

REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC) The Kyrgyz Republic

ACCOUNTING AND AUDITING

November 10, 2008

Contents

Executive Summary

- I. Introduction
- II. The Institutional Framework for Accounting and Auditing:
 - II.A. The statutory framework for financial reporting, accounting and auditing
 - II.B. The accounting and auditing professions
 - II.C. Professional education and training
 - II.D. Setting accounting and auditing standards
 - II.E. Enforcing accounting and auditing standards
- III. Accounting Standards as Designed and as Practiced
- IV. Auditing Standards as Designed and as Practiced
- V. Perceptions on the Quality of Financial Reporting
- VI. Policy Recommendations

Executive Summary

This report provides an assessment of accounting, financial reporting and auditing requirements and practices within the enterprise and financial sectors in the Kyrgyz Republic. The report uses International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA) as benchmarks and draws on international experience and good practices in the field of accounting and audit regulation to assess the quality of financial information and make policy recommendations.

Accounting and Audit Reform in the Kyrgyz Republic

The Kyrgyz Republic has made progress in updating its legal and statutory framework for corporate financial reporting. These achievements include the Law on Accounting (2002) which envisages IFRS as the basis for financial reporting for Kyrgyz companies, the Government decree “On International Financial Reporting Standards” (2001) which foresees the gradual implementation of IFRS, the Law on Auditing Activity (2002) which defines International Standards on Auditing (ISA) as the basis for statutory audits, the Government Decree “on International Standards on Auditing in Kyrgyz Republic” (2003) and recent amendments to the Law on Joint-Stock Companies (2003) and the Law on Banks and Bank Activity (1997). However, there is no process for official adoption and publication of IFRS as and when standards are amended and new standards issued, and an official translation of IFRS has never been adopted, so it is not clear which “version” of IFRS is applied by Kyrgyz entities. Further, delays inherent in the process for reflecting changes in ISA in the Kyrgyz regulatory framework (including those associated with translation from the original English) have as a consequence that the auditing standards in force, which are applied by the majority of audit firms, are ISA as of 2001, and no account has been taken of significant changes since then. Since compliance with IFRS and ISA can be asserted only on the basis of applying the full and current standards, it should be understood that Kyrgyz requirements are not, in fact, in full formal compliance with

This report was prepared on the basis of the findings from a diagnostic review carried out in the Kyrgyz Republic by a team from the World Bank in October 2007. The team was led by Jon Hooper and comprised Gabriella Kusz, Andrei Busuioc, and Jan Tyl (ECSPS). The review was conducted through a participatory process involving various stakeholders and led by the country authorities

IFRS and ISA.

Further significant reforms are needed. This report recommends that the Service for Regulation and Supervision of Financial Markets of the Kyrgyz Republic (SRSFM) intensifies work with Parliament, relevant regulatory institutions and other stakeholders to lead this reform process.

The main finding of this report is that enhancements in accounting and auditing legislation have often not been carried through to improvements in practice. Greater efforts need to be made to apply and enforce legal requirements properly. Compounding this challenge is the lack of compliance with existing public disclosure requirements and there is a need for greater public availability of financial information. Otherwise, even if accounting and auditing improves, users will not be able to access and make use of this information, reducing the overall benefits to society and the potential for private-sector-led economic growth. The Kyrgyz economy has achieved moderate growth (5.4% in 2004, -0.2% in 2005 and 2.7% in 2006¹); however, in order to enhance growth, promote further economic development, and decrease the cost of capital, additional reforms in accounting and auditing are required to produce financial information of high quality.

Recommendations to increase the effectiveness with which the legal requirements for corporate financial reporting are enforced and to increase the capacity of those involved in the financial reporting process are outlined in detail in Section VI of this report, and are summarized below.

Statutory Framework

It is recommended that the statutory and legal framework be amended to:

- Define, and distinguish between, public interest entities (PIEs), small and medium-sized enterprises (SMEs) and micro-entities for the purposes of tailoring proportionate financial reporting requirements appropriate to the needs of the market and the entities' own information needs.
- Expand the SRSFM's standard financial reporting forms to include provision for notes to the financial statements, since such footnote disclosures form an integral part of IFRS financial statements as defined in IAS 1, "Presentation of Financial Statements."
- Establish effective oversight of the audit profession and an audit quality assurance review program.

Public Availability of Financial Statements

Measures to improve the enforcement of corporate financial reporting requirements include:

- Require all regulated entities to submit full financial statements (which include all notes to the financial statements in compliance with IFRS) to their appropriate regulator. Each regulatory agency should publish these financial statements on their websites, thus implementing the current legal requirement that company financial statements be publicly available, at least for those entities.
- In the longer term, the Kyrgyz government should create a function of register² where the financial statements of all companies would be centrally filed and publicly available.
- The validity and, where applicable, renewal of audit licenses for both audit firms and individuals should be contingent upon evidence of compliance with applicable legal requirements (continuing professional development, indemnity insurance³, etc.)

¹ World Bank national accounts data

² Two options might be considered by the Government for the function of financial statements register: (i) within SRSFM; (ii) within National Statistics Committee where all companies currently submit statistical reports.

Institutional Capacity Building

All regulators and other institutions with responsibilities in the field of financial reporting face increasing challenges as the accounting and auditing environment of the Kyrgyz Republic develops and changes. There is currently no mechanism in place to enforce compliance with IFRS. This is exacerbated by the lack of the audit quality control function execution. There is a need for capacity building measures at all concerned institutions. In particular, the expanding roles of the SRSFM in the areas of audit quality control and IFRS enforcement will necessitate extra resources if they are to be carried out effectively. Accordingly, it is recommended that:

- The Division for Accounting and Financial Reporting Development, Division for Monitoring of IFRS Implementation and Division of Auditing Development within the SRSFM receive significant support, including from international peer institutions, to build its capacity in terms of the number, qualification levels and training of its staff.
- The professional organizations of accountants and auditors should receive similar support, increase their capacity to regulate their members effectively, subject to appropriate supervision and oversight by the SRSFM.

Section VI of this report outlines more detailed recommendations specific to each of the major regulators and other institutions.

Professional Education and Training

In parallel to improving the statutory framework and institutional capacity, there is a strong need to strengthen the capacity of the accounting and auditing professions and to improve university education programs. The proper understanding and application of international accounting and auditing standards and requirements requires a solid foundation of education and training for financial statement preparers, auditors, and regulators. It is essential to enhance the capacity of existing accountants and to ensure the capacity of future accountants. To accomplish this, the following actions are recommended:

- As the capacity of the current providers of education and training in accountancy is insufficient to meet the needs of the Kyrgyz economy effectively, programs to update the skills of university professors in contemporary accounting and auditing techniques should be created, to enable them to transfer this knowledge to their students.
- Syllabi for university education in some universities are out of date and do not cover IFRS and modern accounting techniques and principles. Support should be given to the Ministry of Education and SRSFM⁴, as well as voluntary inter-university committees and projects for development of state educational standards for higher professional education in accounting, analysis and audit, to create high quality and more uniform programs nation-wide.
- Emphasis should be placed on better integration of professional certification and licensing requirements and university programs.

³ Although Article 13 of the LOAA requires auditors to have professional indemnity insurance, this form of insurance is not readily available on market thereby making it impossible for auditors to comply with this requirement.

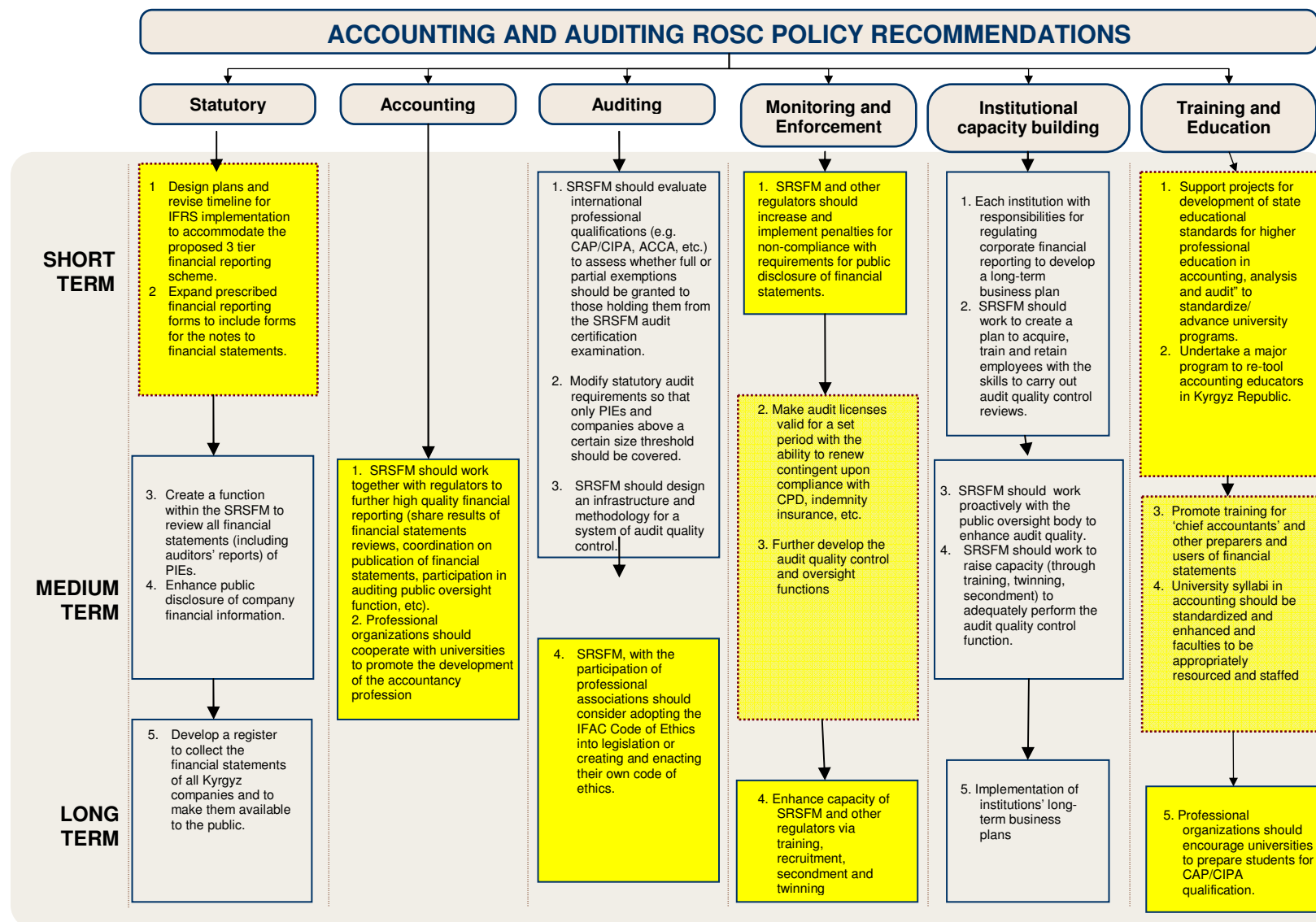
⁴ Ordinarily, the SRSFM is consulted before accounting and auditing syllabi are approved by the Ministry of Education

