

REPORT ON THE OBSERVANCE OF  
STANDARDS AND CODES (ROSC)

ACCOUNTING AND AUDITING

ARMENIA

JUNE 2008

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## Executive Summary

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This report provides an assessment of accounting, financial reporting and auditing requirements and practices within the enterprise and financial sectors in Armenia. The report uses International Financial Reporting Standards (IFRS) – formerly International Accounting Standards (IAS) - and International Standards on Auditing (ISA) as benchmarks and draws on international experience and good practices in the field of accounting and audit regulation, including in European Union (EU) Member States, to assess the quality of financial information and make policy recommendations.

High quality financial reporting makes a major contribution to:

- Enhancing the business climate and bolstering domestic and foreign direct and portfolio investment in the private sector;
- Assisting the integration of Armenia into the European and global economies;
- Strengthening the stability and competitiveness of the banking and non-banking financial sectors; and mitigating the risk of crises due to loan collection problems and weak capital base;
- Encouraging greater transparency in both State and privately-owned enterprises, thus allowing shareholders and the public at large to assess management performance and influence its behavior; and
- Facilitating SME access to credit by encouraging a shift from collateral-based lending decisions to lending decisions based on the financial performance of the prospective borrower, thereby supporting growth in the SME sector.

### Political and Economic Overview

Armenia is a presidential, representative democratic republic with a gross national income (GNI) per capita<sup>1</sup> of US\$1,930 and a population of about 3 million people<sup>2</sup>. Armenia's GDP growth performance has been strong, increasing more than 100% from 2000 to 2006<sup>3</sup>.

### Accounting and Auditing Reforms in Armenia

The current legislative framework for accounting and financial reporting in Armenia requires the use of Accounting Standards of the Republic of Armenia (ASRA) (IAS as of 2001, slightly modified) for financial reporting purposes for all companies regardless of company size and does not allow reduced reporting requirements for smaller companies. The lack of modified requirements for smaller companies can also be seen in the Armenia's legislative framework for auditing. Current legislation stipulates that all joint stock companies may appoint auditors to audit their annual financial statements. The lack of size thresholds in accounting and auditing legislation places additional pressure on the country's developing accounting and auditing environment and may hinder the production of high quality financial information.

International Standards on Auditing (ISA) are adopted for use by auditors as "Standards on Auditing for the Republic of Armenia" (SARA). However, as with accounting standards, time lags in the translation of ISA and their adoption as SARA lead to a gap in the standards between the latest set of ISA issued by the IAASB and the standards in use by auditors in Armenia.

Currently, the capacity of the accounting and auditing profession in Armenia is low. There are approximately 150 individuals who hold the Ministry of Finance accountancy qualification certificates and 75 who hold the Ministry of Finance auditor qualification certificates. Few

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<sup>1</sup> Per World Bank World Development Indicators as of the Atlas Method (2006).

<sup>2</sup> Population statistics are from World Bank World Development Indicators as of 2005 (most recent).

<sup>3</sup> GDP Growth (Annual %) increased from 6% in 2000 to 13% in 2006.

professionals belong to professional associations and/or pursue internationally recognized qualifications. This stems from the lack of recognition the Ministry of Finance has given to the qualifications offered by professional associations. In addition, the low number of professional auditors can be partially attributed to the Ministry of Finance's decision not to offer its professional certification examination from 2001 until 2006.

New accounting and auditing measures are underway to meet the challenges of a growing Armenian economy and a developing accounting and auditing environment. Among these are proposals for new accounting and auditing laws which, based on the EU Eighth Company Law Directive, will require auditing and accounting professionals to obtain a minimum number of hours of continuous professional development (CPD) and will develop a government body to oversee the profession. These accounting and auditing laws will also provide for a new translation of IFRS to be adopted as ASRA.

**With regard to the statutory and legal framework for financial reporting and auditing, it is recommended that:**

- A three-tier financial reporting requirement be implemented: Public Interest Entities (PIEs) be required to apply full IFRS; Small and Medium-Sized Entities (SMEs) be required to apply IFRS for private entities (when it is available and given sufficient time for successful implementation); and micro-entities be required to report solely for tax purposes. For all entities, the linkages between general-purpose financial reporting and reporting for regulatory purposes (including tax reporting) should be structured so as to restrict differences to those required to achieve valid public policy objectives, thereby minimizing additional reporting burdens and leveraging the enforcement powers of the relevant regulatory authorities to enhance the quality of financial information made publicly available to the market.
- ASRA be replaced by an up-to-date translation of IFRS and that a sustainable process for timely translation of future amendments to IFRS be established, bearing in mind the costs and benefits flowing from the use of full IFRS, and having regard to the relative importance of other reforms in the field of accounting and auditing.
- SARA be replaced by an up-to-date translation of ISA and a sustainable process for timely translation of future amendments to ISA be established.
- A company registry which is currently being established should also have the mandate and capacity whereby companies required to publish their financial statements file such financial statements with the registry within a defined period.

**With regard to institutional and capacity building measures to support corporate financial reporting, it is recommended that:**

- The Ministry of Finance to delegate the performance of some of its regulatory functions with regard to accountancy and auditing, such as the qualification of professional accountants and auditors and audit quality control, to one or more professional organizations. The MoF could then modify its role to that of oversight of the profession, more in line with the new EU Eighth Company Law Directive, also having regard to the opportunities provided by the establishment of the proposed 'Chamber of Auditors and Accountants'.
- Professional bodies such as the Association of Accountants and Auditors of Armenia (AAAA) reach out to universities and to the corporate sector to increase market recognition of the accounting profession, increase their membership and become self-financing.

**With regard to measures to improve education and training in accounting and auditing at professional and other levels, it is recommended that:**

- Universities work to further develop their connections with the private sector, regulatory bodies and professional organizations.
- A sustainable program to ‘re-train the trainers’ be undertaken to help update educators’ skills and knowledge.
- Armenian universities continue and increase their efforts to hire accounting faculty staff with relevant practical experience to teach courses in accounting and auditing.

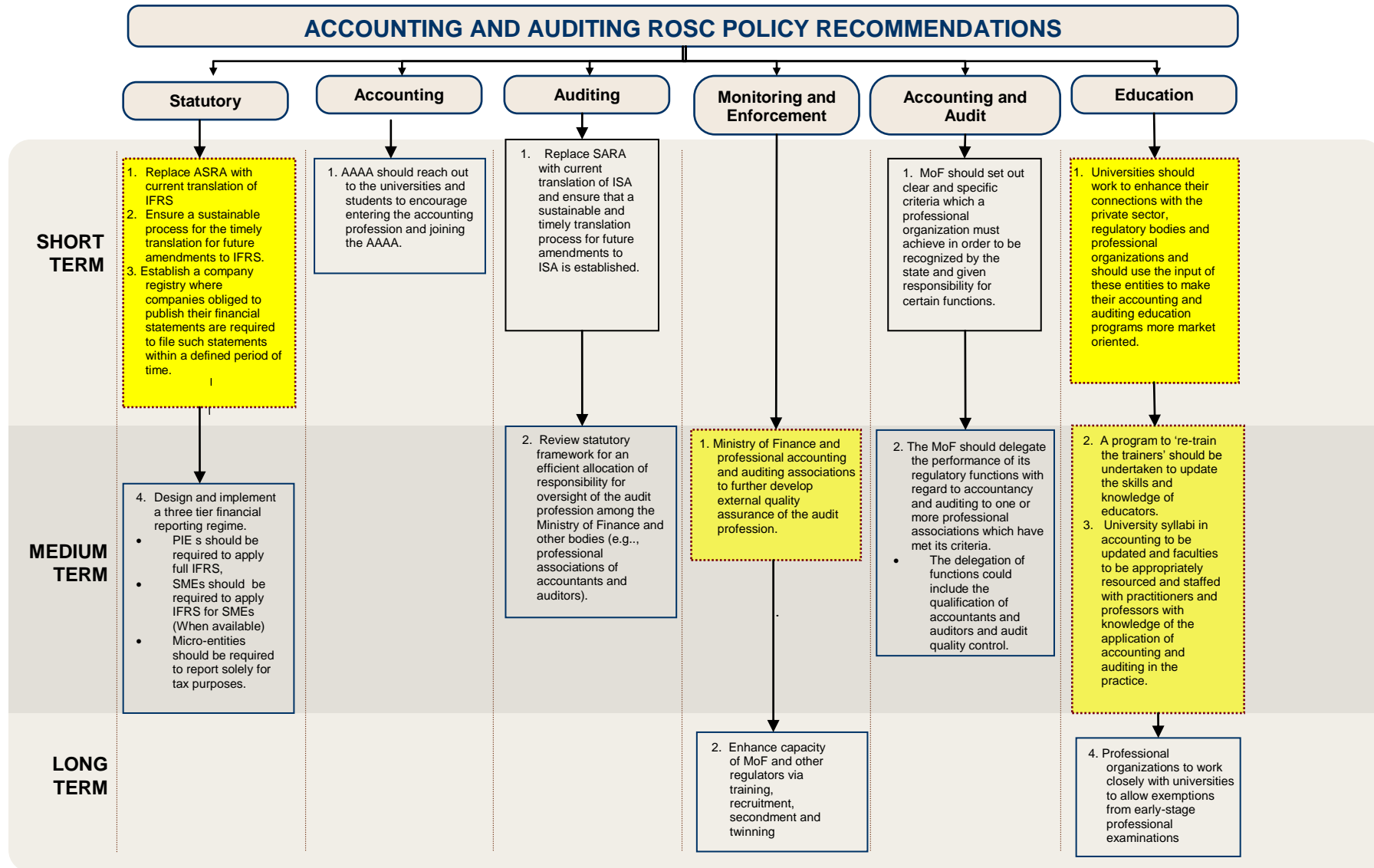
**How Recommendations May Become Reform**

These recommendations require a holistic, multi-disciplinary approach and should be implemented as soon as possible following the publication of this report. Such implementation will require the cooperation of a wide range of stakeholder groups including the Government, regulators and the accountancy profession, and should be championed by a senior Government figure.

