lack of accounting-related books in Estonian. Also, in order to enhance the relevance of the education in the accounting field, electronic learning environments, including demo versions of databases held by the state, would be of critical importance. We recommend the state to consider the above needs when moving on with the zero-bureaucracy project (refer to section 2.7.1). Also, the developments in the above areas are subject to finding a sustainable financing.

7. Independence of the Standard Setter

As described in section 2.3.1, in accordance with the expected changes to the Accounting Act, the standards to be issued by EASB will need to be approved by the Minister of Finance. Also, EASB does not have any budget to be used at their discretion, but is dependent on the Ministry of Finance. The above may be seen as potential threat to the independence of the EASB. Independence of a standard setter is of a crucial importance to ensure development of accounting standards for the ultimate benefit of investors, creditors and other stakeholders. Therefore, we recommend the steps be taken to ensure the independence of the standard setting body.

8 Appendices

8.1 Appendix 1 References

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8.2 Appendix 2 Meetings

Interviews with the following institutions were carried out as part of the project:

	Institution	Date	Purpose	Participants
1	Estonian Board of Auditors	9.10.2015	Interview	Mare Kingo, Sven Siling, Mati Nõmmiste, Märt-Martin Arengu, Stan Nahkor
2	Association of Estonian Accountants	13.10.2015	Interview	Margus Tammeraja
3	Estonian Accounting Standards Board	13.10.2015	Interview	Juta Maar, Ago Vilu
4	Majandusarvestuse Õpetajate Kogu (MÕK)/Estonian Business School	14.10.2015	Interview	Ülle Päril
5	Tallinn College of Tallinn University of Technology	14.10.2015	Phone Interview	Ester Vahtre
6	Oversight Board of the Estonian Board of Auditors	15.10.2015	Interview	Siim Tammer
7	Tallinn School of Economics, Lääne-Viru College	16.10.2015	Group Interview	Ainika Ööpik-Vaade, Helle Noorväli
8	Estonian Association of Small and Medium Enterprises (EVEA), Estonian Traders Association, Estonian Chamber of Commerce and Industry	19.10.2015	Group Interview	Paavo Siimann, Ene Rammo, Riin Savi, Raivo Altmets
9	University of Tartu	21.10.2015	Interview	Toomas Haldma
10	Tallinn University of Technology	26.10.2015	Interview	Lehte Alver
11	Swedbank AS, AS SEB Pank, Svenska Handelsbanken AB Estonian Branch, KredEx	29.10.2015	Group interview	Ave Sullin, Jarmo Liiver, Igor Matveitsev, Mare Margat, Kadri Riisalu, Lia Hõim

