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Pursuant to Article 173, paragraph (8) and Article 174, paragraph (7) of the Credit Institutions Act (Official Gazette 159/2013, 19/2015, 102/2015 and 15/2018) and Article 43, paragraph (2), item (9) of the Act on the Croatian National Bank (Official Gazette 75/2008 and 54/2013), the Governor of the Croatian National Bank hereby issues the

Decision on the refusal of annual financial statements of credit institutions and the content of an audit for the purposes of the Croatian National Bank

I GENERAL PROVISIONS

Article 1

(1) This Decision governs in detail:

- 1) the reasons for the refusal of annual financial statements or annual consolidated financial statements of credit institutions;
- 2) the procedure and manner of application of Article 173 of the Credit Institutions Act (Official Gazette 159/2013, 19/2015, 102/2015 and 15/2018, hereinafter referred to as 'the Act');
- 3) the content of an audit for the purposes of the Croatian National Bank; and
- 4) the reasons for the refusal of audit firms' assessments provided in accordance with the provisions of Article 174, paragraph (1) of the Act.

(2) Annual consolidated financial statements shall consist of annual consolidated financial statements of a group of credit institutions and annual consolidated financial statements of a group, where group members include non-financial institutions.

II REASONS FOR THE REFUSAL OF ANNUAL FINANCIAL STATEMENTS AND ANNUAL CONSOLIDATED FINANCIAL STATEMENTS OF CREDIT INSTITUTIONS

Article 2

(1) The Croatian National Bank shall refuse annual financial statements or annual consolidated financial statements:

- 1) where it determines that annual financial statements and annual consolidated financial statements have been prepared contrary to regulations; or
- 2) where it determines that the annual financial statements and annual consolidated financial statements that received an unqualified or a qualified opinion in the audit report fail to provide a true and fair view of a financial position and performance, and of cash flows.

(2) The Croatian National Bank shall consider that annual financial statements or annual consolidated financial statements have not been prepared in accordance with regulations:

1) if such statements have not been prepared in accordance with the provisions of regulations governing the structure and content of annual financial statements of credit institutions or if they have not been prepared in such a way that the forms prescribed under these provisions of regulations are an integral part of annual financial statements, following the statements themselves, and if there is no clear reference between published and prescribed annual financial statements with an explanation of differences;

2) if such statements have not been prepared in accordance with the applicable financial reporting framework or the provisions of Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards (OJ L 243, 19.7.2002) and Commission Regulation (EC) No 1126/2008 of 3 November 2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council (OJ L 320, 29.11.2008); and

3) if it determines that the delivered annual financial statements or annual consolidated financial statements have not been mutually reconciled or have not been prepared correctly in terms of calculation and logic.

(3) The Croatian National Banks shall consider that the annual financial statements and annual consolidated financial statements that received an unqualified or a qualified opinion in the audit report fail to provide a true and fair view of a financial position and performance, and of cash flows of a credit institution or a group of credit institutions where, in the exercise of supervision, it identifies illegalities, irregularities and weaknesses in the operation of the credit institution or the group of credit institutions that materially influence a statement of a financial position and performance, and of cash flows in annual financial statements or annual consolidated financial statements or where it establishes the existence of facts that jeopardise the ability of the credit institution or the group of credit institutions to continue as a going concern.

III THE PROCEDURE AND MANNER OF DISMISSING AND REFUSING ANNUAL FINANCIAL STATEMENTS AND ANNUAL CONSOLIDATED FINANCIAL STATEMENTS OF CREDIT INSTITUTIONS

Article 3

(1) The Croatian National Bank shall establish the reasons for the dismissal and refusal of annual financial statements or annual consolidated financial statements by exercising supervision of a credit institution or a group of credit institutions in the manner prescribed in the provisions of Title XVI of the Act and the provisions of regulations governing in detail the exercise of supervision of credit institutions and the imposition of supervisory measures.

(2) The Croatian National Bank shall dismiss or refuse annual financial statements or annual consolidated financial statements by a decision.

IV AUDIT FOR THE PURPOSES OF THE CROATIAN NATIONAL BANK

Article 4

For the purposes of this Decision, 'audit for the purposes of the Croatian National Bank' means a procedure for the verification and assessment of the following, carried out by the audit firm of a credit institution:

- 1) compliance with risk management rules;
- 2) the adequacy of the operations of the risk control function, the compliance function and the internal audit function;
- 3) the state of the information system and the adequacy of information system management; and
- 4) the regularity, accuracy and completeness of the reports delivered by a credit institution to the Croatian National Bank.

Article 5

(1) An audit firm shall provide an assessment of whether a credit institution complies with risk management rules in accordance with the provisions of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013) and delegated regulations adopted under the provisions of that Regulation, the provisions of the Act and regulations adopted under the Act.