Armenia should establish a multidisciplinary National Steering Committee (NSC) led by a senior official, ideally at Deputy Minister level, to coordinate the above accounting and auditing reforms. The NSC should advise policymakers and regulators regarding the implementation of the recommendations. Based on the successful experience of other countries, this report recommends that the NSC develop a Country Strategy and a detailed Country Action Plan which clearly sets out the key actions and allocates responsibilities for implementing the necessary reforms. The plan should include a itemized budget indicating the resources necessary for successful implementation and the government, policymakers and development partners should work together to secure those resources so as to achieve the common goal of enhancing the quality and availability of financial information in Armenia.

This report was prepared on the basis of the findings from a diagnostic review carried out in Armenia by a team from the World Bank in July 2007. The report reflects the current situation as of June 27, 2008; however some developments between June 27 and December 31, 2008 are reflected in the footnotes. The team was led by Jon Hooper and comprised Arman Vatyan, Gabriella Kusz (ECSPS) Galina Alagardova (IFC), Gerald Kogler (consultant). Andrei Busuioc has contributed to the finalization of the report. The review was conducted through a participatory process involving various stakeholders and led by the country authorities.

## ACCOUNTING AND AUDITING ROSC POLICY RECOMMENDATIONS



## MAIN ABBREVIATIONS AND ACRONYMS

AAAA	Association of Accountants and Auditors of Armenia
ACCA	Association of Chartered Certified Accountants
ARMEX	Armenian Stock Exchange
ASRA	Accounting Standards of the Republic of Armenia
BCBS	Basel Committee on Banking Supervision
CAP	Country Action Plan
CBA	Central Bank of Armenia
CPA	United States Certified Public Accountant
CPD	Continuing Professional Development
EU	European Union
GDI	Gross Domestic Income
GNI	Gross National Income
FIG	Financial Industrial Group
FDI	Foreign Direct Investment
IAASB	International Auditing and Assurance Standards Board
IAESB	International Accounting Education Standards Board
IAIS	International Association of Insurance Supervisors
IAPS	International Auditing Practice Statement
IAS	International Accounting Standards (included in IFRS)
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IASCF	International Accounting Standards Committee Foundation
IES	International Education Standard
IESBA	International Ethics Standards Board for Accountants
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards (including IAS)
IMF	International Monetary Fund
ISA	International Standards on Auditing
ISQC	International Standards on Quality Control
JSC	Joint stock company
LLC	Limited liability company
MoF	Ministry of Finance
NAS	National Accounting Standards
NBFIs	Non-Banking Financial Institutions
NSPF	Non-State Pension Fund
PIE	Public Interest Entity
ROSC	Reports on the Observance of Standards and Codes
SARA	Standards on Auditing for the Republic of Armenia
SME	Small and Medium-Sized Enterprise
SMO	Statement of Membership Obligations of IFAC
SOE	State Owned Enterprise



## I. INTRODUCTION

1. This assessment of accounting and auditing practices in Armenia is part of a joint initiative of the World Bank and International Monetary Fund (IMF) to prepare Reports on the Observance of Standards and Codes (ROSC). The assessment focuses on the strengths and weaknesses of the accounting and auditing environment that influence the quality of corporate financial reporting and includes a review of both mandatory requirements and actual practice. The report uses International Financial Reporting Standards (IFRS)<sup>4</sup> and International Standards on Auditing (ISA)<sup>5</sup> as benchmarks and draws on international experience and good practice in the field of accounting and auditing regulation.

2. Armenia is a presidential, representative democratic republic with a gross national income (GNI) per capita<sup>6</sup> of US\$1,930. With an overall population of about 3 million people, it is the second most densely populated of the former Soviet republics. An estimated 57 percent of Armenians live in urban areas with Yerevan, the capital and largest city, having approximately 1 million inhabitants<sup>7</sup>.

3. Armenia's GDP growth performance has been strong, increasing more than 100% from 2000 to 2006<sup>8</sup>. Growth in 2006 was furthered by expansion in the construction sector. This was partly a result of new investment in mining and energy sectors and partly due to increased residential and office development in Yerevan.

4. Currently, there are 22 banking institutions in Armenia, and the majority has foreign investments in their share capital, including those made by institutional investors. Although foreign ownership is low, competition is set to increase in Armenia's banking sector as a significant number of foreign banks are looking to invest in the country. With the influx of foreign banks, the sector may move towards more complex banking products.

5. Armenia's non-banking financial institution (NBFI) sector is relatively undeveloped. The main difficulty faced by the sector's accounting professionals is the lack of a comprehensive, sector-specific accounting and financial reporting methodology to be applied in practice<sup>9</sup>. The Central Bank of Armenia (CBA), which is responsible for overseeing the NBFI sector, requires certification of managers and chief accountants of financial institutions. This certification provides for standards of education, experience and probity; such direct regulation of managers and accountants goes further than comparable regulations in many other countries.

6. Armenia's securities market is small. There are currently 14 companies with corporate securities listed on the Armenian Stock Exchange (ARMEX<sup>10</sup>). On January 1, 2006 the supervision and regulation of the securities market (along with the insurance and banking sector)

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<sup>4</sup> IFRS, which include the International Accounting Standards (IAS), are issued by the International Accounting Standards Board, an independent accounting standard-setter based in London, United Kingdom. For simplicity's sake, the term IFRS will mean both IFRS and IAS in this report.

<sup>5</sup> ISA are issued by the International Auditing and Assurance Standards Board of the International Federation of Accountants (IFAC).

<sup>6</sup> World Bank World Development Indicators per the Atlas Method as of 2006.

<sup>7</sup> Population statistics are from World Bank World Development Indicators as of 2005 (most recent).

<sup>8</sup> GDP Growth (Annual %) increased from 6% in 2000 to 13% in 2006 according to World Bank Development Indicators.

<sup>9</sup> The chart of accounts and its interpretations, forms of financial statements and rules for their preparation for credit organizations, insurance companies, and investment firms regulated by the CBA have been developed.

<sup>10</sup> ARMEX has been renamed to NASDAQ OMX Armenia CJSC since January 26, 2009.

was taken over by the CBA. At the end of 2007, ARMEX and the central depository were acquired by OMX<sup>11</sup>.

7. As Armenia moves towards further reform, liberalization and deregulation to enhance the business environment, improved financial transparency and accounting and auditing practices will be needed to support this process of reform. Increasing levels of both foreign direct investment (FDI) and domestic investment demand a higher quality of financial information consistent with international standards. Continuing the strengthening and development of financial reporting, accounting and auditing, and the regulatory framework that governs them, will bring benefits to Armenia and its citizens. In this context, this report sets out policy recommendations to enhance the quality of corporate financial reporting and to foster a financial reporting platform conducive to sustainable private and financial sector growth, thus increasing access to global financial markets and other tools of the market economy.

## II. INSTITUTIONAL FRAMEWORK<sup>12</sup>

### A. Statutory framework

#### A.1. *The Statutory Framework for Accounting and Financial Reporting*

8. **Accounting requirements for enterprises in Armenia are regulated by the Law on Accounting, which came into effect in 1998 and was last amended in 2003.** Accounting regulations are implemented by the Ministry of Finance (MoF). The MoF endorses accounting standards, issues the recommended chart of accounts, develops instructions for the application of the standards and chart of accounts and issues other statutes regulating accounting; according to Art. 4-2.1 of the Law on Accounting, the MoF may also approve sample forms of financial statements and instructions for completing them based on IFRS and IFRIC interpretations<sup>13</sup>. In 1999, the MoF, with assistance of USAID, developed Accounting Standards for the Republic of Armenia (ASRA) based on the IAS current in 1999. The latest full update of ASRA was implemented in 2001. As a result, the present version of ASRA represents a slightly modified version of IFRS/IAS from 2001 (more details of ASRA development and its current status are given in section II.D, ‘Setting Accounting Standards’). The Law on Accounting empowers the Central Bank of Armenia (CBA), as regulator, to define accounting and reporting requirements for its regulated entities.<sup>14</sup>

9. **In 2001, in addition to ASRA, the MoF issued a chart of accounts with instructions for its application.** Only certain codes of the chart of accounts relating to the major components of financial statements are of compulsory nature, including non-current assets, current assets, shareholders equity, liabilities, income and expense. Additionally, certain concepts of ASRA and procedures for their application are further explained in methodological guidance for

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<sup>11</sup> The OMX Company operates in the exchange industry. OMX owns exchanges in the Nordic and Baltic region, and develops and provides technology and services to companies in the securities industry.

<sup>12</sup> This report outlines the legal principles applicable with regard to accounting, auditing and financial reporting and does not attempt to give anything more than an introduction to the issues. This report is not meant to be an exhaustive rendition of the law nor is it legal advice to those reading it.

<sup>13</sup> In general, local interpretations of IFRS are not encouraged by the IASB and therefore if the MoF issues sample formats of financial statements, these should have only the character of recommendations.

<sup>14</sup> According to the Law on Introducing Consolidated Financial Regulation and Supervision, adopted on December 8, 2005, regulatory and supervisory functions over the financial system participants (i.e. banks, credit organizations, securities market participants, investment firms and insurance companies) were transferred to CBA starting from January 1, 2006.

accountants, issued by the MoF in 2001. The guidance assists the interpretation of standards and contains practical examples and suggestions for typical accounting transactions.