⁵ This working group should include as members representatives of state authorities (such as banking regulator, insurance regulator, financial market regulator), professional associations. The group may also have representatives of donors as observers.

From ROSC to Reform

The recommendations above 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 with sound political support. In addition, input from peer countries may present the Kyrgyz Republic with unique insights into how similar challenges have been addressed in similar countries.

The Kyrgyz Republic should establish a multidisciplinary (inter-departmental) Coordination Working Group (CWG)⁵ to coordinate the above accounting and auditing reforms. The CWG should advise policymakers and regulators regarding the implementation of the recommendations. Based on the successful experience of other countries, it is recommended that the CWG develop with assistance of local and international experts a detailed Country Action Plan which clearly sets out the key reform actions, prioritized by importance, and allocates responsibilities for their implementation. The plan should include a comprehensive budget indicating the resources necessary for successful implementation. Government, stakeholders 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 the Kyrgyz Republic.



SUMMARY OF POLICY RECOMMENDATIONS				
Action	Responsibility	Timing		
		Short-term (less than 1 year)	Medium-term (1 to 3 years)	Long-term (3 to 5 years)
Statutory / legislation				
1. Design plans and revise timeline for IFRS implementation to accommodate the proposed 3 tier financial reporting scheme.	SRSFM	X		
2. Expand prescribed financial reporting forms to include forms for the notes to financial statements.	SRSFM	X		
3. Create a function within the SRSFM to review all financial statements (including auditors’ reports) of PIEs.	SRSFM		X	
4. Enhance public disclosure of company financial information	SRSFM, NBKR		X	
5. Develop a function of register to collect the financial statements of all Kyrgyz companies and to make them available to the public.	SRSFM			X
Accounting				
1. SRSFM should work together with regulators to further high quality financial reporting (share results of financial statements reviews, coordination on publication of financial statements, participation in auditing public oversight function, etc).	SRSFM, NBKR		X	
2. Professional organizations should cooperate with universities to promote the development of the accountancy profession	Professional associations and universities		X	

Auditing				
1. SRSFM should evaluate international professional qualifications (e.g. CAP/CIPA, ACCA, etc.) to assess whether full or partial exemptions should be granted to those holding them from the SRSFM audit certification examination.	SRSFM	X		
2. Modify statutory audit requirements so that only PIEs and companies above a certain size threshold should be covered.	SRSFM	X		
3. SRSFM should design an infrastructure and methodology for a system of audit quality control.	SRSFM	X		
4. SRSFM, with the participation of professional associations should consider adopting the IFAC Code of Ethics into legislation or creating and enacting their own code of ethics.	SRSFM, professional associations		X	X
Monitoring and Enforcement				
1. SRSFM and other regulators should increase and implement penalties for non-compliance with requirements for public disclosure of financial statements.	SRSFM	X		X
2. Make audit licenses valid for a set period with the ability to renew contingent upon compliance with CPD, indemnity insurance, etc.	SRSFM		X	
3. Further develop the audit quality control and oversight functions	SRSFM		X	
4. Enhance capacity of SRSFM and other regulators via training, recruitment, secondment and twinning	SRSFM			X
Institutional capacity building				
1. Each institution with responsibilities for regulating corporate financial reporting to develop a long-term business plan	SRSFM and professional associations	X		
2. SRSFM should work to create a plan to acquire, train and retain employees with the skills to carry out audit quality control reviews.	SRSFM	X		

3. SRSFM should work proactively with the public oversight board to enhance audit quality.	SRSFM, Public oversight board		X	
4. SRSFM should work to raise capacity (through training, twinning, secondment) to adequately perform the audit quality control function.	SRSFM		X	
5. Implementation of institutions' long-term business plans	SRSFM and professional associations			X
Training and Education				
1. Support projects for development of state educational standards for higher professional education in accounting, analysis and audit to standardize/advance university programs.	SRSFM, professional associations, Ministry of Education, and universities	X		
2. Undertake a major program to re-tool accounting educators at tertiary level.	SRSFM, Ministry of Education and universities	X		
3. Promote training for 'chief accountants' and other preparers and users of financial statements	SRSFM, professional associations		X	
4. University syllabi in accounting should be standardized and enhanced and faculties to be appropriately resourced and staffed	SRSFM, Ministry of Education and universities		X	
5. Professional organizations should encourage universities to prepare students for CAP/CIPA qualification.	Professional associations and universities			X

MAIN ABBREVIATIONS AND ACRONYMS

ACCA	Association of Chartered Certified Accountants
BCBS	Basel Committee on Banking Supervision
CAP	Certified Accounting Practitioner
CIPA	Certified International Professional Accountant
CPA	Certified Public Accountant (USA)
CPD	Continuing Professional Development
COA	Chamber of Accountants and Auditors
CEO	Chief Executive Officer
EU	European Union
GDI	Gross Domestic Income
GDP	Gross Domestic Product
FIG	Financial Industrial Group
IAASB	International Auditing and Assurance Standards Board
IAESB	International Accounting Education Standards Board
IAIS	International Association of Insurance Supervisors
IAPS	International Auditing Practice Statements
IAS	International Accounting Standards (included in IFRS)
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IES	International Education Standard
IESBA	International Ethics Standards Board for Accountants
IFAC	International Federation of Accountants
IFRIC	International Financial Reporting Interpretations Committee
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
LOA	Law on Accounting
LOAA	Law on Auditing Activity
LLC	Limited liability company
MoF	Ministry of Finance
NAS	National Accounting Standards
NBFI	Non-Banking Financial Institution
NBKR	National Bank of the Kyrgyz Republic
NSPF	Non-State Pension Fund
OBA	Union of Accountants and Auditors
PIE	Public Interest Entity
ROSC	Reports on the Observance of Standards and Codes
SRSFM	Service for Regulation and Supervision of Financial Markets
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 the Kyrgyz Republic 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 in the Kyrgyz Republic and includes a review of both statutory requirements and actual practice. The report uses International Financial Reporting Standards (IFRS)⁶ and International Standards on Auditing (ISA)⁷ as benchmarks and draws on international experience and good practice in the field of accounting and auditing regulation. The previous Country Financial Accountability Assessment (CFAA) undertaken in 2004⁸ identified the following issues with respect to corporate sector financial reporting: (i) a lack of critical mass of accountants to implement accounting and auditing standards adequately; (ii) the review of implementation of IFRS should be undertaken and the appropriateness of these standards for companies with no significant public interest should be evaluated; and (iii) the enforcement and monitoring capacity of state agencies is weak.

2. The Kyrgyz Republic functions as a unitary presidential republic and has a gross national income (GNI) per capita⁹ of US\$ 440. The country has a total population of about 5 million people with approximately one million of its inhabitants living in Bishkek, its capital city.

3. Until recently the Kyrgyz Republic economy had experienced growth due in large part to agriculture and the development of the Kumtor gold mine. Although still very dependent on agriculture, in 2002, the country's increasing economic reliance on the Kumtor gold mine was demonstrated by the dramatic reduction in Kyrgyz GDP growth following an accident at the mine (the country's GDP growth, as an annual percentage, decreased from 5% in 2000-2001 to 0% in 2002¹⁰).

4. During the period 2003-2007, the economy experienced a long-term growth trend due to the development of other sectors of economy, such as services, construction, and industry (excluding gold). Macroeconomic performance in 2007 was remarkable, with the highest growth since 1997 and the best fiscal performance since independence. Real GDP increased by 8.2% in 2007 with construction (20%), commercial services (17.6%) and industry (excluding gold) (10.7%) as the key driving sectors. This high growth occurred despite a decline in gold production and a slow recovery of agriculture¹¹.