(2) An audit firm shall assess whether a credit institution adequately manages the following risks:

- 1) credit risk;
- 2) liquidity risk;
- 3) market risks;
- 4) interest rate risk in the non-trading book;
- 5) operational risk;
- 6) risk of money laundering and terrorist financing; and
- 7) other risks to which a credit institution or a group of credit institutions is significantly exposed in its operation, and which might affect the safety and stability of the operation of the credit institution or the group of credit institutions.

(3) An audit firm shall provide an assessment of compliance with the rules on the management of the risks referred to in paragraph (2) of this Article based on an assessment of:

- 1) compliance with prescribed organisational requirements regarding the management of a particular risk;
- 2) compliance with prescribed requirements regarding policies and procedures for the management of a particular risk;
- 3) the implementation of adopted policies and procedures;
- 4) the adequacy of identifying, measuring and monitoring a particular risk; and
- 5) the adequacy and efficiency of internal control systems relating to the management of a particular risk.

(4) An audit firm shall also assess the regularity and accuracy of the calculation of asset impairment and provisions for off-balance sheet items of a credit institution in accordance with International Financial Reporting Standard 9 – Financial Instruments, for the following:

- 1) models for the calculation of expected credit losses on exposures for which the credit risk on a debtor's individual exposure has not increased significantly after initial recognition and for exposures for which the credit risk on a debtor's individual exposure has significantly increased after initial recognition;
- 2) indicators for establishing a significant increase in the credit risk on a debtor's individual exposure after initial recognition;
- 3) the quality of data obtained from the information system for the purposes of calculating expected credit losses;
- 4) conversion factors the credit institution applies in the calculation of expected credit losses on off-balance sheet items; and
- 5) the adequacy of the calculation of impairment or provisions for defaulted exposures.

Article 6

(1) When providing an assessment of control functions, an audit firm shall verify and assess at a minimum whether:

- 1) a credit institution has established stable and efficient control functions;
- 2) a credit institution has organised an internal audit function as a separate organisational unit, functionally and organisationally independent both from the activities it audits and from other organisational units of the credit institution;
- 3) a credit institution has established control functions so as to avoid conflicts of interest;

- 4) the bylaw on control functions is adequate and adopted by the management board subject to the prior approval of the supervisory board;
 - 5) a credit institution has ensured, proportionally to its size and the nature, scale and complexity of its activities, a sufficient number of persons with adequate knowledge and experience for the carrying out of control function activities;
 - 6) annual control function work plans are adopted and appropriate;
 - 7) control functions prepare control function work reports; and
 - 8) control functions perform the activities assigned to them.
- (2) An audit firm shall provide an assessment of the control functions referred to in paragraph (1) of this Article with respect to the requirements laid down in the Act and subordinate legislation adopted under the Act.

Article 7

- (1) An audit firm shall carry out an audit of information systems and provide a separate assessment of the state of a credit institution's information system and the adequacy of its information system management.
- (2) An audit firm shall:
- 1) apply the methods and procedures for an audit of information systems based on risk assessment;
 - 2) define the scope of an audit of the information system based on risk assessment prior to the beginning of an audit of the information system;
 - 3) define the depth of an audit of the information system, depending on the current state of the information system; and
 - 4) verify whether the credit institution complies with:
 - a) the Act and subordinate legislation adopted under the Act relating to information systems;
 - b) Commission Delegated Regulation (EU) 2018/389 of 27 November 2017 supplementing Directive (EU) 2015/2366 of the European Parliament and of the Council with regard to regulatory technical standards for strong customer authentication and common and secure open standards of communication (OJ L 69, 27.11.2017); and
 - c) the Regulation of the Government of the Republic of Croatia on the cybersecurity of essential service operators and digital service providers adopted under the Act on the Cybersecurity of Essential Service Operators and Digital Service Providers (Official Gazette 68/2018).
- (3) Based on an audit of the information system, an audit firm shall warn of significant risks to which the credit institution is exposed.

Article 8

(1) In auditing the reports delivered to the Croatian National Bank, an audit firm shall verify the regularity, accuracy and completeness of the reports delivered in accordance with:

1) the Decision on supervisory reports of credit institutions (Official Gazette 41A/2014, 127/2014, 67/2015, 119/2015, 7/2017, 44/2017, 120/2017 and 85/2018), for the following reports:

- Report on off-balance sheet items (IBS)
- Report on credit risk exposure by risk categories (RS4)
- Report on holdings in the capital of an undertaking (UKT5)
- Report on tangible assets (MIKI3)
- Report on acquired assets (PIKI2)
- Report on exposure to currency induced credit risk (VIKR3)
- Report on past due receivables (DNP1)
- Report on the remaining maturity of assets and liabilities (ROC2)
- Report on exposure to protection providers (IDZ2)
- Detailed trading book (DKT)
- Report on exposures to persons in a special relationship with a credit institution (POKI2);

2) regulations governing the management of interest rate risk in the non-trading book, for the following reports:

- Total weighted position (EVKI ZBR)
- Impact of interest rate risk in the non-trading book on net interest income (NPK);