10. **The Law on Accounting lays down enterprises' financial reporting obligations.** The Law sets the fundamental IFRS-based accounting principles and assertions, such as consistency, the accrual basis of accounting, understandability of information presented in financial report, prevalence of substance over form, prudence, completeness, etc. The Law also prescribes how enterprises should perform bookkeeping and deals with how the accounting process should be organized and documented. Furthermore, the Law requires that:

- Enterprises prepare financial reports including a balance sheet, an income statement, a cash flow statement, a statement on the changes in the share capital and notes to the financial statements including disclosure of accounting policies, and other disclosures as required by ASRA.
- For those companies subject to audit, the submission of an auditor's report on the financial statements.
- While the general director of an enterprise is solely responsible for the organization of the accounting function, the general director and the person in charge of accounting (in most cases the chief accountant) are jointly responsible for any violation of accounting legislation.
- Companies submit annual financial statements to the shareholders (proprietors), to state bodies which have authority over such enterprises (however, the only such body currently is the CBA), and to the statistical bureau. In addition, entities regulated by the CBA, including reporting issuers (hereinafter also referred to as listed companies)<sup>15</sup>, submit quarterly financial statements to the CBA.

11. **The MoF has recently drafted amendments to the Law on Accounting which have been submitted to the National Assembly and which envisage: i) the replacement of ASRA with IFRS translated into Armenian, ensuring that the translation process is ongoing and in conformity with the requirements of the International Accounting Standards Committee Foundation (IASCF); ii) the adoption of a new standard chart of accounts based on IFRS.** Under the draft law, IFRS application would become mandatory for large companies<sup>16</sup> and accounting standards for SMEs would be developed on the basis of the IASB 'IFRS for private entities', when the latter are issued. It is likely that SMEs will have difficulty in applying IFRS up to the period when reduced standards can be developed, and even then SMEs in Armenia will have difficulty properly applying 'IFRS for private entities' due to capacity, skills and training constraints. According to the above draft law, banks operating in the Republic of Armenia will prepare and submit financial statements in compliance with IFRS and IFRIC interpretations starting from January 1, 2009. Credit organizations, payment and settlement companies, listed companies, investment firms, the regulated market operator, the Central Depository, insurance companies, reinsurance companies, and insurance brokers should prepare and submit financial reports in compliance with IFRS and IFRIC interpretations starting from January 1, 2010. In the meantime, large non-financial sector entities other than the above mentioned will be required to submit such reports starting from January 1 of the year following the six-month period after

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<sup>15</sup> There is no definition of "listed company" in the law of the Republic of Armenia "On Securities Market". However, according to the paragraph 14, art. 3 of the law "On Securities Market", "reporting issuer" means the issuer whose securities of the some class are admitted to trade on the regulated market within the territory of the Republic of Armenia, therefore the term "listed companies" in the context of the legislation of Republic of Armenia refers to "reporting issuers".

<sup>16</sup> According to the Law on Accounting amended in December 2008, the definition of a large company applies to a company which meets one of the following criteria: a) Annual income from the previous year exceeds AMD 500 million (approx. 1.35 mln USD), or b) Book value of assets as at the end of the previous year exceeded AMD 500 million (approx. 1.35 mln USD).

IFRS and IFRIC interpretations are officially adopted by the Republic of Armenia. In addition to the above, another change to the law specifies that the accounting regulatory body is permitted to define accounting standards other than the IFRS to be applied for certain type of taxpayers determined by the Government.

12. **The new draft law on accounting proposes to establish a ‘Chamber of Auditors and Accountants’ to regulate accounting.** The draft law proposes that the Chamber will: conduct IFRS translation and approve SME standards; approve the legislative acts on accounting regulation; approve the standard chart of accounts; and issue guidelines on the application of the chart of accounts and the standard set of financial statements. While it is a positive move that some accounting regulation will be passed to such a body, the composition of the body and strategy for establishing the Chamber remain to be determined in detail. The proposed Chamber could potentially also play a role with respect to the oversight of audit, should the Ministry of Finance delegate certain of its powers to professional organizations.

13. **The requirements for financial reporting by corporate entities are summarized below:**

**Table 1: Corporate Financial Reporting Requirements**

<b>Financial statements</b> <b>Entities</b>	<b>Legal Entity Financial Statements</b>	<b>Audit Requirements</b>
<b>Companies admitted to trading on ARMEX (listed companies)</b>	Currently required to use ASRA. Under the new draft Law on Accounting, these companies will be required to report in accordance with IFRS.	Annual audit required
<b>Open joint-stock companies</b>	Currently required to use ASRA. Under the new draft Law on Accounting, these companies will be required to report in accordance with IFRS if qualified as large companies.	No audit required
<b>Closed joint-stock companies</b>	Currently required to use ASRA. Under the new draft Law on Accounting, these companies will be required to report in accordance with IFRS if qualified as large companies.	No audit required
<b>Private limited liability companies</b>	Currently required to use ASRA. Under the new draft Law on Accounting, these companies will be required to report in accordance with IFRS if qualified as large companies.	No audit required
<b>Banks</b>	Accounting and reporting in accordance with CBA requirements and regulations, which should in principle be developed considering current international standards but which differ in some key respects from IFRS (see Section III)	Annual audit required
<b>Insurance companies</b>	Currently required to use ASRA. Under the new draft Law on Accounting, these companies will be required to report in accordance with IFRS.	Annual audit required

14. **When preparing their financial statements, all corporate entities operating in Armenia must currently follow ASRA irrespective of their size.** There are no simplified accounting requirements applicable to small and medium sized enterprises. However, ASRA provisions are not applied consistently and properly by the majority of SMEs due to the

complicated nature of the ASRA standards, which are not designed specifically for SMEs, and due to the lack of expertise by SME financial statement preparers. Armenian legislation requires all companies to present their financial statements to their owners and submit certain financial indicators to the Department of Statistics. In addition, open-joint stock companies have to publish their financial statements in the media, which they do in summarized form. Most SMEs are incorporated as either limited liability or closed joint-stock companies and are not accountable to any regulatory body that oversees compliance of their financial statements with ASRA. As a result, many SMEs prepare only tax reports to be filed with tax authorities. In practice, very few SMEs prepare ASRA financial statements and mainly then only in cases when the business requires funding from external users. Although banks that are the major source of debt financing for SMEs often do not rely on company financial information and perform their own additional financial analysis of proposed borrowers, current trends observed indicate some increase in the use of financial statements<sup>17</sup>.

**15. Accounting and financial reporting by banks are regulated by the CBA. The Law on Banks and Banking requires banks to account in compliance with procedures agreed by the CBA and the authorized government body (MoF), in accordance with ASRA.** The same law provides that the CBA should take into consideration existing international standards (IFRS) and should establish financial forms to be published and submitted to the CBA. The CBA elaborated financial statements and disclosure forms for banks and established accounting regulations for main banking activities. However, those rules and forms do not fully comply with IFRS requirements (such as with regard to recognition and measurement principles, etc.).

**16. The Banking Law requires all commercial banks to be subject to an annual external audit.** The General Meeting of shareholders appoints the external auditor on the basis of selection criteria determined by CBA. Currently, only two international audit firms operating in Armenia meet the requirements of the CBA. Recently, the CBA set additional requirements for the external audit of prudential reports submitted to the CBA throughout the year. However, the degree of audit assurance required, and the scope of the associated work, still remain to be defined in detail.

**17. Banks are required to submit to the CBA at least once a year financial statements of legal entities which hold a significant participation in the bank's statutory fund and of parties related to those legal entities.** Banks have to publish their audited annual financial statements in the press within four months of the year end and their quarterly financial statements within 15 days of the end of the quarter. The majority of banks publish quarterly and annual financial statements on their websites.

**18. The CBA also supervises non-banking financial institutions (NBFIs), including credit organizations, insurance companies and investment firms.** The CBA requires NBFIs to submit audited annual financial statements prepared in accordance with ASRA. In addition, the CBA requires NBFIs to make regulatory reports covering such information as premiums and claims analyzed by class of insurance, liquidity of assets, solvency of balance sheet, reinsurance premiums and a range of other data analyzed in greater detail than in the financial statements prepared under ASRA. According to the requirements of the Accounting Law, NBFIs' audited annual financial statements have to be published in a newspaper meeting certain minimum circulation levels.

**19. In joint stock companies, the general director of the company is responsible for the organization of accounting and financial reporting.** The Law on Joint Stock Companies stipulates that the general director is responsible as for the truthfulness of accounting records and

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<sup>17</sup> The increase is explained by the fact that in a number of banks the indexes (scoring systems) calculated on basis of the data disclosed in the borrowers' financial statements are applied as objective criteria for loan decisions.

other company-related information (including financial information) submitted to the company's shareholders and other interested parties. The general director is also responsible for the timely submission of financial, statistical and other reports as required by the corresponding laws. The JSC Law does not set any specific requirements for consolidated financial statements, though ASRA (based on IFRS) requires consolidated financial statements to be prepared and this requirement is included in Paragraph 1 of Article 21 of the Law on Accounting: "in cases stipulated by law and the standards, the parent is required to prepare consolidated financial statements".

20. **All joint-stock companies are legally required<sup>18</sup> to have a Controlling Commission or Controller, an internal body responsible for the review of the company's annual financial performance results.** The Controlling Commission/Controller is accountable to the General Meeting of Shareholders and should be composed of individuals who are not members of management body. The law does not specify what qualifications members of the Controlling Commission/Controller should possess, although ideally they should be persons with a financial background and/or some audit experience. Under current legislation, the Controlling Commission represents to some extent a combination of an internal audit function and an Audit Committee, although it is not entitled to perform many of either an Audit Committee or an internal audit functions, such as the evaluation of internal control systems, approval of the appointment of the auditor, review the performance and independence of the auditor, ensuring that management responds to recommendations by the external auditors, and so forth. Due to the lack of monitoring by shareholders of the Controlling Commission, in many joint stock companies the Commission is either not established or plays only a nominal role. In those entities that are regulated by the CBA, the function of the Controlling Commission/Controller is exercised by internal audit divisions which maintain control over the entity's day-to-day activities and risks, its executive body, the chief accountant, and the heads of divisions. The Law should be amended to replace the Controlling Commission in listed companies with an Audit Committee whose role is in conformity with the best international practice. Such an Audit Committee should be required, at minimum, for all banks, insurance companies, companies admitted to trading on ARMEX and other public interest entities (PIEs). This matter has been addressed in greater depth in the 2005 Corporate Governance ROSC for Armenia.