5. The Kyrgyz Republic banking sector has developed greatly since independence. Currently, the sector consists of 22 commercial banks. Foreign banks hold 61.4% of the shares in the banking sector and 7% are held by the state.¹² Two important banking sector reforms contributed to this success; the first was the closure of uncompetitive small banks which could not meet government mandated minimum capital requirements and the second reform worked to

⁶ International Financial Reporting Standards are issued by the International Accounting Standards Board, an independent accounting standard-setter based in London, United Kingdom. In April 2001, the IASB announced that it would adopt all of the International Accounting Standards issued by the International Accounting Standards Committee. For simplicity's sake the term IFRS will mean both IFRS and IAS in this report.

⁷ International Standards on Auditing are the standards issued by the International Auditing and Assurance Standards Board of the International Federation of Accountants.

⁸ Kyrgyz Republic Country Financial Accountability Assessment, World Bank report No. 2970-KG, March 1, 2004

⁹ Per the Atlas Method as of 2005.

¹⁰ World Bank Development Indicators 2000-2006.

¹¹ The Kyrgyz Republic: Recent Economic Developments 2007, World Bank Country office in the Kyrgyz Republic

¹² Data as of December 31, 2007 provided by the National Bank of Kyrgyz Republic

strengthen banking supervision and introduced measures to liquidate insolvent banks. Today the banking sector provides domestic credit equal to nearly 15% of GDP.

6. The insurance sector of the Kyrgyz Republic is still developing. Currently, the sector has 15 different insurance companies; however, the majority of the market is controlled by a handful of large companies. Only 2 of the 15 companies provide life insurance services in addition to their non-life services. Although a relatively small market, there is a large degree of foreign involvement. Close to half of all Kyrgyz insurance companies have foreign shareholders. The Kyrgyz Republic maintains very few laws requiring mandatory insurance coverage (e.g., no laws requiring motor vehicle insurance). This may contribute to the low level of development of this sector.

7. There are 10 companies listed on the Kyrgyz Stock Exchange, but no one company's securities are permanently traded. The lack of 'truly' listed companies may be due in part to a culture of confidentiality of business information and lack of confidence of the public to invest. This has caused resistance to publicly listing companies as listing would require a greater degree of transparency of financial information and business operations. As a result, most companies seeking financing either opt for closed offerings or bank loans.

8. The Kyrgyz Republic has privatized many of its former state owned entities. For the most part, state owned entities remain only in 'strategic' sectors. Debate surrounds the need for greater transparency of the remaining state owned entities and the possible need for these entities to report financial information using IFRS due to the fact that normally such enterprises operate on the market as commercial entities with very limited or no financing from the budget.

9. Recent developments in the economy of the Kyrgyz Republic and significant growth in a number of sectors demand a stronger financial reporting regime. The economy will require new financing sources in the form of domestic and foreign direct investment. Reliable and easily accessible financial information will facilitate growth through easy access to finance at lower costs, and increased trust and willingness to provide additional investments on the part of foreign investors.

10. The Kyrgyz Republic has made many improvements in its accounting and auditing laws to advance financial reporting; however, there are large discrepancies between accounting and auditing in law and in practice. The Kyrgyz Republic has legislated to adopt IFRS and ISA as its official accounting and auditing standards, which is an important move in bringing greater financial transparency. However, the absence of a process for the adoption, official translation and publication of changes to IFRS, and delays inherent in the process for reflecting changes in ISA in the Kyrgyz regulatory framework (including those associated with translation from the original English), have as a consequence that the international standards in force are not current. Since compliance with IFRS and ISA can be asserted only on the basis of applying the full and current standards, it should be understood that Kyrgyz requirements are not, in fact, fully aligned with IFRS and ISA. Furthermore, many enterprises do not follow the legal requirements in practice and enforcement and monitoring mechanisms are weak. Financial reporting reforms in the Kyrgyz Republic were supported by donors, specifically by ADB and USAID, and the overall results of these reforms were positive. ADB provided significant support for the first publication of the 2001 edition of IFRS and for training of a significant number of accountants and auditors, as well as for the development of a methodology for monitoring the introduction and application of IFRS, and USAID has established and supported an international CAP/CIPA certification program. However, no assistance has been provided to establish enforcement mechanisms in the financial reporting system.

II. INSTITUTIONAL FRAMEWORK¹³

A. Statutory framework

11. **The legal system of the Kyrgyz Republic is based on civil law and was developed within the framework of Soviet state law.** In addition, Kyrgyz law maintains some features of the French legal system (in regard to the state structure), as well as maintaining some elements of the legal system of the Russian Federation. Currently the system of law is also influenced by peer CIS countries in view of harmonizing legislation with the members of Euro-Asiatic economic community and treaties. Business activities in the Kyrgyz Republic are regulated by the country's Civil Code (part I – 1996, Part II – 1998) and the following laws: Law On Joint-Stock Companies (2003, No. 64), Law On the State Registration of Legal Entities (1996), Law On the Economic Partnerships and Companies, Law on Banks and Banking Activity (1998, No. 60), Law On Securities Market (1998), Law On the Investment Funds (1999, No. 92), Law On Micro Finance Institutions (2002, No.124), Law On Credit Unions (1999, No. 117), Law On Cooperatives (2004, No. 70), and Law On Organization of Insurance (1998, No. 96).

12. **The Kyrgyz Republic's company law regulates matters related to incorporation, management, activities, reorganizations, transformation, and liquidations of companies.** In most cases, company law provisions on financial reporting refer to specialized accounting and auditing laws.

13. **The following are the various types of companies permitted by Kyrgyz law and the number of companies which exist for each category¹⁴:**

- Cooperatives – 1,535
- Farms – 1,119
- Limited liability companies – 7,710
- Companies with additional liability¹⁵ 141
- Joint-stock companies (JSC) – 979 (comprised of open joint-stock companies – 777 and closed joint-stock companies – 202)¹⁶
- State owned enterprises (including municipal enterprises) – 623.

In addition to these companies there are microfinance organizations (229) and credit unions (272). Information on the percentage each category of company contributes to GDP is not available; however, in 2007, small and medium businesses contributed about 45.2% of the Kyrgyz Republic's overall GDP.

14. **According to the Law on Accounting (LOA) and Companies Laws, although the individual or company providing accounting services is responsible to the Board for the accuracy of accounting records, the primary responsibility for accounting and financial reporting stays with the CEO or, as in the case of JSCs, with the Board of Executive Directors.** Although the legislation indicates that responsibility for financial reporting is with the CEO and does not specifically require that financial statements should be signed by a company's chief accountant, in practice financial statements are signed by both the CEO and the chief accountant, as was required under the Kyrgyz Republic's previous system of accounting. It is

¹³ 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.

¹⁴ Data provided by the National Statistics Committee as of January 1, 2008

¹⁵ Additional Liability Companies are those in which the shareholders' liability is expanded to include their own property in cases of bankruptcy.

¹⁶ According to the law on joint stock companies, the number of shareholders of a closed company should not exceed fifty. If the number of shareholders exceeds fifty, a closed JSC should be transformed into an open JSC.

considered international best practice that the Executive Board bears collective responsibility for the financial statements.

15. **According to Kyrgyz banking laws, each bank should have an audit committee comprised of three members of the Board of Directors (non-executives).** The Board of Directors is responsible for selecting auditors and this selection should be confirmed by the general meeting of the shareholders.

16. **In JSCs and insurance companies the auditor is appointed by the Board of Directors (non-executives) and confirmation by shareholders is not required by law.** Overall, a company's shareholders do not play a significant role in the financial reporting process, except in approving the appointment of the auditor (in the case of banks) and in approving the annual financial statements prepared by management. The Kyrgyz Republic has no legislative provisions related to the termination of an audit assignment, except that banks are required promptly to inform the National Bank if an audit assignment is terminated during the course of an audit.

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

17. **Accounting and financial reporting requirements for enterprises in the Kyrgyz Republic are mainly regulated by two laws: the Law on Accounting (LOA) (2002) and the Law on Auditing Activity (LOAA) (2002).** When addressing issues of accounting and auditing, other company legislation typically refers back to these two laws. Although most financial reporting obligations can be found in these two laws, there are some additional and/or more specific requirements related to certain institutions such as banks, microfinance institutions, credit unions, and listed companies.

18. **The Law on Accounting (2002, No. 76) sets out the main principles of accounting and financial reporting in the Kyrgyz Republic, including the basis of, and regulations and responsibilities for, accounting and financial reporting.** This law is applicable to all legal entities. The law provides that financial statements, except for budgetary institutions and individual entrepreneurs, be prepared in accordance with the provisions of International Financial Reporting Standards (IFRS), and thus should consist of a balance sheet, a profit and loss account, a cash flow statement, a statement of changes in equity, and notes to the financial statements. The law refers to a specific plan of implementation of IFRS whereby the requirement to use IFRS is phased-in for certain types of enterprises as approved by the Government. Individual and consolidated financial statements should be prepared by entities where required by IFRS. However, the absence of a process for the official publication of IFRS and delays inherent in the process for reflecting changes in IFRS in the Kyrgyz regulatory framework (including those associated with translation from the original English) have as a consequence that the international standards in force are not current.

19. **The LOA states that financial statements should be presented to enterprise owners/shareholders and to the state authorities within 60 days of the year-end, with the financial year beginning on January 1 and ending December 31 of each calendar year.** The law requires publishing of financial statements and an entity's audit report 90 days after the year-end but not later than June 1. In regards to the manner of publishing, the requirement is not specific and merely refers to "publishing according to the legislation." This may create some variations in the methods of publishing used and in the degree of availability and ease of access to financial information.

