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and Codes on Accounting and Auditing

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Main Abbreviations and Acronyms

A&A	Accounting & Auditing
ACCA	Association of Chartered Certified Accountants
CPD	Continuing Professional Development
EU	European Union
DCFTA	Deep and Comprehensive Free Trade Agreement
ECA	Europe and Central Asia
GDP	Gross Domestic Product
GEL	Georgian Lari
GFPAA	Georgian Federation of Professional Accountants and Auditors
GoG	Government of Georgia
IASB	International Accounting Standards Board
IAASB	International Auditing and Assurance Standards Board
IAS	International Accounting Standards
IDA	International Development Association
IES	International Education Standard
IESBA	International Ethics Standards Board for Accountants
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
ISA	International Standards on Auditing
ISQC 1	International Standard on Quality Control 1
JSC	Joint-Stock Company
LLC	Limited Liability Company
NBG	National Bank of Georgia
NSC	National Securities Commission of Georgia
PAO	Professional Accountants Organization
PIE	Public Interest Entity
ROSC	Report on the Observance of Standards and Codes
ISSSG	Insurance State Supervision Service of Georgia
SME	Small and Medium-Sized Entity
SMO	Statement of Membership Obligation
SMP	Small and Medium Practice
SOE	State owned enterprise

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A. Context

1. **This assessment of accounting and auditing practices in Georgia is part of a joint initiative, implemented by the World Bank and the International Monetary Fund (IMF), to prepare Reports on the Observance of Standards and Codes (ROSC).** It provides an updated assessment of the financial reporting requirements and practices in the country's enterprise and financial sectors since the previous ROSC A&A in 2007. It focuses on the strengths and weaknesses of the accounting and auditing environment that influence the quality of corporate financial reporting, and includes a review of both statutory requirements and actual practices. International Financial reporting Standards (IFRS) and International Standards on Auditing (ISA) are used as benchmarks.
2. **Georgia is implementing a strategic plan to improve the local business climate and raise the competitiveness of its private sector.** One element of this “Socioeconomic Development Strategy 2020” is to improve corporate financial reporting and auditing standards and practices, along with enhanced disclosure of financial information. Another important element is to help reduce the “accounting gap” for large, small and medium enterprises, thus easing their access to finance. This ROSC report reflects the reforms undertaken by the Government of Georgia since 2007 and seeks to: (i) assess progress made in implementing the recommendations of the original ROSC A&A; (ii) assist the government of Georgia in prioritizing their strategic objectives to enhance governance and ensure sustainable improvements in the business climate in the country; (iii) propose steps to improve the quality of statutory audits and thus raise the credibility of financial reports, and (iv) balance the administrative burden of statutory audits and financial reporting requirements in relation to entities’ size and importance to the Georgian economy.
3. **The Association Agreement signed in June 2014 with the European Union has demonstrated Georgia’s commitment to reform. Legislation must now be adapted and aligned with EU norms.** The current statutory framework for financial reporting and auditing in Georgia is significantly less developed than the EU *acquis communautaire*.¹ Reforms in the area of financial reporting and auditing are complex and will require significant efforts and resources for their implementation in the country. They may pose significant challenges, specifically in the areas of standards enforcement, disclosure requirements, audit quality assurance, as well as education and training for professional accountants. A key focus for Georgia will be to put in place the human and financial capacity to develop the necessary structural framework and ensure its proper implementation by businesses and regulators. The Association Agreement provides three years for reforms to be implemented, and Georgia should take this time to carefully consider the options available and evaluate the experience of peer countries with comparable economies.

¹ The EU *acquis communautaire* is the body of EU law and obligations from 1958 to the present day, which bind all the Member States together within the European Union.

B. Key Findings

4. **Overall, progress in implementing the recommendations of the 2007 A&A ROSC has been relatively slow.** The 2007 A&A ROSC recommended: (a) updating and modernizing the statutory framework; (b) adopting and implementing of international accounting and auditing standards, and monitoring their application; and (c) improving education and training for accountants and auditors.
5. **The Georgian Government had to adjust its priorities in 2008 to address the most crucial issues during a stressful “twin shocks” period.** During 2008 and the following years the country’s efforts were dedicated to addressing effects of the global economic crisis and the conflict with Russian Federation. Hence, more time was needed for key stakeholders to develop a common vision for accounting and auditing practices in Georgia as part of the broader ongoing complex reform process in the country.
6. **Recently, Georgia has demonstrated some progress in reforming its statutory framework for corporate financial reporting.** Important legislative changes have been introduced by the new Accounting and Auditing Law, demonstrating the Government’s commitment toward building a robust corporate financial reporting framework in Georgia.