3) Commission Implementing Regulation (EU) No 680/2014 of 16 April 2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council (hereinafter referred to as ‘Regulation (EU) No 680/2014’), for the following reports:

- Own funds (C 01.00)
- Own funds requirements (C 02.00)
- Capital ratios (C 03.00)
- Exposures and losses from lending collateralised by immovable property (C 15.00)
- Large exposures limits (C 26.00)

- Identification of the counterparty (C 27.00)
- Exposures in the non-trading and trading book (C 28.00)
- Detail of the exposures to individual clients within groups of connected clients (C 29.00)
- Leverage ratio calculation (C 47.00)
- Performing and non-performing exposures (F 18.00)
- Forborne exposures (F 19.00);

4) the Decision on the IT-solutions for the delivery of reports of credit institutions in accordance with European Union regulations (Official Gazette 9/2018 and 120/2018), for the following reports:

- Performing and non-performing exposures (F 18.00)
- Forborne exposures (F 19.00).

(2) An audit firm shall verify the regularity, accuracy and completeness of the reports referred to in paragraph (1) of this Article by assessing whether they have been prepared in accordance with the Act and subordinate legislation adopted under the Act and Regulation (EU) No 680/2014.

(3) An assessment of the reports referred to in paragraph (1) of this Article shall be provided in the form of a statement that the reports have been prepared in accordance with the Act and subordinate legislation adopted by the Croatian National Bank and Regulation (EU) No 680/2014.

(4) Individual reports referred to in paragraph (1) of this Article shall also be signed by a person from the credit institution's management board responsible for reporting.

Article 9

(1) Based on an audit for the purposes of the Croatian National Bank, an audit firm shall prepare an audit report.

(2) Assessments of an audit for the purposes of the Croatian National Bank shall range from completely satisfactory to completely unsatisfactory (satisfactory, mostly satisfactory, partly satisfactory, and unsatisfactory). The assessments provided should be further reasoned.

(3) The audit report referred to in paragraph (1) of this Article shall contain:

- 1) a separate assessment of compliance with rules on the management of each individual risk referred to in Article 5, paragraph (2) of this Decision;
- 2) a separate assessment in accordance with the requirements of Article 5, paragraph (4) of this Decision;

- 3) a separate assessment of the adequacy of the operations of the risk control function, the compliance function and the internal audit function referred to in Article 6 of this Decision;
 - 4) a separate assessment of the state of the information system and the adequacy of information system management referred to in Article 7 of this Decision;
 - 5) a separate assessment of the regularity, accuracy and completeness of the reports delivered to the Croatian National Bank in accordance with the provisions of Article 8, paragraph (1) of this Decision;
 - 6) a list of deficiencies identified in the course of an audit for the purposes of the Croatian National Bank;
 - 7) recommendations for the improvement of policies, procedures and processes relating to the management of the risks referred to in Article 5, paragraph (2) of this Decision; and
 - 8) a statement as regards recommendations and deficiencies identified by auditors in preceding years.
- (4) The audit report referred to in this Article shall be prepared and signed by certified auditors and a legal representative of the audit firm and shall be accompanied by the reports referred to in Article 8, paragraph (1) of this Decision that were subject to audit.

V CORRECTION AND REFUSAL OF AN AUDIT FIRM'S ASSESSMENT FOR THE PURPOSES OF THE CROATIAN NATIONAL BANK

Article 10

(1) Where the Croatian National Bank establishes that the audit firm's assessment referred to in Article 9, paragraph (2) of this Decision is not in accordance with the Act and subordinate legislation adopted under the Act, or in accordance with this Decision, or where, in the exercise of supervision of a credit institution or a group of credit institutions or in any other way, it establishes that the assessment is not based on true and objective facts, it may:

- 1) require the auditor to correct or supplement the assessment; or
- 2) refuse the assessment and require the credit institution to obtain another assessment by certified auditors of a different audit firm at the expense of the credit institution.

(2) The Croatian National Bank shall deliver the request referred to in paragraph (1), item (1) of this Article to the audit firm and the credit institution in the form of a conclusion issued in accordance with the provisions of the regulation governing the general administrative procedure.

(3) The provisions of Title XVI of the Act shall apply *mutatis mutandis* to the procedure of refusing an audit firm's assessment for the purposes of the Croatian National Bank.

(4) The Croatian National Bank shall refuse an audit firm's assessment for the purposes of the Croatian National Bank by a decision.

VI TRANSITIONAL AND FINAL PROVISIONS

Article 11

(1) On the date of the entry into force of this Decision, the Decision on the contents of audits of credit institutions (Official Gazette 1/2009 and 75/2009) shall cease to have effect.

(2) This Decision shall enter into force on the eighth day after the day of its publication in the Official Gazette and shall be first applied to annual financial statements and annual consolidated financial statements prepared as at 31 December 2019.

No.: 40-020/02-19/BV

Zagreb, 15 February 2019

Croatian National Bank
Governor

Boris Vujčić, m.p.