21. **Financial statements of companies are generally not readily available to the public.** The Law on Joint Stock Companies requires open joint stock companies to publish only their audited annual balance sheet and income statement in the media<sup>19</sup>. However, cash flow statements, disclosure of accounting policies and notes to financial statements are not required. Such a requirement to publish limited extracts from financial statements in newspapers is ineffective, due to the incomplete nature of the financial statements, which are often of little use to external users<sup>20</sup>. A public registry where financial statements would be publicly available should be established (as is required in EU Member States); regulated entities and PIEs should be required to make their full financial statements available on their websites and on the websites of the relevant regulator.

22. **The Securities Market Law requires all companies which securities are admitted to trading on the ARMEX to file ASRA-compliant quarterly and audited annual financial statements with the CBA. Copies of these financial statements should also be filed with Armenian Stock Exchange.** The CBA discloses financial statements to public by publishing them on its website. However, many of the companies regulated by the CBA file tax statements in ASRA-compliant formats.

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<sup>18</sup> The Law on Joint Stock Companies applies to the companies regulated by the CBA to the extent it does not contradict the respective laws regulating activities of companies.

<sup>19</sup> The general requirement is to publish financial statements in newspaper with published copies not less than 1,000.

<sup>20</sup> The financial institutions regulated by the CBA are required to publish the full set of their annual audited financial statements as well as their interim financial statements on their websites.

## A.2. *The Statutory Framework for Auditing*

23. **The requirement for statutory audit is defined as detailed above in the table on page 5; all open joint stock companies (which include all listed companies) are required to have an audit of their annual financial statements.** This requirement for statutory audit is different from the EU audit requirement, which permits Member States to exempt small companies from audit. The EU sets maximum limits on the size criteria for ‘small’ companies but Member States can set lower (thereby exempting fewer companies). Given the limited current capacity of the audit profession in Armenia, the statutory audit requirement should be confined to those companies where there is a public interest in there being an audit.

24. **The requirements governing the conduct of and audit are set out in the Law on Audit.** This Law requires auditors to be licensed and to use audit standards defined by the Government of the Republic of Armenia, based on the International Standards on Auditing and the IFAC Code of Ethics. The Law also requires that audit firms should not engage in any commercial activities other than the provision of audit services apart from certain specified accounting-related activities such as preparation of financial statements, tax and legal advice, etc. However, the Law prohibits provision of audit services where financial statement preparation or valuation services have been performed. The Law also sets out requirements for the independence of auditors, prohibiting acting as auditor where there is any ‘close’ relationship between the auditor and entity.

25. **The Law on Audit defines the auditor’s report as that laid down by the auditing standards and permits the audited entity to decide whether to publish unless otherwise required by law. However, certain important issues are not addressed.** The Law does not set out specific procedures or requirements governing the appointment and dismissal of auditors, or requirements for reporting to shareholders. The Law also does not specifically address auditor liability, but does provide that an auditor’s license can be terminated where a ‘false auditor’s statement’ has been issued. There is no requirement for auditors to hold indemnity insurance against claims arising as a result of audit work.

26. **Auditors of corporate entities are required by the Law on Audit to hold a license which is issued by the Ministry of Finance (MoF).** Holders of such an audit license can be individuals or firms with at least two auditors where at least 50% of the ownership is held by auditors. In order to obtain this license, an auditor must pass the Audit Qualification Examination, currently administered by the ‘Authorized Entity’, which is in practice the MoF. However, the Law on Audit allows for a ‘Specialized Entity’ which might conduct audit qualification certifications with the approval of the ‘Authorized Entity’ and the ‘Audit Qualifications Commission’<sup>21</sup>. More detail on this qualification is given in Sections II.B and II.C below.

## B. **The Profession**

### B.1. *The Accounting Profession*

27. **The total number of professional accountants in Armenia is not easy to define accurately as the profession is still relatively informal and most professional accountants are not affiliated with a membership organization.** The MoF estimates that there are about

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<sup>21</sup> According to the Government Decree adopted in August 2008, accountants and auditors holding qualifications obtained through examinations conducted according to IFAC educational standards are recognized by the MoF for certification purposes. The AAAA in November 2008 was accredited to qualify accountants and auditors, with qualification procedures to be agreed with the MoF.

153 individuals who hold the accounting certificate issued by the MoF<sup>22</sup>, and, in addition, the main professional organization has approximately 700 members.

28. **The holders of the MoF accounting certificate mainly comprise company ‘chief accountants’<sup>23</sup>. Armenian legislation requires that companies which wish to publish their financial statements (mainly open JSCs) must first have these signed by a MoF certified<sup>24</sup> ‘chief accountant’.** Although there are other certification schemes available which qualify individuals as professional accountants, they are not recognized by the MoF. The chief accountants employed in financial institutions regulated by the CBA are required to be examined and licensed by the Central Bank.

29. **In order to become certified by the MoF, individuals must have an acceptable level of education and professional experience<sup>25</sup> and pass the MoF’s certification examination.** The topics which are covered on the professional accountant examination are chosen by the Ministry of Finance and include ASRA, the laws on accounting standards, Armenia’s chart of accounts, taxation and all other mandatory contributions, and financial analysis. The questions for the examination are written by different divisions in the MoF with support from the private sector (accounting and auditing firms, practitioners, etc.). During 2006-2008 approximately 222 individuals attempted the examination for the accounting certificate and the average pass rate was about 38% (approximately 85 individuals) and 199 individuals attempted the examination for the auditor certificate respectively, and the pass rate was 26% (approximately 52 individuals).

30. **The MoF professional accountant certificate is valid for only five years. Following expiration, individuals are required to re-take and pass the entire certification examination in order to be re-certified by the MoF.** Under the new draft accounting law, re-examination and certification will be substituted by a requirement to obtain an appropriate number of hours of Continuing Professional Education (CPE) per year. The MoF intends to allow this CPE to be obtained from third party providers and plans to oversee rather than perform this function.

31. **In Armenia, there is one main professional organization for both accountants and auditors, The Association of Accountants and Auditors of Armenia (AAAA). The AAAA was established in 1997 and achieved associate membership of the International Federation of Accountants (IFAC) in 2005.** The AAAA’s membership includes 216 full members and approximately 500 associate members<sup>26</sup>. The association continues to receive significant support from the international community. With this support, the AAAA has constructed a high quality certification scheme based on that of, and assessed by, the Association of Chartered Certified Accountants (ACCA). This scheme creates three levels of certification based on the number of papers passed: certified bookkeeper (obtained after the passage of the first paper on the preparation of financial statements and the second paper on financial information for management), certified accountant (obtained after passing further papers on Armenian corporate and business law, Armenian business taxation, financial management and control, and financial reporting) and certified auditor (obtained after completion of the first six papers as well as the seventh paper in audit and internal review). Because over 90% of the AAAA papers are based on ACCA papers, obtaining the highest level of AAAA certification (certified auditor) provides individuals with exemptions from six of the ACCA’s fourteen assessment papers. At present, the AAAA has 336 individuals in its certification scheme. Once individuals pass the certification

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<sup>22</sup> As of March 2009.

<sup>23</sup> The ‘chief accountant’ is generally responsible for the preparation of the entity’s financial statements and for other financial reporting such as internal management accounting.

<sup>24</sup> Typically, ‘chief accountants’ hold the MoF professional accountant designation.

<sup>25</sup> Either university level education and at least 18 months of professional experience, or secondary level education and at least three years of professional experience.

<sup>26</sup> The 500 associate members are mostly students.



scheme and become full members of the AAAA, they are required to undertake at least 40 hours of Continuing Professional Education (CPE) annually.

32. **Although the AAAA has developed greatly over the past few years, maintains international links, has constructed a strong certification scheme, and is recognized as an associate member of IFAC, the organization faces two major challenges.** The first of these is the AAAA's lack of recognition and presence in the marketplace. The AAAA estimates there are several thousand potential members (i.e. professional accountants) in Armenia, of which, only a few hundred are members of their association. Few companies, universities and organizations are knowledgeable about the AAAA and its certification scheme. This may be partially attributed to the lack of recognition of the AAAA's certification by the Ministry of Finance and/or to the AAAA's difficulties in marketing the organization and the benefits of membership. This lack of recognition and presence restricts the organization's efforts to increase its number of members and hinders the AAAA's ability to raise funds and become a self-sustaining body. Secondly, the AAAA has significant corporate governance difficulties which must be resolved urgently if the organization is to progress. The AAAA's current charter has made the required periodic election of the organization's president and board of directors difficult, leading to a delay in elections for these positions and some internal conflict in the organization. As a result, the AAAA has had to hold a number of Emergency General Meetings over the last year in order to function. The resolution of the governance issues will allow the AAAA to address the recognition issue in conjunction with the MoF and other stakeholders in the profession.

33. **The number of Armenians who have acquired internationally recognized English-language accountancy qualifications such as the ACCA or American Certified Professional Accountant (CPA) designations is low.** Most of those who have obtained these qualifications are concentrated in the larger auditing firms and international organizations. In addition, Armenian law only requires the MoF certification for a small number of professional accountants. As a result, only small numbers of accountants hold professional qualifications, either from the MoF, the AAAA, the ACCA or other organizations. Many accountants have received little or no formal training in modern, internationally recognized accounting techniques and financial reporting (other than limited exposure at university or college). In addition, many accountants focus on accounting for taxation purposes only and downplay accounting for financial reporting purposes. This is largely due to the requirement for companies to file financial information for tax purposes and the lack of such a filing requirement for financial reporting purposes. As a result, while Armenia has adopted ASRA based on IFRS<sup>27</sup>, many preparers struggle to understand and implement their requirements. Principles-based accounting standards such as ASRA and IFRS require interpretation and accounting estimates and are very different from the previous strictly regulated rules-based requirements. The capacity of preparers of financial statements, and with it the quality of financial reporting, depends on improving the ability of all Armenian accountants to understand and apply the principles and concepts put forward in ASRA and IFRS.<sup>28</sup> Enhancing the level of understanding of contemporary accounting concepts by preparers of financial statements must be an area of focus as the MoF prepares to adopt IFRS in place of ASRA.