Statutory framework

7. **New Accounting and Auditing Law, adopted in 2012, addressed a number of recommendations from the 2007 A&A ROSC, strengthening the statutory framework in financial reporting.** In particular, the document clarifies the applicable accounting, auditing and ethical standards for different types of entities. It outlines the statutory audit requirements for: (i) banks and other credit institutions subject to supervision of the National Bank of Georgia (NBG); (ii) insurance companies; (iii) listed companies and other entities regulated by NBG’s Non-Bank Supervision; and (iv) certain SOEs as specifically defined by the Government.
8. **A multi-tiered approach to accounting requirements has been expanded under the 2012 A&A Law.** Applicable accounting standards and reporting requirements are clearly outlined for different classes of entities, introducing simplified accounting requirements for smaller size businesses². This is a major improvement since 2007, though, more simplification is possible.
9. **As of the date of this Report, the implementation of several provisions of the 2012 A&A Law has been delayed until June 1, 2015,** including: (i) adoption of the IFRS for SMEs; (ii) requirements for the registration of statutory auditors; (iii) a requirement for auditors to comply with IFAC’s Code of Ethics; (iv) initiation of mandatory quality assurance reviews for statutory auditors; and (v) measures related to investigation and disciplinary actions towards auditors. It is important that these critical provisions of the 2012 A&A Law are implemented as envisaged with no further delay.

² This provision of the 2012 A&A Law has been delayed until June 1, 2015.

Setting accounting and auditing standards

10. **The new 2012 A&A Law requires the use of international accounting and auditing standards.** From June 1, 2015 all Georgian entities subject to statutory audit are obliged to prepare their financial statements in accordance with IFRS; and all other entities should prepare their financial statements in accordance with the IFRS for SMEs as approved by the IASB³. No specific standards have been designed or adopted for micro entities.
11. **The 2012 A&A Law requires that all statutory audits be carried out in accordance with ISA and that statutory auditors comply with the Code of Ethics issued by the International Ethics Standards Board for Accountants (IESBA).**⁴ Institutional arrangements regarding the appointment of statutory auditors and the conduct of audits have been improved substantially and correspond with good international practice including those prescribed in the EU audit directive.⁵
12. **The process for the translation of international standards is lagging behind and the quality of translations needs improvement.** The 2012 A&A Law assigns the responsibility for standards translation to an IFAC-accredited professional organization. As of the date of this report, there is only one such organization in Georgia and since 2008, it has had sole responsibility for translating and publishing the latest editions of IFRS, the IFRS for SMEs and ISA in the Georgian language. This process in its current form is not sustainable due to insufficient funding and lack of technical resources.

Compliance with accounting and auditing standards

13. **Demand for high-quality financial statements is still limited overall.** The Georgian capital market remains rather shallow, with banking sector dominating the financial sector. Georgian banks tend to give very little value to proper financial reports furnished by potential and existing borrowers, mainly relying on loan collateral. Collateralization requirements in Georgia averaged 223%⁶ of the loan values, and are partially caused by the lack of credibility and transparency of the financial information presented by borrowers.
14. **The quality of financial statements remains uneven across different sectors and types of entities.** These financial statements lack many of the key basic attributes of good quality financial statements, such as explanatory notes. A detailed review of sample financial statements revealed little to no improvement in the quality of the financial statements since 2007 A&A ROSC.
15. **Most regulatory agencies lack technical expertise and human resources to properly execute their supervisory and enforcement functions.** Monitoring and enforcement of accounting standards in Georgia remains decentralized and performed by multiple agencies, each responsible for their field of regulatory compliance. Different regulators have different approaches towards standards enforcement and the required level of compliance, leaving

³ This provision of the 2012 A&A Law has been delayed until June 1, 2015.

⁴ IESBA is an independent standard setting board operating under the auspices of IFAC from January 2013.

⁵ Directive 2006/43/EC “on statutory audits of annual accounts and consolidated accounts”, as amended by the Directive No 2014/56/EU of the European Parliament and of the Council of 16 April 2014.

⁶ As published in Enterprise Survey 2013: <http://www.enterprisesurveys.org/data/exploreeconomies/2013/georgia>

gaps in supervision, enforcement and monitoring. The mandatory implementation of IFRS by regulated entities remains a challenge at present.

16. **Public access to financial statements in Georgia remains limited.** Financial statements of commercial banks are publicly disclosed and can be accessed through their internet pages. By contrast, access to the financial statements of other regulated entities is difficult, even though they are required to publicly disclose these. Companies other than JSCs reporting to the NBG's non-banking supervision department, are not required to file or publish their financial statements regardless of their size and legal incorporation.