20. **Kyrgyz law allows for other legislation to create provisions on accounting; however, in cases where provisions on accounting are inconsistent with the LOA, the law makes it clear that the provisions of the LOA should govern.** This provision is important as the accounting and financial reporting of the National Bank, commercial banks and other financial

institutions licensed by the National Bank are governed by legislation issued by the National Bank which, in theory, should comply with the LOA.

21. **The main state authority responsible for regulation of accounting and financial reporting is the Service for Regulation and Supervision of the Financial Market of the Kyrgyz Republic (SRSFM).** The main functions of SRSFM include regulation and supervision of insurers, non-state pension funds and the securities market and in the area of accounting and auditing. Its structure includes the Division of Accounting and Financial Reporting Development, the Division of Monitoring of IFRS Implementation, and the Division of Auditing Development. The main functions of this body in terms of financial reporting are to issue accounting and auditing standards and to ensure that IFRS and relevant guidelines are available in the Kyrgyz Republic. SRSFM is also empowered to enforce accounting legislation through its responsibility for “control over IFRS application.” Although SRSFM has this power, currently no mechanisms are in place to execute this enforcement function effectively.

22. **As noted above, the main responsible person for accounting and financial reporting in an enterprise is either the manager or Executive Board of Directors (in the case of JSCs).** According to Kyrgyz law, the accounting function of an enterprise can be maintained by dedicated staff, outsourced, or maintained by the manager of the enterprise. Overall, the manager is responsible for all business transactions.

23. **The law specifies that all accounting entries should be made on the basis of source documents confirming specific transactions.** While it may be appropriate for the determination of taxable income, this approach does not recognize that IFRS often requires recognition and measurement on a basis other than actual transactions (e.g. valuation adjustments in respect of doubtful debts), where there will be no externally generated primary source documents. In practice, accounting entries necessary to ensure compliance with IFRS are often not made because they are not recognized for tax purposes. By law, the content of accounting ledgers, internal reports and other documentation is confidential. Access to these documents can only be granted by a decision of the manager (owner) of the entity or on the basis of court or prosecutor’s order.

24. **There are no pending proposals (new draft laws or amendments) for changes to the main accounting and auditing laws.** Overall, the existing laws provide a good basis for accounting and financial reporting, although some implementation and enforcement mechanisms are lacking that bylaws and secondary legislation, if created, may be able to partially address.

25. **The supporting methodologies and further regulations promulgated by the Kyrgyz Government are aimed to provide suitable guidelines for Kyrgyz Republic enterprises on how to implement IFRS.** These guidelines comprise: (i) a recommended chart of accounts; (ii) guidelines on the development of accounting policies; (iii) guidelines on financial statements; and (iv) other guidelines related to specific IFRS and IAS implementation.

26. **These guidelines give rise to several concerns:**

- *Delays inherent in the process for reflecting changes in IFRS (including those associated with translation from the original English) have as a consequence that the accounting standards in force are those as of 2001.* No account has been taken of significant changes since then. Since compliance with IFRS can be asserted only on the basis of applying the full and current standards, it should be understood that Kyrgyz requirements are not, in fact, aligned with IFRS.
- *Because there was no official adoption, publication, and translation of IFRS (into Russian and Kyrgyz languages), various editions and unofficial translations are applied in practice.* There was a publication of an official Russian translation of

IFRS (2001 version) with the assistance of ADB; however, this publication was not attached to the relevant legislation and no updates to the translated version have been made since then. Since compliance with IFRS can be asserted only on the basis of applying the full and current standards, the existing practice is not aligned with IFRS.

- *The financial statements have prescribed formats.* Although the respective prescriptions about financial statement formats have the character of recommendations, there is a general perception on the part of both preparers and users of financial statements that those forms are mandatory. Although ‘suggested’ formats may be useful in assisting companies in reporting financial information, enterprises should have flexibility to enable them to include all information necessary to fully comply with IFRS. The prescribed reporting formats do not contain explanatory notes to financial statements and explanatory notes requirements are not enforced by bodies responsible for collecting financial statements from enterprises. Thus, many enterprises assume that they are not required to prepare notes as part of their financial statements and that the inclusion of explanatory notes is not necessary to comply with IFRS.
- *Recommendations on accounting policy contain provisions that are interpreted by enterprises as requirements, such as for example the use of the government approved chart of accounts as the basis for developing their own internal charts of accounts.* This interpretation provides little flexibility to enterprises which believe that they are not allowed to develop their own charts of accounts, an activity which is normal for enterprises preparing accounts according to IFRS.
- *The preparation of methodological guidelines related to specific IFRS or IAS by the SRSFM provides a good basis for the initial stages of IFRS implementation.* Although, Kyrgyz legislation indicates that these guidelines are only provided as recommendations, it should be specifically stated that they do not substitute for IFRS and the official interpretations of IFRS issued by the International Financial Reporting Interpretations Committee (IFRIC). Currently these guidelines are perceived by users as compulsory.

27. Kyrgyz securities legislation does not impose significant additional financial reporting obligations on listed companies. Substantial reliance is placed on the accounting and auditing reporting requirements imposed by the general statutory framework for companies. The areas where listed company disclosure requirements go beyond IFRS include¹⁷: (i) an annual report on securities issued or cancelled; (ii) significant events influencing financial-economic activities of an enterprise; (iii) quarterly reports on issuing securities; (iv) disclosures about general meetings, etc. However, the financial statements available on the Kyrgyz Stock Exchange website do not contain footnote disclosures; rather, they are limited to the four basic forms prescribed by the SRSFM.

28. Except in the cases of banks (according to banking legislation) and listed companies (according to stock exchange rules), there is no statutory requirement for companies to make their financial statements publicly available. It is compulsory for companies to provide their financial statements to the tax authorities as an annex to their annual tax returns; however, the tax authorities do not ask for the notes to the financial statements and they are not entitled to disclose company financial information to the public. Public availability of financial statements is essential for a healthy corporate sector and has benefits in terms of (i) transparency of the corporate sector; (ii) market discipline; and (iii) availability of information for investors and creditors.

¹⁷ Regulation on the information disclosures on securities market, approved by the Resolution of the former State Agency of Financial Supervision and Reporting under the Government of the Kyrgyz Republic No. 24 dated April 4, 2006

29. **Although banks are obliged by law to make their audited general purpose financial statements available to the general public, it is not always possible to obtain such statements.** This requirement is often, but not always, accomplished through making copies of the audited general purpose financial statements available at bank branches. According to banking legislation, banks are required to publish a special brochure containing the bank's annual report; in practice, however, banks often publish only their monthly balance sheets and income statements (with no notes). Few banks publish their full financial statements (including notes) on their websites.

30. **Except for the role foreseen for the SRSFM, there are no specific statutory requirements for the monitoring of compliance with legislation on financial reporting.** Furthermore, although the SRSFM is legally empowered to do so, in reality it does not have the resources or capacity to effectively monitor companies' compliance with financial reporting requirements.

31. **The main laws regulating the banking and credit sector of the Kyrgyz Republic are: (i) Law On Banks and Bank Activity (1997, No. 65-66); (ii) Law on the National Bank of the Kyrgyz Republic dated (1997, No. 62-63), (iii) Law On Microfinance Institutions (2002, No. 124); and (iv) Law On Credit Unions (1999).** Bank financial statements should be prepared in accordance with the Law on Accounting (LOA) and the Law on Banks and Bank Activities, which specify IFRS (see para. 16 above) as the basis to be used. Additional requirements are laid down in the NBKR Regulation (2003).

32. **In accordance with the Regulation on Prudential (Regulatory) Reporting (approved by the NBKR Board on August 25, 2005), banks must also present prudential information in an established format.** These reports include: (i) daily tentative balance sheet; (ii) monthly balance sheet and income statement; and (iii) quarterly balance sheet, and statements of income, cash flows, and changes in equity. Annual financial statements are required to be prepared in accordance with IFRS (see para. 16 above) and to be published together with the auditor's report not later than April 30 of the year following the reporting year.

33. **The following sector-specific laws have been enacted to regulate the corresponding institutions: (i) Law on Micro-Finance Institutions (2002); (ii) Law on Credit Unions (1999); (iii) Law on Investment Funds (1999); and (iv) Law on Non-Government Pension Funds (2001).** Some Non-Banking Financial Institutions (NBFI) are also required to comply with National Bank regulations. These include one specialized credit institution, 233 microfinance organizations (including 2 microfinance companies), 127 micro-credit agencies, 104 micro-credit companies), 272 credit unions, and 181 pawnbrokers. NBFIs licensed by the NBKR are required to publish annual financial statements including an income statement, balance sheet, cash flow statement and statement of changes in equity¹⁸. The financial statements are published together with the auditor's report after the completion of the audit and not later than April 30 of the year following the reporting year. Monthly and quarterly prudential (regulatory) reports are also prepared in compliance with the Reporting Regulations and Instructions.

34. **There are no requirements for the publication of full financial statements of investment funds (of which there are five, with total assets SOM 32 million) and non-government pension funds.** Only the general rules for JSCs¹⁹ apply.

¹⁸ The latest changes operated in legislation in 2008 require that only microfinance companies should publish financial statements. For the other types of NBFI (credit unions, micro-credit companies, micro-credit agencies, pawnbrokers) publication is not mandatory.

¹⁹ The legal form of investment funds and non-government pension funds is JSC. JSCs with more than 500 shareholders and having at least one public emission of shares have to publish annual financial-economic report.