## *B.2. The Audit Profession*

34. **Although there are a number of certification schemes available in Armenia which certify the skills of professional auditors (ACCA, AAAA, etc.), the only accredited certification scheme which can lead to licensure and practice as a professional auditor in Armenia is the MoF's own certification scheme.** As of 2006, the MoF had both certified and

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<sup>27</sup> ASRA is based on IFRS as of 2001.

<sup>28</sup> It is important to note, that, in general, the situation is somewhat better in the financial sector, when compared to the other parts of economy.

licensed 155<sup>29</sup> professional auditors. In order to be certified by the MoF as a professional auditor, individuals must have obtained either a university level education in economics and at least three years of professional experience in the last five years, or must have obtained a university level education in a course of study other than economics and have obtained at least five years of professional experience in the last seven years. In addition, all individuals must pass the MoF's certification examination to be certified to practice in Armenia.

35. **The MoF professional auditor certification examination is created by an examination committee which is specified by law to contain four representatives from the MoF, two representatives from the Central Bank as well as representatives from NGOs and universities.** The examination consists of one hundred multiple choice questions and six longer written questions and covers such subjects as taxation, accounting, economic law and auditing. Of the 95 students who sat for the examination in 2006, 28 (30%) passed.

36. **From 2001-2006, the MoF did not offer its professional auditors certification examination and as a result the number of licensed professional auditors in the country did not increase.** The MoF believes the level of interest seen for its examination offered in 2006 will grow and expects to see more auditors attaining their professional certification in the coming years. In addition, in the next few years, Armenia is expecting the introduction of new auditing firms into its market, including international network firms. This is likely to increase the interest in certification and increase the number of certified, licensed auditors in the country. However, certain aspects of the administration of the certification regime should be improved to ensure full transparency with respect to the examination system, and prevent risks of rent-seeking and allegations of corruption, which could undermine confidence in the integrity of the process.

37. **Until recently, MoF professional auditor certification was only valid for five years.** Upon expiration of their certification, professional auditors (like professional accountants) were required to re-take certification examinations in order to be re-certified. The new draft audit law will do away with this requirement and will substitute re-certification with a requirement to complete a minimum number of CPE hours each year.

38. **As noted above there is one main professional association which represents both the accounting and the audit profession, the AAAA.** Individuals who meet the educational and professional experience requirements and pass all seven papers of the association's examination are eligible for certification by and membership in the AAAA. AAAA requires that its members follow SARA<sup>30</sup> when performing audits and disclose any departures from these standards in the audit report.

39. **There is a perception that the quality of an audit varies greatly across the range of auditors and audit firms in Armenia.** While the local member firms of international networks have the benefit of firm-wide internal quality control procedures, many local firms have to rely solely on their own, limited resources and experience. As a result, there is a perception that only a very few local audit firms are capable of performing high quality audits and that, outside these few firms, audit quality is very low, even to the extent that no effective assurance is given. Large differences in the technical proficiency, level of experience and level of resources across audit firms contribute to the significant variations in audit quality.

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<sup>29</sup> As of March 2009 there are 153 certified accountants and 75 certified auditors in Armenia.

<sup>30</sup> "Standards on Auditing for the Republic of Armenia", which are translations of International Standards on Auditing (ISA). However, as with accounting standards, time lags in the translation of ISA and their adoption as SARA lead to a gap in the standards between the latest set of ISA issued by the IAASB and the standards in use by auditors in Armenia.

### C. Professional Education and Training

40. **Professional education and training in accounting and auditing in Armenia is needed by all participants in the corporate financial reporting process.** Different levels and types of competence are required by different participants; preparers of financial statements need a good working knowledge of the standards to which they must prepare financial statements, which are currently ASRA and IFRS. Bookkeepers need knowledge of only the basics of the accounting system they use; auditors need a higher level of knowledge to cover auditing standards and techniques in addition to accounting standards; regulators need specific knowledge of the law and regulations relating to financial reporting in their field; and taxation officers need to know both the taxation regulations and the interaction between these regulations and the accounting principles used to prepare financial statements. Education and training in accountancy are delivered through three channels – the university education system, professional certification by the Ministry of Finance (MoF) and/or the AAAA, and professional development courses organized by professional organizations.

41. **Accountancy and audit education is typically offered at universities, colleges and business schools in Armenia as part of a degree in accounting, economics, management or business administration.** Overall, universities do not appear to have any difficulties recruiting students for these degree programs and typically require students to complete a number of accounting courses to attain these degrees. Such courses' curricula generally include teaching ASRA and may also cover to a lesser extent the differences between ASRA (which is based on IFRS from 2001) and the IFRS of today. The accounting courses' syllabi include subjects such as financial and managerial accounting, taxation, and financial analysis.

42. **Universities also lack an adequate supply of teaching and reference materials in the Armenian language.** Many of the books and texts, especially those which discuss current topics in accounting and auditing, are only available in the English language. This hinders the transfer of accounting and auditing knowledge from professors to students.

43. **Several years ago a program to 're-train the trainers' was implemented in Armenia and was seen as very successful and helpful in refreshing the knowledge of university professors.** However, professors noted that the main drawback to this program was the lack of sustainability and also noted the need for a systematic process for keeping the knowledge of university professors current. As professors often provide the only training or education accountants obtain before entering the workplace, such a systematic program of retraining should not only focus on updating the skills of professors for today's accounting and auditing environment, but also focus on creating lasting relationships with European and North American universities to ensure a sustainable system for updating the knowledge of Armenian professors (i.e. through conferences, international exchange programs, etc.) for the accounting and auditing environment of tomorrow. As this issue is faced by universities throughout the region, Armenia could consider working with universities in nearby countries to create a sustainable regional program to 're-train the trainers'.

44. **As noted above in the Accounting and Auditing Profession sections (II.B.1 and II.B.2), currently only the AAAA requires that its members complete continuous professional development (CPD).** AAAA members mostly achieve their required 40 hours of CPD per year by attending AAAA events which feature speakers and discussions on emerging issues in accounting and auditing. The topics covered during these meetings include, among others, such areas as taxation, cost accounting, financial management issues, and the AAAA Code of Ethics. As noted before, in the coming years, the Ministry of Finance (MoF) will require certified accountants and auditors to obtain a minimum amount of CPD. The MoF intends for this CPD to be provided by third parties with oversight by the MoF.

45. **Currently, both the MoF and the AAAA maintain certification schemes.** Although both schemes test an individual’s knowledge of a wide variety of topics and issues relating to accounting and auditing, the AAAA’s qualification scheme has been assessed by the ACCA. As such, if it is successfully completed, an individual can be exempted from 6 of the 14 papers required for ACCA certification (an internationally recognized accounting and auditing certification). The AAAA’s certification creates an incentive for AAAA-certified professionals to continue their professional development by attaining ACCA certification. To reduce the current duplication of effort and to allow appropriate specialisation of skills, the MoF should consider delegating to the AAAA responsibility for professional accountant and auditor certification in Armenia. This delegation to a professional organization should be conditional on the organization meeting criteria set out by the MoF, and being subject to robust public oversight, for example by the proposed new ‘Chamber of Auditors and Accountants’. If such delegation occurs, the MoF may wish to retain responsibility for issuing the audit licenses and overseeing the AAAA’s certification scheme.

#### **D. Setting Accounting and Auditing Standards**

46. **The accounting standard-setting process for current general purpose financial reporting requirements involved the development of Accounting Standards for the Republic of Armenia (ASRA) based on IAS 2001.** Under the Law on Accounting, the Ministry of Finance (MoF) is empowered to set accounting standards and other accounting related regulations. The Audit and Accounting Methodology Department of the MoF began the translation and adoption of IAS in Armenia in 1997. In 1999 the MoF, with USAID assistance, translated IAS into Armenian and adopted the translated IAS, with minor modifications, as the first 15 ASRA standards. In 2001, the remaining IAS were translated into Armenian and adopted as ASRA. Current ASRA slightly differs from the IAS 2001. The major variances are as follows:

- Elimination of the indirect method in IAS 7 “Cash Flow”;
- The formats of the balance sheet, income statement, statement of changes in equity and cash flow are defined by the authorized body, i.e. the MoF, and are compulsory for all entities;
- There is some clarification of text, especially of terms and definitions, mostly with the purpose to make it more understandable for Armenian users

No changes have been made to ASRA since 2001. As a result, significant differences now exist between current IFRS and ASRA. Further analysis of these differences is given below in the section entitled “Accounting Standards as Designed and as Practiced”.

47. **In 2001, the MoF supplemented ASRA by creating methodological guidance and a chart of accounts to help Armenian entities apply ASRA more consistently<sup>31</sup>.** ASRA compliance is still very low, especially by small and medium entities, even with the MoF’s issuance of methodological guidance. Therefore, more educational efforts, seminars, training and updated guidance materials are needed to enhance the business environment’s understanding of, and compliance with, ASRA. Currently, the MoF does not have enough resources to implement these actions and should consider delegating this function to a professional body recognized by the MoF.

48. **Currently, the MoF has plans to make the application of IFRS compulsory for all companies in Armenia.** A majority of banks, several insurance companies and some large corporate entities already apply IFRS on a voluntary basis, providing existing and potential foreign users of financial information with IFRS financial statements. The MoF realizes that ASRA is outdated and is not in line with current IFRS. To remedy this, the MoF has decided to

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<sup>31</sup> Please see the Statutory Framework section of this report for further discussion of this topic.

replace ASRA with IFRS as Armenia's official basis for financial reporting. The MoF is currently considering a proposal from USAID to fund an updating of the IFRS translation, provided that arrangements are put in place to ensure the sustainability of the mechanism for ongoing translations in the longer term, given the frequency with which existing IFRS are amended and new IFRS issued. The translation is intended to be performed in accordance with the requirements of the International Accounting Standards Committee Foundation (IASCF). The administrative and financial burdens associated with this are considerable, and decisions as to committing the resources required should have regard to other reform priorities. In particular, given the number and importance on enterprises other than public interest entities in Armenia, consideration should be given to the priority to be given to enhancing the financial reporting regime applicable to these smaller entities. The draft Law on Accounting envisages that the IFRS translation process would be implemented by the "Chamber of Accountants and Auditors," but a more clearly defined strategy should be established before this takes place.

**49. Banks are required to follow accounting procedures laid down by the Central Bank of Armenia (CBA) in agreement with the MoF, and in accordance with ASRA.** While the CBA requires general purpose financial statements to be prepared in accordance with ASRA, it has issued a number of regulations and instructions that differ from or contradict ASRA requirements, in areas such as loan loss provisioning, the definition of related parties, and loss provisioning for investments in securities. Details of these discrepancies are discussed in Section III of this report.

**50. Annual and quarterly financial statements to be submitted to the CBA are required to be prepared according to the forms and procedures established by the CBA.** According to the Banking Law, the CBA shall establish these forms and procedures taking into consideration existing international standards (i.e. IFRS). The CBA issued approximately 40<sup>32</sup> (annual, quarterly, monthly and weekly) forms to be completed by commercial banks and filed with the CBA. However, current CBA-prescribed formats of financial statements to some extent contradict ASRA. A number of banks try to work around these contradictions by issuing combined financial statements prepared partially according to ASRA and partially according to the prudential requirements of CBA. Auditors generally report on the financial statements prepared in accordance with CBA regulations rather than ASRA.

**51. There are specific accounting regulations for insurance companies that are required to apply ASRA in their general purpose financial statements.** Insurance companies have used a tailored chart of accounts since January 1, 2007. With effect from October 2007, insurance companies are required to submit up to 20 forms to the CBA for prudential reporting purposes as well as standard forms of financial statements to be prepared based on the rules approved by the CBA.

**52. The CBA has the right to set financial reporting requirements for companies that come under its jurisdiction.** However, according to the law, these requirements should not contradict ASRA. The CBA has established special standard forms for financial statements of banks, credit organizations, and insurance companies. Such forms for investment firms are being developed and are expected to enter into force from January 1, 2009. Financial statements are required to be prepared in accordance with ASRA<sup>33</sup>.

**53. According to the Law on Audit, all statutory audits in Armenia should be conducted in accordance with International Standards on Auditing (ISA).** These are translated and adopted for use as "Standards on Auditing for the Republic of Armenia" (SARA). However, as with accounting standards, time lags in the translation of ISA and their adoption as

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<sup>32</sup> In total up to 400 forms are submitted by commercial banks to the CBA within a year.

<sup>33</sup> According to the draft accounting law, IFRS will be compulsory for banks since January 1, 2009, and for other financial institutions since January 1, 2010.

SARA lead to a gap in the standards between the latest set of ISA issued by the IAASB and the standards in use by auditors in Armenia.

## E. Enforcing Accounting and Auditing Standards

### E.1 Enforcing Accounting (Financial Reporting) Standards

54. **On January 1, 2006 the supervision and regulation of the insurance sector and the securities market were taken over by the Central Bank of Armenia (CBA), which was previously responsible for the banking sector only.** The stated aim of this reform was to introduce an independent and efficient consolidated supervision and regulation system to ensure a stable and well functioning financial system and to protect the rights of consumers. The major reasons for merging the three regulatory functions under the CBA were:

- To enable the steady development of financial holdings, different business lines of which were regulated by various regulators with minimal or no cooperation/coordination.
- To eliminate gaps in regulation, when separate regulating bodies would introduce legislative acts that disregarded norms and regulations of other financial market sectors.
- To improve the quality of operation, funding and independence of the regulators. Consolidating regulatory authority in the CBA was considered the best solution to improve the overall system.

The CBA has the authority to enforce accounting standards<sup>34</sup> pertaining to commercial banks, insurance companies, investment firms, the Central Depository, the Armenian Stock Exchange and companies admitted to trading and listed on the Armenian Stock Exchange (ARMEX). It has the right to evaluate and review financial results, and to check the accuracy of data in submitted statements and information. No direct reference is made to reviewing full sets of general purpose financial statements.

55. **The CBA Financial Supervision Department's main priority is the enforcement of prudential reporting rather than general purpose financial reporting.** Banks are required to submit up to 40 forms of audited<sup>35</sup> daily, weekly, monthly, quarterly and annual prudential reports. The accuracy of off-site reporting is verified through on-site examinations<sup>36</sup>. During such inspections, CBA staff mainly test whether banks comply with the CBA prudential norms and regulations. In addition, special attention is paid to whether or not banks follow CBA regulations on "Minimum Requirements for Internal Control" and risk management. Supervisors also review auditors' management letters to banks, to learn about noted shortcomings and to review whether auditors' findings and recommendations (mainly regarding internal controls, and accounting policies and practices) are properly addressed by banks. Although this is important for effective oversight, it should be noted that in most cases the audit report is issued on financial statements which are prepared in accordance with CBA requirements and not ASRA. Therefore the audit report does not provide assurance with respect to compliance with ASRA. In giving greater priority to prudential reporting, less attention is placed on the general purpose financial statements which play an important role in facilitating the exercise of market discipline by

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<sup>34</sup> The CBA also defines selection criteria for auditors of financial statements of banks, but it does not enforce the application of auditing standards.

<sup>35</sup> Required by the Law on Banks (article 58.2). In total up to 400 reports are submitted by commercial banks to the CBA within a year.

<sup>36</sup> The CBA exercises risk-based supervision. The number of examinations in a bank is determined by the risk profile of the bank.

market participants (as foreseen under the third pillar of Basel II), which itself can be a powerful complement to supervisory oversight.

56. **Auditors are obliged to report any significant deterioration of a bank's financial condition or significant internal control deficiencies directly to the CBA.** The CBA is permitted by law to request the auditor to provide any documents related to the audit, including working papers, to the CBA, even if this information is otherwise confidential. In practice, working papers are not usually reviewed by CBA supervisors and meetings are rarely conducted with auditors to discuss audit findings. However, the CBA is currently working on improvements of this area.

57. **The CBA may impose sanctions against banks for non-compliance with the CBA's instructions for prudential reporting and for breaching accounting rules and rules regulating the submission of accurate financial information.** The Banking Law<sup>37</sup> stipulates that, in instances where a bank breaches any prudential standard or submits reports in an untimely manner to the CBA, the amount of the fine should not exceed 5% of the minimum statutory fund. In other cases such as non-compliance with regulations concerning accounting records and the accuracy of presented financial information, a bank can be penalized up to 1% of the minimum statutory fund. The relationship between sanctions for late reporting and those for misleading reporting suggests a disproportionate emphasis on matters of form rather than substance. The CBA also has the power to suspend or revoke a bank's license, although no such cases have occurred during the past 3 years. The CBA actively exercises its right to impose sanctions when prudential standards and other internal instructions are violated. Sanction procedures are standardized, transparent and well disclosed to the banks. However, as mentioned earlier, the fact that the significant enforcement powers of the CBA are not brought to bear with regard to the general purpose financial statements of banks implies an undervaluing of the role of financial reporting in facilitating market discipline.

58. **The Investors and Clients Rights Protection Division of the Financial Supervision Department of the CBA has the responsibility to monitor and enforce compliance with ASRA for listed companies.** Currently there are 14 such companies accountable to the CBA. These 14 companies are required to submit electronically quarterly and audited annual financial reports prepared according to ASRA. The CBA Statistical Department collects these reports and ensures arithmetical accuracy of the figures presented. Afterwards, the staff from the division agrees the figures in financial statements with those in the notes to financial statements, ensure compliance of the audit opinion with the financial statements, and review the reasons for significant variations in financial ratios and indicators throughout the periods. The division employs five staff members who are financially literate economists (i.e., familiar with accounting and financial reporting requirements). The department does not segregate duties; each supervisor reviews the entire set of reports provided, including financial statements. Supervisors exercise off-site and on-site supervision in compliance with the manuals (off-site and on-site) and their respective checklists are approved by the Central Bank. During the last year, three on-site inspections were conducted where accounting records of the inspected companies have been reviewed.

59. **The CBA frequently utilizes its right to impose sanctions on listed companies; during the past year each of the 14 companies listed on the securities market was penalized at least once for different types of violations.** The main violation was late filing. Although the CBA has achieved timely submission of reports and compliance with some other regulations, the quality of the financial statements is still low and compliance with ASRA is questionable. The majority of listed companies still submit tax reports rather than full ASRA financial statements. The CBA should make it a priority to work to enforce listed companies' compliance with ASRA and to ensure the disclosure of high quality ASRA compliant financial statements to the public.

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<sup>37</sup> Banking Law Article 60

60. **There are no enforcement mechanisms to ensure compliance with ASRA by Armenian companies which are not under the supervision of the CBA.** In total, only 14 listed companies, in addition to 18 non-listed banks and 15 non-listed insurance companies and insurance brokers are supervised by the CBA in addition to other participants of the securities market<sup>38</sup>. For the remainder of Armenian companies, there exist no mechanisms to enforce compliance with ASRA.

61. **Although considerable achievements have been made through the merger of Armenian's supervisory functions under the CBA, further improvements are needed.** In order to ensure more efficient monitoring and enforcement of financial reporting by regulated companies, using ASRA or IFRS (when adopted as national standards), the CBA should continue to build its expertise and capacity.

## *E.2 Enforcing Auditing Standards*

62. **Currently, responsibility for enforcing compliance by licensed auditors with auditing standards lies with the MoF.** The Division of Control and Licensing at the Ministry carries out annual quality control inspections of all licensed auditors and audit firms. All licensed auditors are required to submit quarterly and annual reports to the Ministry confirming that they are still in compliance with all licensing requirements and, in the annual report, give details of the number of audits performed and a breakdown of their fee income. The reviews take the form of on-site inspections carried out by MoF staff, which focus on compliance with its code of ethics, licensing requirements, and audit standards (SARA), but it is understood that there are no substantive technical reviews of actual audit engagements performed. There is no requirement that the staff carrying out these inspections be qualified auditors or have direct audit experience or expertise.