35. **There are no specific financial reporting requirements for SOEs and there is no centralized monitoring of financial information of these enterprises by the Government.** The MoF and SRSFM are currently considering which SOEs should follow corporate sector financial reporting requirements and which should apply public sector accounting standards, taking into account the nature of their activities and their funding mechanisms. It is argued that SOEs undertaking regular business activities should apply the same rules as corporate sector entities (where the SOEs obtain part of their funding from the government budget, this funding should be treated in accordance with standards applicable to government grants), while entities financed totally by budgetary and/or extra-budgetary funds should apply public sector reporting rules. In addition to financial reporting requirements, the MoF should consider assessing fiscal risk and the impact of SOEs' activities. To carry out such an assessment, however, reliable financial information prepared in accordance with sound financial reporting standards and duly audited is necessary.

36. **Small and Medium-sized Enterprises (SMEs) follow the requirements of the legislation, should apply Kyrgyz National Accounting Standards (based on the 1996 version of IAS), and should implement IFRS by 2009.** As noted above, such entities prepare financial information in prescribed formats consisting of the main four financial statements. Individual entrepreneurs are required to prepare only a statement of revenues and expenses. For many SMEs, compliance with financial reporting requirements is a significant challenge. Very few SMEs are incorporated as Joint Stock Companies and external demand for their financial information is often limited to the tax authorities. Moreover, with concentrated ownership and limited access to external financing, the requirement to produce comprehensive financial information is often perceived as unnecessarily burdensome. NAS are complex and many SMEs encounter significant difficulties in complying with them; moreover, the majority of SMEs even do not use NAS but rather the old accounting practices. Financial information prepared by SMEs is frequently fragmented and inconsistent. It can often be of little value to potential users such as banks which, as a result, instead rely only on collateral when making lending decisions.

37. **Current Kyrgyz legislation requires SMEs to transition to the application of full IFRS by 2009.** The Kyrgyz Government may wish to reconsider this decision in light of the cost and difficulty associated with achieving this goal. The Kyrgyz Government should develop new National Accounting Standards for SMEs (or amend the existing ones) which are more tailored to the Kyrgyz environment. Individual entrepreneurs are permitted to use simplified financial reporting forms (as specified in the Methodological Guidelines on Simplified Forms of Accounting and Financial Reporting for Individual Entrepreneurs 2002, No. 31). They are not required to use double entry book-keeping, although they are obliged to report on an accrual rather than cash accounting basis.

The following table summarises the requirements applicable to different types of entities:

Table 1: Corporate Financial Reporting Requirements

Financial statements Entities	Legal Entity and Consolidated Financial Statements	Audit	Public Disclosure
Open (Public) Joint Stock Companies	IAS/IFRS ²⁰ .	Required	Must publish its annual financial and economic report (laws do not explicitly specify whether the financial statements should be a “full” set, as required by IFRS).
Large Private Limited Liability Companies	IAS/IFRS	Not Required	None
Small and Medium Private Limited Liability Companies	Kyrgyz Accounting Standards (based on 1996 version of IAS). According to the current law, will be required to apply IFRS (2001) by 2009	Not Required	None
Unincorporated Businesses	Regulation on Simplified Forms of Accounting and Financial Reporting for Individual Entrepreneurs (2002, No. 31)	Not Required	None
Insurance Companies	IAS/IFRS	Required	Must publish its annual report (including balance sheet and income statement) in print media
Banks	IAS/IFRS	Required	Required to make a full set of financial statements ²¹ available to the general public through the publication of a special brochure (printed media).
Non-Banking Financial Institutions (NBFI) Licensed by the NBKR	IAS/IFRS	Required	Required to publish financial statements and auditor’s report.
State Owned Enterprises	No specific reporting requirements. Ongoing debate regarding whether these entities should follow the financial reporting requirements for corporate sector entities or public sector accounting rules	Not Required	None

²⁰ It is important to note that reporting in accordance with IFRS in the Kyrgyz Republic often means reporting in accordance with a version of IFRS as of 2001, which was not published as a legislative act.

²¹ A “full” set of financial statements includes: (i) balance sheet, (ii) income statements, (iii) statement of cash flows, (iv) statement of changes in equity, and (v) the notes to financial statements.

38. **According to the ‘Law On Auditing Activity’, statutory audit is required for the following:**

- banks and other institutions licensed by the National Bank of the Kyrgyz Republic (NBKR);
- insurance undertakings;
- issuers of publicly traded securities;
- other entities specified by law²².

In compliance with the Law on Auditing Activity (LOAA) and with the Kyrgyz Government’s ‘Resolution on the International Standards on Auditing’ (ISA), dated April 22, 2002, ISA are required to be used as the methodological basis for statutory audit. However, delays inherent in the process for reflecting changes in ISA in the Kyrgyz regulatory framework (including those associated with translation from the original English) have as a consequence that the international standards in force are those as of 2001, and no account has been taken of significant changes since then. Since compliance with ISA can be asserted only on the basis of applying the full and current standards, it should be understood that Kyrgyz requirements are not in full formal compliance with ISA.

39. **In addition, according to the LOAA and the ‘Law On Banks and Bank Activity’, special requirements apply to the auditors and the audits of banks, bank holding companies, and affiliated legal entities.** These requirements mandate that statutory auditors of such entities, in addition to meeting general requirements for statutory audit, must possess not less than three years’ experience of auditing financial institutions. Furthermore, the audit of all entities that comprise a bank group must be performed by a single auditing firm. NBKR regulations also establish minimum requirements for the scope of auditing procedures.

40. **The requirement for statutory audit defined in the LOAA differs from that in many other countries. For example, EU Member States may exempt small companies from the audit requirement.** The EU sets maximum limits on the exemption criteria, but Member States are permitted to set lower size criteria, thereby exempting fewer companies. Given the limited current capacity of the audit profession in the Kyrgyz Republic, it may be advantageous to limit the requirement for statutory audit to public interest companies, and perhaps to companies above a certain size threshold, so as better to match supply and demand..

41. **The conduct of the statutory audit of commercial enterprises is regulated by the LOAA. The statutory audit may be performed by a licensed auditing organization (audit firm) or by a licensed individual auditor (sole practitioner).** The SRSFM maintains the register of auditors and audit firms. An audit firm is required to:

- Adopt a specific legal form, limited to partnerships and limited liability companies; audit firms may not be open joint-stock companies.
- Ensure that at least 50 percent of its employees are citizens of the Kyrgyz Republic permanently resident in the country. If a foreign citizen is the head of the audit firm, the share of employees who are Kyrgyz citizens must be at least 75 percent.
- Have a certified auditor as head of the executive board of the audit firm.
- Include at least two certified auditors among the staff of the audit firm.

Only those audit firms and individual auditors licensed in the Kyrgyz Republic may provide audit services in the country.

²² For example, for JSCs an audit can be demanded at any time by decision of a shareholders’ general meeting, board of directors, supervisory board or a shareholder / shareholders owning not less than ten percent of shares with voting rights.

42. **Although Article 13 of the LOAA requires that auditors hold indemnity insurance, this form of insurance is not readily available due to the low level of development of the insurance market, and thus compliance with this provision of the law is not enforceable.** An auditor's liability is limited to double the amount of the audit fee.

43. **The National Bank does not maintain a list of approved auditors of banks and other financial institutions regulated by the NBKR.** However, according to the 'Law on Banks and Bank Activity', individual auditors are not permitted to audit financial institutions; only audit firms may do so. In addition, the NBKR requires rotation of audit firms every five years. Given the limited capacity of the auditing profession, this requirement may be challenging in Kyrgyz circumstances.

44. **Independence requirements for auditors set out in the LOAA include:**

- An auditor or audit firm may not perform the audit of an entity where they, or their close relatives (parents, spouses, brothers, sisters, children; brothers, sisters, parents and children in law), are founders (participants), shareholders, or employees of the audited entity, or in subsidiaries, branches and representatives of these audited entities. Further, an audit may not be conducted by an auditor or audit firm having any interest in the company, other than that resulting from conducting the audit and providing accompanying services.
- The audit firm may not perform the audit of an entity, which is its founder (participant) or shareholder.
- An auditor or audit firm may not provide public services or engage in any other commercial activity except for research, education, and creative activities.
- An auditor or audit firm may not provide accounting and/or financial statement compilation services to an entity during the two years prior to performing the audit of that entity.

45. **Statutory auditors are appointed by various company bodies depending on the entity type:**

- In accordance with the Law On Joint-Stock Companies, for joint-stock companies with more than 50 employees the authority for the selection and appointment an external auditor lies with the Board of Directors (non-executive).
- For banks, the authority to appoint external auditors belongs to the General Meeting of Shareholders.

B. The Profession

B.1. The Accounting Profession

46. **The accounting profession is not formally recognized in Kyrgyz legislation and no requirements or criteria have been established for the certification and competence of professional accountants.** There are several accounting and auditing associations; however, only two of them engage in meaningful activities: the Union of Accountants and Auditors (an associate member of IFAC) and the Chamber of Accountants and Auditors. In 2007, another association, the Institute for Accounting and Auditing Development, was established and its head is a former SRSFM official. Despite of the fact that creation of these associations is foreseen under specialized accounting and auditing legislation, they do not have the regulatory functions and membership in a professional association is not mandatory for auditors. The exact number of auditors who are not registered with a professional association is not known because the associations do not share the relevant membership information with the SRSFM.

47. **The Union of Accountants and Auditors (OBA) was founded in 1999 and became an associate member of IFAC in 2000.** IFAC requires that its members, both associate and full, make their best efforts to comply with IFAC Statements of Membership Obligations (SMOs)²³. At present, the OBA does not comply in full with any SMO even though it is the only professional association to receive support from international development agencies. It has 11 active members, 578 regular members and 420 candidates (as of April 1, 2007). OBA members work in both the public and private sectors.