63. **In addition, the AAAA performs some limited quality control of its members, including those that are licensed auditors.** As a member body of IFAC, the AAAA must comply where possible with the Statements of Membership Obligations (SMO) of IFAC for its member bodies. One of the SMOs relates to quality control and sets out the objectives and procedures which the AAAA is expected to comply with when performing quality control of the activities of its members. The AAAA's quality control is based on their members' compliance with the AAAA Code of Ethics and the AAAA Internal Procedures Manual which includes a summary of all key AAAA, IFAC and IASB requirements and also includes all necessary checklists and control schedules to assist with compliance.

64. **Due to a lack of resources and, in particular, a lack of specialist expertise at the Ministry, the current regime of enforcing compliance with auditing standards through audit quality inspections is not effective.** The goal of audit quality control should be improving the quality of audit and raising standards; its primary goal is not to punish or persecute auditors, rather to identify quality and training gaps and require that auditors address such gaps through appropriate training and methodological improvements. Thus for such a regime to be effective, the inspections must be carried out by those with specialist expertise and extensive experience of audit in practice. It is unlikely that such expertise can be afforded within the salary restrictions of state budget funded agencies.

65. **This difficulty is resolved in many countries, including many European countries, by formal delegation of the practical function of the audit quality control by the Government to professional organizations, subject to proper oversight.** Such professional organizations can have access to the necessary expertise and resources to carry out effective

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<sup>38</sup> Such as brokers and dealers.



quality control and inspections (either through peer inspections or through a dedicated inspection team). However, the Government usually retains the licensing function; the professional organizations report to the licensing authority which includes the outcomes of quality control inspections in its re-licensing procedure, or can decide to revoke or suspend licenses conditional on necessary improvements in audit quality. In addition, the Government retains oversight of the professional organization's exercising of the delegated authority. Such an arrangement would appear to be appropriate in Armenia, where the practical function of audit quality control could be delegated to the AAAA, which might report the outcomes of inspections to the proposed Chamber of Accountants and Auditors for consideration regarding licensing.

### III. ACCOUNTING STANDARDS AS DESIGNED AND AS PRACTICED

66. The purpose of this section is to analyze the significant differences between Armenian National Accounting Standards (ASRA) and IFRS (the 'standards gap') and the level of compliance of statutory financial statements with ASRA (the 'compliance gap') to identify any systemic non-compliance issues; the potential adverse impact on the reliability of financial statements of both gaps is also analyzed.

67. **ASRA were adopted in 2001 and are based on a slightly amended version of IAS as of 2001.** However, ASRA has not been updated since whereas IAS (now IFRS) has changed significantly since 2001. Among the major changes, which comprise the major standards gap between ASRA and IFRS, are:

- ASRA does not have any specific rules for share based payments.
- ASRA does not provide for separate treatment of discontinued activities.
- ASRA does not include an updated treatment for distinguishing equity from liabilities.
- ASRA contains outdated disclosure requirements on Financial Instruments.
- Under IFRS, certain criteria apply to insurance contracts. Such requirements do not exist in ASRA.
- Certain developments in IAS 39 (e.g. fair value option, financial guarantees etc) are not covered in ASRA.
- For items of inventories that are interchangeable, the FIFO or weighted average cost formulas are allowed. The LIFO formula, following the 2003 revision of IAS 2, is no longer permitted under IFRS but is still allowed under ASRA.
- Under IFRS, the cash flow statement can be prepared by using either the direct or indirect methods. Under ASRA, the indirect method is not allowed.

The impact of the above differences on the usefulness of financial statements prepared according to ASRA as compared to IFRS may in some cases be significant. The existence of the differences introduces a lack of comparability between ASRA and IFRS financial statements and restricts the usefulness of ASRA financial statements to users not familiar with those standards. However, in many cases the compliance gap noted below has a much greater impact on the reliability and usefulness of ASRA financial statements than the standards gap noted above.

68. **Another source of a 'standards gap' occurs when regulators set accounting regulations for the entities they regulate which differ from or contradict the requirements of accounting standards.** In Armenia, banks are required to implement accounting under the procedures of the Central Bank of Armenia (CBA) which are agreed with the MoF, in accordance with ASRA. While the CBA requires general purpose financial statements to be prepared in accordance with ASRA, it has issued a number of regulations and instructions that differ from or contradict ASRA requirements; such as their requirements for loan-loss

provisioning. These differences cause confusion as firms question whether their reporting should be in line with ASRA or prudential reporting requirements.

**The ROSC assessed the compliance gap, sampling:**

- 4 sets of audited financial statements which purport to be prepared in accordance with ASRA. For the sample review, 2 insurance companies and 2 banks were selected. All sets of financial statements in the sample were audited by local member firms of international audit firm networks. No qualified opinions issued.
- 4 sets of audited financial statements which purport to be prepared in accordance with IFRS. For the sample review, the ROSC team reviewed two banks, one industrial company and a chamber of commerce. All the financial statements in the sample were audited by local member firms of international audit firm networks. Three of the audit reports were unqualified and one was qualified.

The ROSC team attempted to obtain 15 sets of ASRA financial statements; however, only four full sets of financial statements were available.

*ASRA compliance*

69. **Companies are required to submit annual financial information to the State Statistics Committee; although in reality they submit just some major financial figures and ratios and not full financial statements.** Apart from the limited review of financial statements by the CBA described above in Section II.E, covering banks, insurance companies and listed companies, there appears to be little use made of financial statements beyond the company, its management and owners. For example, little or no use of financial statements is made by banks as a basis for loan decisions; collateral-backed lending is prevalent. However, there is evidence of increasing demand for, and usage of, financial statements in lending decisions<sup>17</sup>. Areas of non-compliance noted in the review of the four sets of ASRA financial statements include:

- Non-disclosure of accounting policy for tax, financial instruments, insurance contracts, revenue, impairment, provisions.
- Non-disclosure of risk or risk management policies for financial instruments or for insurance.
- Non-disclosure of deferred taxation;
- Incorrect reconciliation of tax charges;
- Confusion of profit after tax with accounting profit;
- Property, plant and equipment stated, under the disclosed accounting policies, to be held at cost where in fact there was a significant revaluation reserve. No information was provided on the basis of valuation.

70. **Confusion between the bases of key accounting items in general purpose financial statements prepared according to ASRA and accounting items calculated as part of the calculation of corporate taxation, together with the lack of understandability of ASRA, is probably the major factor in non-compliance with ASRA.** Where the rules and standards for taxation purposes are different to those in ASRA, many preparers use the taxation rules. This leads to significant non-compliance in any area relating to accounting estimates (as taxation calculations do not generally allow estimates), valuation of assets and liabilities (taxation often requires a formulaic approach and the recognition of liabilities only if supported by paper-based evidence), and inaccurate use of accruals.

## *IFRS compliance*

71. **IFRS financial statements are prepared by companies on a voluntary basis, mainly by banks, insurance companies, and companies accessing foreign capital.** It was noted that generally, banks prepare IFRS financial statements with limited assistance from audit firms, while other companies still prepare their financial statements with major assistance from audit firms.

Areas of noted non-compliance in the IFRS financial statements include:

- Non-disclosure of deferred taxation;
- Disclosures in respect to revaluation of property, plant and equipment were generally incomplete;
- In general, a failure to disclose significant judgments and estimates;
- Failure to disclose the effects of fundamental error correction.

72. **In general, companies that prepare IFRS financial statements, including banks and insurance companies, conduct quite simple operations, thus preparing relatively simple accounts that do not involve the application of some of the more disclosure-intensive IFRS standards.** For example, none of the companies appeared to have defined benefit pension schemes, share option or discontinued operations, so IAS 19, IFRS2, and IFRS 5 (respectively) were not relevant. Most of the companies appeared to list only one class of business and geographical segment so IAS 14 was not relevant. Even financial instruments disclosures were limited as most companies did not appear to use derivatives.

## **IV. AUDITING STANDARDS AS DESIGNED AND AS PRACTICED**

### *The auditing standards gap*

73. **In principle there is no auditing standards gap in Armenia, as International Standards on Auditing (ISA) are adopted for use by auditors as “Standards on Auditing for the Republic of Armenia” (SARA).** However, as with accounting standards, time lags in the translation of ISA and their adoption as SARA lead to a gap in the standards between the latest set of ISA issued by the IAASB and the standards in use by auditors in Armenia.

74. **Given the significant challenges faced by auditors in Armenia in applying the auditing standards, it is unlikely that the differences in standards between ISA and SARA are the major cause of difficulties in complying with auditing standards and performing a high quality audit.** However, the IAASB, which sets and publishes ISA, is currently undertaking a ‘Clarity Project’ which will result in significant changes to many ISA upon completion of the project in the relatively near future. Once these revised standards are issued, the standards gap to SARA will become significant and must be addressed.

### *The auditing standards compliance gap*

75. **Of the sample of eight financial statements reviewed (see details above), seven were audited by local member firms of the ‘Big four’ international audit firm networks and the eighth was audited by the local member firm of another international network.** Only one audit report was qualified; this was due to the company in question not disclosing the fair value of land it had received as a grant from the Government, due to the valuation exercise not being completed. There were no significant deficiencies noted in the audit reports in the sample of financial statements.

76. **From discussions with auditors from a variety of audit firms in Armenia, it is clear that the level of compliance with ISA varies greatly across audit firms and that it is to some degree determined by the level of resources, experience and training of audit staff and the audit methodology used by audit firms.** Application of the ISA standards requires an auditor to make an assessment of risk and internal controls, leading to an audit strategy and plan that encompass systems, transactions and balance testing which will enable the auditor to gain sufficient and appropriate audit evidence to enable him to express an opinion on the financial statements. From these discussions, it is clear that member firms of international audit networks often have better-trained staff and access to audit methodologies which are designed by the networks to comply with ISA and updated regularly. However, small audit firms or individual auditors struggle to keep up-to-date with changes to ISA and may have no access to a formal audit methodology which has been designed to comply with ISA. The larger national audit firms are placed between the two extremes.