48. **The Chamber of Accountants and Auditors (COA) was established in 2001 as the result of a merger of four previously-existing professional associations: the Chamber of Auditors (created in 1994 and originally designed to be the sole professional body for auditors), the Association of Accountants and Auditors, the Union of Accountants, and the Institute of Professional Accountants.** Following a period of decline and revival, COA, a self-financing entity, now claims approximately 500 individuals as full, honorary and candidate members.

49. **The Institute for Accounting and Auditing Development (IAAD) was established in 2007.** IAAD's primary objective is to support the Government, SRSFM and other state bodies in the further development of, and improvement in, accounting and auditing. Currently, the Institute has about 30 members, a majority of them auditors.

50. **None of the professional associations administers a professional certification program. The only qualification schemes available in the Kyrgyz Republic for accountants and auditors are CAP/CIPA and ACCA.** Furthermore, professional associations are not involved in the licensing of auditors, or accounting and auditing standard-setting, nor have they developed any quality control mechanisms. Even though OBA has translated the IFAC Code of Ethics, the Code is not enforced. Neither OBA nor COA has developed a working relationship with the SRSFM. For the accounting reform to succeed there is an urgent need to further develop the organized profession, especially if there is to be some degree of delegated regulation of the audit profession, subject to public oversight (full or partial delegation could be considered in the future for certification and CPD). This, however, is unlikely to be achieved without uniting the limited resources in the Kyrgyz Republic, through cooperation between the SRSFM, professional associations and other stakeholders.

51. **Although thousands of individuals are involved in accounting functions, most were trained under the previous regime and system.** Educating the accountants who work at the majority of Kyrgyz companies is key to improving the practical application of IFRS and principles-based accounting. While the level of understanding of modern accounting concepts of newly qualified accountants may be higher than that of current accounting practitioners, the established accountants should also be given an opportunity to improve their theoretical and practical skills. To accomplish this objective, it is important that all stakeholders are involved in the process.

B.2. The Audit Profession

52. **The audit profession is supervised by the SRSFM.** The SRSFM was established in July 2007 by Kyrgyz Republic government decree, taking over the functions of the previous State Agency of Financial Supervision and Reporting, and its responsibilities, among others, include submission for approval and implementation of accounting and auditing standards (methodology), organization and administration of audit examinations, issuance of audit

²³ IFAC SMOs are designed to provide clear benchmarks to current and potential IFAC member organizations to assist them in ensuring high quality performance by accountants worldwide. SMOs cover quality assurance, education standards, auditing standards, ethics, investigation and discipline, etc. For additional information, refer to <http://www.ifac.org/Compliance/index.php>.

qualification certificates and licenses, quality assurance review and public oversight of auditors. As of September 2007, there were 46 audit firms and 17 sole practitioner auditors. Given the requirements of the Law on Audit Activity (only banks, insurance firms and other financial entities are subject to a statutory audit requirement), the audit universe consists, at a maximum, of 984 entities (22 banks, 15 insurance companies, 5 investment funds, 1 private pension fund, and 942 NBFI, such as credit unions, micro finance agencies, etc.). State-owned enterprises, which include some of the most important Kyrgyz undertakings, are not subject to statutory audit.

53. With the exception of the independence criteria laid out in the Law on Audit Activity (LOAA), there are no other ethical requirements. The government decree requiring the use of ISA (2001) did not include the IFAC Code of Ethics. Both the Union of Accountants and Auditors and the Chamber of Accountants and Auditors are in the process of developing codes of ethics for their members. However, neither has a disciplinary function with respect of their members; the SRSFM will hold this responsibility when the ethics code is approved.

54. Existing legislation permits the recognition of foreign qualifications only when there is a mutual recognition agreement with the other country. There are currently no such agreements in place. Foreign auditors therefore have to pass the same examinations as Kyrgyz candidates in order to obtain the certificate and license.

55. The SRSFM is responsible for examining, certifying and licensing auditors. The Law on Audit Activity requires that candidates with a university degree in economics/finance must acquire three years of relevant experience, while candidates not holding such a degree must have seven years of relevant experience. Relevant experience is not defined in detail, but is typically interpreted as “financial analytical and/or controlling-revision” work. Other requirements include integrity, no prior court convictions, and the ability to enter into legal transactions.

56. Candidates wishing to obtain an audit certificate and license must pass four examinations. The topic areas include law and taxation, accounting, audit, and financial analysis. Candidates must achieve a score of at least 80 percent to pass. However, the examinations do not have to be passed in a single session – candidates are allowed to take each exam individually, with passing exams scores remaining valid for three years from the date the first examination was taken.

57. Examinations are difficult, standards are high and passing rates are low (5-30%). A successful candidate is awarded a certificate; to provide audit services, however, the candidate must also obtain an audit license. The department for audit development of SRCFM is responsible for certification process, and certificates and licenses are issued by department for licensing and certification of SRCFM, which maintains the register of certified auditors, audit firms and individual auditors-entrepreneurs.

58. Although the CAP/CIPA qualification is required for admission to the OBA and COA, and although a growing number of individuals are attaining this certification, the SRSFM does not grant exemptions from its auditor certification and licensing scheme for individuals with these credentials. The SRSFM is currently assessing the possibility of partial exemptions, but this is still at a preliminary stage.

C. Professional Education and Training

59. Professional education and training in accounting and auditing requires significant further development. Business and economics education often does not produce graduates at the entry level for professional accountancy study. Not all institutions have adapted their

curricula to reflect current financial reporting requirements. The business community reports difficulties in recruiting accounting graduates of suitable quality and a shortage of qualified instructors. Few university lecturers have experience of, or qualifications in, IFRS-based financial reporting. Furthermore, although a program to update the skills and knowledge of university professors has been undertaken in the past, more current training and skills development programs are needed.

60. **In addition to updating the skills and knowledge of faculty staff, there is a need to enhance the teaching materials available.** There is a shortage of textbooks, training materials and reference materials, including Russian translations of IFRS and ISA.

61. **Initiatives to integrate professional certification and university programs have been launched and are one of the successes of Kyrgyz accounting and auditing education.** Some universities, specifically the Bishkek Financial-Economic Academy and American University in Central Asia, have integrated CAP/CIPA courses into their programs. Other universities with professors having specialized knowledge in IFRS and ISA have offered extra-curricular programs to support students who are preparing for the CAP examinations. Further integration would assist the development of the profession. The total number of universities in Kyrgyz Republic is over twenty, and while some of them have accounting faculties and departments, others teach accounting and auditing subjects.

62. **Another success was the creation of the temporary working group “Developers of State Educational Standards for Higher Professional Education in Accounting, Analysis and Audit” to standardize and raise the quality of university accounting and auditing education programs nation-wide. It is proposed that similar work on development of educational standards should be continued with the involvement of experts with international experience, if possible.** Involvement of the private sector (audit firms, companies, professional accounting and auditing associations, etc.) would assist in the achievement of these goals by facilitating input on the needs and demands of the marketplace, thereby helping to create high quality, market-oriented educational programs that produce superior graduates ready and able to contribute to the growing Kyrgyz economy.

63. **Current training offered on IFRS is not sufficient; much IFRS knowledge is obtained through self-study or from experience with local member firms of the international audit networks.** Even in the cases of banks and large companies, IFRS financial statements are often prepared with the assistance of the auditor. This may undermine the objectivity of the audit process, and limit the extent to which management and Boards fully understand - and take real responsibility for - their own entities' financial statements.

64. **The Law on Audit Activity requires that auditors should maintain their expertise by attending courses and seminars on professional topics.** This effectively represents a CPD requirement, even though it is not currently interpreted as such by the SRSFM due to the absence of respective bylaws. However, also because of the absence of bylaws, there are no accompanying requirements as to the quantity and quality of the education (e.g. number of hours per year), attendance is not required, records are not well kept, and sanctions are not applied when auditors do not participate.

D. Setting Accounting and Auditing Standards

65. **Kyrgyz accounting and auditing standards are set by legislation.** The Law on Accounting (LOA) and the Law on Auditing Activity (LOAA) refer to IFRS and ISA as the standards applicable to Kyrgyz entities. SMEs should implement IFRS by 2009, and until then should apply NAS.

66. **The LOA and supplementing government decree were adopted in 2002; however, both are silent on the applicable edition of IFRS, and on how account should be taken of changes to IFRS, and neither provides a mechanism for the official publication of IFRS in the Kyrgyz Republic.** It is not clear which edition of IFRS is applied by Kyrgyz entities; however, the unofficial Russian translation of the 2001 edition of IFRS is widely available in the Kyrgyz Republic, and it is understood that this is used by most entities.

67. **The government decree requires the use of ISA 2001.** Since ISA have undergone a number of revisions and, in addition, the audit approach was modified to risk-based auditing, the extant Kyrgyz auditing standards cannot be understood as ISA. This lag is exacerbated by the difficulties surrounding the official Russian translation of ISA.

E. Enforcing Accounting and Auditing Standards

E.1 Enforcing Accounting (Financial Reporting) Standards

68. **With the exception of banks, there is currently little or no effective enforcement of the application of financial reporting standards.** Some entities have applied IFRS since 2002 and all entities will be required to apply IFRS from 2009. However, there is no systematic enforcement of this requirement.

69. **The statutory audit function has limited effect in ensuring compliance with financial reporting requirements.** Audit quality varies greatly in the Kyrgyz Republic (see below) and a weakness in the capacity of preparers results in significant auditor involvement in the preparation of financial statements in many cases. Thus the level of assurance provided by the audit is reduced.