## V. PERCEPTION OF THE QUALITY OF FINANCIAL REPORTING

77. **In general, commercial banks do not rely on the financial statements presented by potential borrowers in determining whether to grant loans.** There is a perception among the banks that the financial statements of companies in Armenia are of a low quality and do not represent a sufficient basis for assessing the financial position of a potential borrower. Although entities are often required to submit their financial statements as part of the loan application process, banks base their lending decisions on other factors including the amount of collateral, business forecasts and site visits. The financial statements of companies prepared in accordance with ASRA are seen by banks as indications merely of their tax compliance.

78. **The perception of audits performed by sole practitioners is low.** The perception of the market is that financial statements which are audited by small audit firms or individual auditors often do not comply with the quality standards necessary to place reliance on the financial information contained therein.

## VI. POLICY RECOMMENDATIONS

79. **The principal objective of this ROSC assessment is to assist the authorities and other stakeholders in strengthening the financial and non-financial sectors' accounting, financial reporting and auditing practices, as a means to support certain relevant strategic objectives for Armenia, including:**

- Enhancing the business climate and bolstering domestic and foreign direct and portfolio investment in the private sector;
- Assisting the integration of Armenia into the European and global economies;
- Strengthening the stability and competitiveness of the banking and non-banking financial sectors; and mitigating the risk of crises due to loan collection problems and weak capital base;
- Encouraging greater transparency in both State and privately-owned enterprises, thus allowing shareholders and the public at large to assess management performance and influence its behavior;
- Aligning the normative and legal framework in the area of financial reporting, accounting and auditing with the best international practices;
- Facilitating SME access to credit by encouraging a shift from collateral-based lending decisions to lending decisions based on the financial performance of the prospective borrower, thereby supporting growth in the SME sector; and

- Helping to ensure that the financial reporting and auditing rules applicable to different types and sizes of entity are appropriate to the needs of those entities and the users of their financial statements.

Without attempting to provide a detailed tactical design for reforms, this report sketches the policy recommendations to support the implementation of accounting reform and ultimately enhance the quality of corporate financial reporting.

80. **The recommendations of this ROSC are interrelated and mutually supportive, designed to collectively improve the financial reporting environment in Armenia.** For example, good accounting standards are jeopardized if practitioners do not understand how to translate them into journal entries; a rigorous statutory and regulatory framework is unlikely to be effective if it is not enforced. Additionally, some recommendations will not have an immediate effect but still remain of high priority if the financial reporting environment in Armenia is to be upgraded to international standards within a reasonable timeframe.

81. **The policy recommendations outlined in this report are based on the assumption that long-term country objectives include thorough modernization of the accounting and auditing professions, and development of a business environment conducive to preparation of transparent financial information compliant with international standards.** As set forth in this report, achievement of these objectives requires continuous reorganization and improvement of Armenia's legal framework, institutions, accounting and auditing professions, as well as change in its business culture and education system. However, policies should not be developed and enacted without giving due regard to a country's ability to carry out such policies (both in terms of capacity and resources); a relatively lenient rule that is robustly and consistently enforced is preferable to a good, rigorous one that is unenforceable, as the lenient rule can be progressively made more rigorous as the circumstances allow. The policy recommendations below, while challenging, can be carried out in the short- to medium-term and are conducive to Armenia's long-term objectives. They fall into three key areas:

- Statutory framework
- Institutional and capacity building measures
- Professional education and training

82. **These recommendations require a holistic approach to implementation. Armenia should establish a multidisciplinary National Steering Committee (NSC) led by a senior official, ideally at Deputy Minister level, to champion and coordinate the accounting and auditing reforms.** The NSC should advise policymakers and regulators regarding the implementation of the recommendations. Based on the successful experience of other countries, this report recommends that the NSC develop a Country Strategy and a detailed Country Action Plan (CAP) which clearly sets out the key actions and allocates responsibilities for implementing the necessary reforms; the CAP should include a itemized budget indicating the resources necessary for successful implementation and the government, policymakers and development partners should work together to secure those resources so as to achieve the common goal of enhancing the quality and availability of financial information in Armenia.

#### A. **Statutory and Legal Framework**

83. **With regard to the statutory and legal framework for financial reporting and auditing, we recommend that:**

- A three-tier financial reporting requirement be implemented where Public Interest Entities (PIEs) are required to apply full IFRS (not ASRA as at present), Small and Medium-Sized Entities (SMEs) be required to apply IFRS for private entities (when it is available and given sufficient time for successful implementation) and micro-

entities be required to report solely for tax purposes. In addition, the definitions of PIEs and SMEs should be appropriate for the state of development of Armenia's economy. For all entities, the linkages between general-purpose financial reporting and reporting for regulatory purposes (including tax reporting) should be structured so as to restrict differences to those required to achieve valid public policy objectives, thereby minimizing additional reporting burdens and leveraging the enforcement powers of the relevant regulatory authorities to enhance the quality of financial information made publicly available to the market.

- The Accounting Standards for the Republic of Armenia (ASRA) be replaced by an up-to-date translation of IFRS and that a sustainable process for timely translation of future amendments to IFRS be established, bearing in mind the costs and benefits flowing from the use of full IFRS, and having regard to the relative importance of other reforms in the field of accounting and auditing.
- The Standards on Auditing for the Republic of Armenia (SARA) be replaced by an up-to-date translation of ISA and that a sustainable process for timely translation of future amendments to ISA be established.
- The deadline for transition by SMEs to the new requirements should be appropriate to the timeframe for the issuance and implementation of the IASB's standard on 'IFRS for private entities', which is currently in the exposure draft stage. Once the IASB issues the standard, SMEs should be given sufficient time (and training opportunities if possible, see below) to prepare for implementation.
- The statutory framework for financial reporting be revised to (i) ensure that the company registry which is currently being established also has the mandate and capacity whereby companies required to publish their financial statements should file such financial statements with the registry within a defined period and the registry makes them publicly available on a timely and comprehensive basis; and (ii) to replace the current 'control committee' with an 'audit committee' for companies where a statutory audit is required.
- The statutory framework for auditing be revised to support the efficient allocation of responsibilities for the regulation of audit between the Ministry of Finance, the proposed 'Chamber of Auditors and Accountants' acting as a public oversight body, and professional bodies of auditors.

## **B. Institutional and Capacity Building Measures**

### **84. With regard to institutional and capacity building measures to support corporate financial reporting, we recommend that:**

- The Ministry of Finance (MoF) delegate the performance of some of its regulatory functions with regard to accounting and auditing profession to one or more professional organizations. The MoF could then modify its role to that of oversight of the professions, also having regard to the opportunities provided by the establishment of the proposed 'Chamber of Auditors and Accountants'. Currently, there is a great deal of overlap in regard to the functions of the MoF and the AAAA; such delegation will allow for a more efficient allocation of resources. In addition, taking a more oversight-oriented role would help to bring the role of the MoF more in line with the new EU Eighth Directive, which specifically provides for public oversight of the profession.
- The Ministry of Finance set out clear and specific criteria and objectives which a professional organization must achieve in order to be recognized by the state as responsible for such functions.

- The delegation of functions could, and perhaps should, include the qualification of professional accountants and auditors and audit quality control.
- The Ministry of Finance work to enhance its programs of recruitment and training to ensure that employees have the skills necessary to carry out the responsibilities of their positions. The Ministry of Finance should pursue secondment and twinning programs for knowledge transfer and to build the skills and understanding to function effectively.
- The AAAA reach out to universities to encourage students to study accounting and auditing and to educate them regarding the professions and the AAAA itself. The AAAA should work with universities to allow exemptions from early stages of AAAA professional examinations. In addition, the AAAA should reach out to the corporate sector by making companies aware of the benefits that AAAA certified members can bring to their companies. By taking steps to increase its market recognition, the AAAA will help to develop the profession, increase its membership and become self-financing.

### **C. Professional Education and Training**

**85. With regard to measures to improve education and training in accounting and auditing at professional and other levels, we recommend that:**

- Actions be taken to reduce the quality gap between private and public university accounting and auditing education programs. Currently, the differences which exist in the background of lecturers, the number and type of accounting courses required and the differences in the market orientation of degree programs may leave public university students behind their private university counterparts, unable to meet the demands and needs of Armenia’s developing economy and evolving accounting and auditing environment.
- Public universities work to further develop their connections with the private sector, regulatory bodies and professional organizations. In order to further orient public university education toward the needs of the Armenian market, public universities should work to bring together lecturers and representatives from private sector groups (audit firms, companies, etc.), professional organizations such as the AAAA, and representatives from the Ministry of Finance and Central Bank and enhance the dialogue between these groups. This diverse group of advisors should assist the public universities in developing and further standardizing the topics and issues which public university professors of accounting and auditing should cover during their courses. In addition, this group of advisors should assist the public universities in determining the appropriate number and type of accounting and auditing courses students should be required to complete prior to receiving a degree.
- A sustainable program to ‘re-train the trainers’ be undertaken to help update educators’ skills and knowledge. The program should focus on updating the skills of professors for today’s accounting and auditing environment, and should also focus on creating lasting relationships with Western universities to ensure a sustainable system of updating the knowledge of Armenian professors (i.e. through conferences, international exchange programs, etc.). As this issue is faced by universities throughout the region, Armenia should consider working with universities in nearby countries to create a sustainable regional program to ‘re-train the trainers’.
- Armenian universities continue and increase their efforts to hire accounting faculty staff with relevant practical experience to teach courses in accounting and auditing. Professors with knowledge of the application of accounting and auditing in the

workplace can better prepare students for their roles as professional accountants and/or auditors. Universities should also try to encourage their accounting and auditing professors to take sabbaticals with company accounting departments, audit firms, and government bodies to refresh and enhance their knowledge of the practice of accounting and auditing.