70. **The lack of effective enforcement removes a major incentive for companies to invest in the provision of such financial information and the staff required to prepare it.**

E.2 Enforcing Auditing Standards

71. **There is currently little or no effective enforcement of auditing standards in the Kyrgyz Republic.** There is no systematic external quality control of the work of licensed auditors. There is perceived to be a wide degree of variety in levels of compliance, from a perceived high degree of compliance by local member firms of international audit networks and leading national audit firms (which have internal quality control procedures) to a perceived low level of compliance by some individual auditors.

72. **Enforcement of auditing and ethical standards generally takes one of two alternative forms – it is either directly administered by the government agency responsible for audit licensing, or it is delegated to professional organizations of auditors which are themselves subject to public oversight.** As the Kyrgyz Government does not currently have plans to delegate authority to the professional organizations it appears that the administration of audit quality control review directly by the responsible government agency may be the appropriate option, at least in the short to medium term (under this arrangement, creation of an appropriate public oversight board is desirable, as described in para. 74 below). In addition, the fact that auditors are not currently required to be members of a professional organization makes delegation impractical. However, a full or partial delegation of certain regulatory functions to professional associations should be considered in the longer term, particularly if the membership of auditors in professional associations will become compulsory and professional associations have achieved compliance with IFAC's Statements of Membership Obligations.

73. **Audit quality assurance review should have the goal of improving the quality of audit and raising standards.** This requires cooperation between the regulatory agency, the audit profession and other interested parties. In particular, the audit quality control regime must balance the need for specialist expertise to perform quality inspections, which favors the involvement of current or recently-retired audit practitioners, with the necessity to maintain independence and objectivity.

74. **A practical solution to this would benefit from experience of more developed countries which recently reformed and developed audit profession and public oversight mechanisms. An appropriate public oversight board needs to be established to receive the results of audit quality assurance reviews and consider the appropriate measures to be taken.** The board would typically have an ‘Audit Quality Control Group’ which would have representatives of the regulatory agency; professional organizations and leading audit firms; representatives of other relevant regulators, such as the National Bank; and the academic and business communities. It would be so constituted that no one interest group would have sole control of the committee. The group’s task would be to organize and administer quality control reviews.

75. **There are two main options for actually carrying out the quality assurance reviews of auditors – the inspections can be carried out either by dedicated full-time inspection staff or through a system of peer review.** However, peer review may be difficult in the Kyrgyz Republic given the limited capacity of the audit profession currently; thus a dedicated team of independent specialist reviewers may be more appropriate. In the initial stages, the inspection regime may benefit from direct support and input from individuals or agencies from outside the Kyrgyz Republic with established experience in such audit quality control; this would also answer concerns of the perceived independence of the regime in the early stages. Donor assistance would be invaluable to provide this international support.

III. ACCOUNTING STANDARDS AS DESIGNED AND AS PRACTICED

76. **Due to the fact that the Kyrgyz Republic decided to abandon National Accounting Standards in favor of IFRS²⁴, no analysis of significant differences between National Accounting Standards (NAS) and IFRS (the ‘standards gap’) was performed as part of this ROSC assessment²⁵.** Instead the compliance of the statutory financial statements with IFRS (the ‘compliance gap’) was performed to identify any systemic non-compliance issues and the potential adverse impact on the reliability of IFRS-based financial statements.

77. **As part of the ROSC assessment, a *compliance gap* analysis was carried out, which shows that the quality of the financial statements prepared by the majority of enterprises falls far short of the standard implied by the reporting requirements embodied in the statutory framework.** The *compliance gap* assessment covered a sample of 15 sets of audited financial statements which purport to be prepared in accordance with IFRS. These comprised five enterprise sector companies, 7 banks and three insurance companies. As financial statements are not publicly available, these financial statements were provided on a voluntary basis (with the exception of several banks for which full sets of financial statements were available on their web-sites). The results of the review are set forth below;

- (i) Only five sets of financial statements from the banking sector and one set from the enterprise sector included notes to the accounts; the majority of these financial statements were audited by international audit firms; the other sets of financial

²⁴ According to the transition plan, by 2009 all the Kyrgyz Republic companies should use IFRS.

²⁵ It is understood that an analysis of differences at that time between NAS and IFRS was performed jointly with experts from ADB in 2001.

statements did not contain any notes; therefore, these did not comply with IFRS requirements. A majority of financial statements were presented using standard forms, except for the banking sector.

(ii) there are differences between regulatory requirements and IFRS in the banking sector for loan loss allowances and in some cases this difference resulted in a qualified opinion. In addition, no reference was made in the financial statements to the National Bank regulations; therefore, the allowances were presented as compliant with IFRS in the financial statements. Ordinarily, where national regulations give rise to such a difference, disclosures about, and the quantification of, these differences are required.

(iii) financial statements submitted by insurance companies did not include notes and audit reports. Some financial statements included examples of regulatory reports.

78. **The overall conclusion of the review of financial statements is that there is a significant compliance gap between standards as designed and practiced.** Reasons for the gap include the following: (i) lack of expertise among both the preparers and regulators results in non-compliance with IFRS, particularly in relation to the recognition of the significance of notes to the financial statements; (ii) low capacity of auditors results in poor quality audits; (iii) no effective enforcement mechanism over financial reporting process exists.

IV. AUDITING STANDARDS AS DESIGNED AND AS PRACTICED

The auditing standards gap

79. **The Law on Audit Activity (2002) requires that auditing standards be approved by the Government of the Kyrgyz Republic.** In 2003, The Government issued a decree establishing ISA as of 2001 (“ISA 2001”) as the required auditing standards, because this was the most recent version for which a Russian translation existed.

80. **The SRSFM has recently published several auditing manuals suggesting audit methodologies to comply with ISA.** The manuals’ use is not compulsory. The manuals are based on ISA 2001.

81. **The continued use of “ISA 2001” gives rise to a significant risk of inconsistent application and misunderstandings on the part of audit report users.** Several significant changes have been made to ISA since 2001, more are in process, and it cannot be assumed that the application of “ISA 2001” results in the same level of assurance as the application of current ISA. Furthermore, audit reports issued in the Kyrgyz Republic refer generically to “International Standards on Auditing (ISA),” not to “ISA 2001,” or “ISA, as adopted in the Kyrgyz Republic”, and do not draw attention to the differences which exist between the two. Compliance with ISA is achieved only when the auditor has complied with all currently effective ISA.

The auditing standards compliance gap

82. **As discussed in the “Accounting Standards as Designed and Practiced” section, it is difficult to obtain audit reports on even the financial statements of public interest entities.** Out of sixteen sets of financial statements reviewed, seven included audit reports. The reports were obtained from four financial institutions, a consumer products manufacturer, and two service organizations. Of the seven auditors’ reports, five used the standard wording contained in current ISA, while two reports contained the wording required by “ISA 2001”. For the reports using the 2007 wording, however, it is not clear whether the work performed was based on ISA 2001 or current ISA. Some audit reports included either an emphasis of matter paragraph or a note referring to uncertainties arising from an unstable economic environment, i.e. a “soft” going concern qualification. While the number of qualified audit reports may reflect the current

circumstances of the Kyrgyz economy, it may also indicate difficulties in the audit function. However, no conclusions can be made in this respect due to the limited size of the sample.

83. **Even though many entities prepare financial statements that do not include notes, these have “clean” audit reports attached to such financial statements.** The National Bank may reject the audit report and request another audit if it is not satisfied with the auditor’s work. The team, however, did not find evidence of any such rejection.

V. PERCEPTION OF THE QUALITY OF FINANCIAL REPORTING

84. **The overall perception is that the quality of audit in the Kyrgyz Republic is low, with the exception of the Big Four and a small number of local firms.** While the local member firms of the international audit networks benefit from network support, local firms and sole practitioners have not received an adequate support to work with the standards they were not trained for and which they find difficult to apply. This is further exacerbated by the fact that there are currently no practice restrictions or specialist requirements for specialized audits, i.e., audits of financial institutions and insurance companies. There are indications that audit reports are issued which are not supported by sufficient appropriate audit evidence, and that users and other relevant parties are not aware of this fact.

85. **Similarly to general purpose audit statements, audit reports are not generally perceived as useful by users for decision-making purposes. This perception and the weakness of the Kyrgyz institutional framework do not provide auditors with an incentive to improve the quality of their work.**

- Banks base their lending decisions on their own due diligence and collateral, rather than using audited financial statements;
- The tax authorities require that taxpayers use the tax code, developed specifically for tax purposes, which is not linked to IFRS financial statements and for which a conversion bridge has not been designed;
- The absence of disciplinary proceedings against auditors who failed to comply with auditing standards has created an environment where the audit report tends to be regarded as irrelevant.

VI. POLICY RECOMMENDATIONS

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

87. **The recommendations of this ROSC are interrelated and mutually supportive.** 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 the Kyrgyz Republic is to be upgraded to international standards within a reasonable timeframe. Achievement of these objectives requires continuous reorganization and improvement of the Kyrgyz Republic’s legal framework, institutions, accounting and auditing professions, 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 the Kyrgyz Republic's long-term objectives. They fall into three key areas:

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

88. **These recommendations require a holistic approach to implementation.** The Kyrgyz Republic should establish a multidisciplinary (inter-departmental) Coordination Working Group (CWG)²⁶ to champion and coordinate the accounting and auditing reforms. The CWG should advise policymakers and regulators regarding the implementation of the recommendations. Based on the successful experience of other countries, this report recommends that the CWG 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 an itemized budget indicating the resources necessary for successful implementation and the government, policymakers and development partners should work together to secure those resources. To ensure that the CAP provides information on all relevant objectives, actions and required resources, as well as summary budgets and critical assumptions, its development will require assistance of international and local consultants.

A. Statutory Framework

89. **With regard to the statutory framework for accounting, it is recommended that:**

- The Kyrgyz Republic should create definitions of Public Interest Entities (PIEs), Small and Medium-Sized Enterprises (SMEs) and Micro-Entities which take into account the development and capacity of the Kyrgyz economy, and the needs of users of financial information.
- A three-tier financial reporting requirement should be implemented where PIEs are required to apply full IFRS, SMEs are required to apply NAS for SMEs (when developed and given sufficient time for successful implementation) and micro-entities are required to report solely for tax purposes. The current framework allows for the first two tiers; the micro-entity tier will require further definition.
- The standard forms for financial reporting issued by the SRSFM should be expanded to include provision for notes to the financial statements, since such footnote disclosures form an integral part of IFRS financial statements as defined in IAS 1, "Presentation of Financial Statements".
- The National Bank, and the securities and insurance supervisory departments within the SRSFM, should require that all regulated entities submit to them full financial statements, including notes, in compliance with IFRS. Each regulatory agency should publish the financial statements of entities they regulate in full on their websites, thus enforcing the current legal requirement that PIEs' financial statements be publicly available. The regulators should also ensure that a copy of the full financial statements together with the audit report is sent to Division for the Development of Accounting and Financial Reporting within the SRSFM.
- In the short term, the SRSFM should modify the prescribed wording of the audit report to include reference to "International Financial Reporting standards as adopted by the Kyrgyz Republic" and "International Standards on Auditing as adopted by the Kyrgyz Republic." This would inform the reader that the IFRS and ISA applied in

²⁶ This working group should include as members representatives of state authorities (such as banking regulator, insurance regulator, financial market regulator), stock exchange, and professional associations. The group may also include representatives of donors as observers.

the Kyrgyz Republic are not the latest IFRS and ISA approved by the IASB and IAASB.

- In the longer term, the Kyrgyz Republic should ensure that the translations of the latest versions of IFRS and ISA are adopted into law on a timely basis, and that copies of these translations are made readily available to educators and the various preparers, users and auditors of financial statements. The standards could be made available on the SRSFM website, on a free CD (possibly with donor support to cover the costs), and/or in a printed version, although it is unlikely the printed version would be available at no cost unless significant donor support could be secured for this purpose.
- The Divisions for the Development of Accounting and Financial Reporting and for the Development of Auditing within the SRSFM should perform reviews of all PIEs' financial statements, including the auditors' reports, and highlight any inadequacies to the relevant regulatory agency i.e. the National Bank, and the insurance, securities and audit supervisory functions within the SRSFM.
- In the longer term, all companies should be required to file their financial statements with a central financial statement register, where they would be available to the public. Two options for the register could be considered by the authorities, including: (i) creating a new function within SRSFM; or (ii) creating this function within National Statistics Committee (where companies currently file statistical reports). Both options would require a revision of appropriate laws and/or regulations.
- The National Bank should continue its efforts to align the requirements for general purpose financial reporting by commercial banks in accordance with IFRS and regulatory reporting requirements set by the National Bank.

90. **With regard to the statutory framework for audit, it is recommended that:**

- The statutory audit requirement should be set at a level appropriate to the public interest in audit reporting; this should take into account the capacity of the audit profession in the Kyrgyz Republic. The requirement is likely to cover all PIEs and could also be expanded to cover other companies above a certain size threshold.
- The audit certification program administered by the SRSFM, should continue to be reviewed for compliance with the International Education Standards issued by the International Federation of Accountants (IFAC). The SRSFM could also consider adopting the CAP qualification (or equivalent) as a necessary pre-qualification for the auditing certification.
- The SRSFM should evaluate professional qualifications, such as the CAP, CIPA, ACCA and CPA qualifications, and determine if exemptions for certain relevant components of the SRSFM's audit certification can be awarded to holders of these professional qualifications.
- The audit license for both firms and individuals should be valid only for a set period, e.g. one, two or three years. The renewal of the license should be made dependent on the provision of evidence of approved Continuous Professional Development (as per the current common in many countries 40-hour per year requirement), evidence of Professional Indemnity Insurance (where available), the resolution of any issues found in any audit quality inspection, and confirmation that the license holder meets all other licensing conditions. However, license renewal should not be unreasonably withheld.
- A quality assurance review program should be introduced once the methodology for such a regime has been agreed by interested stakeholders. The focus and objective of the regime should be to improve audit quality through identifying gaps in the implementation of auditing standards and encouraging training and improvements in methodology to address the gaps.
- The system of external audit quality review should be implemented by the audit licensing authority, currently the SRSFM, which should accept responsibility for

oversight of the auditing profession, reporting to a public oversight board which would be established to receive the results of audit quality assurance reviews and to consider the appropriate measures to be taken. It will include representatives of the regulatory agency, professional organizations and leading firms and representatives of other relevant regulators, such as the National Bank, the academic and business communities. It would be so constituted that no one interest group would have sole control of the Committee.

- The reviews should be carried out by either dedicated full-time inspection staff or through a system of peer review, even though either may be difficult given the limited capacity of the audit profession currently. In the initial stages, the quality assurance review program would benefit from direct support and input from individuals or agencies with established experience in such audit quality control; this would also answer concerns of the perceived independence of the program in the early stages. Donor assistance would be invaluable to provide this international support.
- The SRSFM should, in cooperation with professional associations, initiate the process to implement the IFAC Code of Ethics and to design and implement procedures enforcing the requirements of the Code, including the establishment of a disciplinary committee and procedures, including the appeal process, and sanctions for transgressions.
- The SRSFM may wish to consider requiring all certified auditors to be members of a professional organization, where such professional organizations would be required to meet certain criteria. Examples of internationally agreed criteria for well-functioning professional organizations are contained in the Statements of Membership Obligations (SMOs) of IFAC.
- As the insurance market grows and professional indemnity insurance becomes more readily available for auditors, the Kyrgyz Republic should consider gradually phasing out the current practice of limiting auditor liability to double the amount of the audit fee and properly enforcing the requirement that auditors maintain indemnity insurance.

B. Institutional Capacity Building

91. With regard to the strengthening of key institutions in the field of corporate financial reporting, it is recommended that:

- The Divisions for the Development of Accounting and Financial Reporting, Monitoring and Analysis of IFRS Implementation, and Development of Auditing within the SRSFM should receive significant support, including from international peer institutions, to build their capacity in terms of the number, qualification levels and training of its staff. Also, the possibility of merging these divisions into a single regulatory body should be considered. This will be necessary if the SRSFM is to carry out effectively its increased role in the enforcement and monitoring of the quality of corporate financial reporting and auditing and to be relied on by other regulators.
- The National Bank and the insurance and securities agencies within the SRSFM should receive support to enforce high quality financial reporting by entities which they regulate. They should have the necessary powers to require compliance by regulated entities with the relevant financial reporting requirements and, in particular, to remedy any deficiencies noted in the reviews of financial statements performed by Division for the Development of Accounting and Financial Reporting within the SRSFM.

- The professional organizations of accountants and auditors should receive support from international peer organizations and should increase their capacity to regulate their members effectively, subject to appropriate supervision and oversight by the SRSFM. Examples of internationally agreed best practices for well-functioning professional organizations are contained in the Statements of Membership Obligations (SMOs) of IFAC; established professional organizations in the Kyrgyz Republic should aspire to comply with the SMOs whether or not they are members of IFAC currently.

C. Professional Education and Training

92. With regard to professional education and training, supporting improvements in corporate financial reporting, it is recommended that:

- The syllabi and teaching approaches for university courses with significant accounting and auditing components should be reviewed to ensure that they are compliant with the latest versions of IFRS, ISA and current legislation in the Kyrgyz Republic. Emphasis should be placed on better integration of professional certification and licensing requirements and university programs.
- The providers of accounting and auditing education in the Kyrgyz Republic, including university lecturers and professional trainers, should be given the necessary support and assistance to update their knowledge and skills to included the latest international best practice in accounting and auditing, including IFRS and ISA. This may involve a major program of re-tooling accounting lecturers at universities, particularly in the state sector and could also involve some tuition in the English language, in which much relevant technical material is published.
- Greater support should be given to activities aiming to standardize and raise the quality of university accounting and auditing education programs nation-wide. Supporting these activities may help achieve many of the other recommendations set forth in this section such as updating and enhancing university syllabi to be compliant with the most recent IFRS and ISA, assisting university professors in keeping their accounting and auditing knowledge current and in aligning university education programs with professional qualifications.
- The Kyrgyz Government should continue its efforts to unite and coordinate provision of accounting education and training with the interests of the professional accounting community, bringing together professional organizations, university educators, relevant Government ministries and leading international and local professional accounting companies to increase the market orientation of accounting courses. This would result in a steady supply of accountants with knowledge and experience relevant to the needs of the Kyrgyz market.
- The SRSFM and professional organizations should monitor and enforce the current requirement for certified and practicing auditors to undertake a number of approved hours of Continuous Professional Development (CPD) each year. This could be achieved through the re-licensing process.
- A review should be undertaken of the quality and suitability for the Kyrgyz market of currently available Russian language professional accounting and auditing qualifications. The results of this review should be utilized to influence policy making in the Kyrgyz Republic, and also to provide valuable feedback to the providers of Russian language professional accountancy qualification.