The accountancy profession

17. **The accounting and auditing profession in Georgia has made some progress since the 2007 A&A ROSC.** Through reorganization of previously existing institutions and establishment of new functions, the profession has become largely self-regulated and independent. The 2012 A&A Law introduced precise definitions of a certified professional accountant, auditor and audit firms.
18. **The support of the Government is critical to strengthening accounting and auditing practices in Georgia.** The 2014 Association Agreement with the EU calls for raising the standard in financial reporting, audit quality and regulation, and businesses accountability. These steps will require close and formal cooperation between relevant Government institutions, such as the Ministry of Finance, Central Bank, various regulators, etc., and professional organizations. Increased cooperation will help enable effective monitoring and enforcement of accounting and auditing standards, and address the quality of audit services and education needs of the accounting profession.
19. **Most audit regulatory functions have been delegated to accredited professional organizations that are members of an internationally recognized professional body⁷.** The 2012 A&A Law delegated the following functions and regulatory enforcement obligations to accredited professional organizations: (i) translation and timely updates of the standards; (iii) initial registration of auditors, and maintenance of such registry⁸; (iv) conducting audit quality reviews⁹. Sustainable funding needs to be established to ensure that translation and timely updates of the standards and other related functions can be carried out free from undue influence and bias.
20. **The Georgian accounting profession is represented by three professional bodies.** The largest professional organization, GFPA, is responsible for accounting and auditing standards translation and enforcement. The other two Georgian professional organizations are seeking international accreditation to provide a greater spectrum of services and full regulatory support to their members. The Georgian accounting profession would benefit from increased collaboration among professional organizations to better represent their interests and leverage limited resources and capacity in the country.

⁷Accredited Professional Organization – a professional organization of accountants or/and auditors, which pursuant to the Georgian legislation, is registered as a non-entrepreneurial (non-profit) legal entity and represents a full member of the International Federation of Accountants (IFAC) or a full member of regional organization recognized by the International Federation of Accountants (IFAC) or an accredited person in accordance with requirements of the 2012 A&A Law.

⁸ This provision of the 2012 A&A Law has been delayed until June 1, 2015.

⁹ This provision of the 2012 A&A Law has been delayed until June 1, 2015.

21. **Accounting and auditing education at university and continuing professional education require strengthening and modernization.** The current level of theoretical knowledge and practical skills among accountants is low, and requires significant investment to improve the standard of professional education and continuous professional development programs. Modern high quality accounting and audit education is crucial for further development of the profession in Georgia. Better education for current and future generations of accountants and auditors will strengthen reporting practices and improve the quality of financial information in Georgia.

C. Areas for Improvement

22. **Equipping Georgia with a modern and effective institutional framework for corporate financial reporting and auditing will require improvements in the following areas:**

- i) Definition of public interest entities (PIEs) in Georgian legislation. To be consistent with the EU's Accounting Directive¹⁰, these should include: (i) entities traded on a regulated market; (ii) credit institutions; (iii) insurance undertakings, and (iv) undertakings that are of significant public relevance due to the nature of their business, their size or the number of their employees.
- ii) Introduction and harmonization of definitions of public-interest entities, large, medium, small, and micro undertakings, by size of their business and type of ownership across various pieces of legislation, including the 2012 A&A Law, to eliminate any lack of clarity, and facilitate standards compliance and enforcement.
- iii) Requirement that all companies significant to the Georgian economy, i.e., PIEs and large undertakings as defined by the Accounting Directive, publish their audited unabridged financial statements before the annual general meeting or within a reasonable period of time, which shall not exceed 12 months after the balance sheet date, either through the internet or by providing copies free of charge, so that shareholders are better prepared to decide on the approval of these statements.
- iv) Identification and designation of an existing regulatory body(-ies), or department(s) within the existing regulators, to enforce the accounting standards and reporting compliance for PIE and large undertakings. This body(-ies) should be equipped with standard enforcement mechanisms and respective enforcement authority.
- v) Centralization of the filing of SOE financial statements. The existing system of SOEs reporting to either the National Agency of State Property or their respective line Ministries creates duplication and does not allow the Government to have a consolidated view of assets and companies in which the state holds capital.
- vi) Establishment of a new body, or designation of an existing body, to become the competent authority in charge of the regulation and/or oversight of statutory auditors and audit firms, as required by the Audit Directive. The Directive provides for significant flexibility in audit regulation. Georgia should use the time allowed under the

¹⁰ Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 “on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings”.

Association Agreement to learn more about this policy area from international experience, explore the obligatory requirements of the Audit Directive and consider the implementation of optional provisions for a later stage.

- vii) Continued increase in regulators' institutional capacity to monitor and enforce compliance with financial reporting requirements. These institutions should have adequate resources to perform in-depth reviews of corporate financial statements and related audit reports.
- viii) Enhanced collaboration between the Government and the accounting professional associations to strengthen compliance with IFRS, establish quality control over audits, ensure timely translation of standards, and raise the quality of continuing professional education.
- ix) Strengthened accounting academic curricula and aligning university programs with professional training and examination requirements at the accredited professional organizations in the field of accounting and auditing, as well as continuing professional education and training, in line with IFAC's education standards.
- x) Introduction of minimum requirements for university-level education in accounting and auditing, based on International Education Standards for Professional Accountants, set and coordinated by the Ministry of Education to ensure consistent application among universities in Georgia.
- xi) Requirement that professional accountants follow training programs to improve and update their knowledge of standards and good practice in the field of accounting and auditing. Professional organizations and leading audit and accounting companies should consider offering comprehensive training courses for bookkeepers and accountants working with IFRS or the IFRS for SMEs.

D. Next Steps

- 23. **The ROSC report provides a framework of identified issues, incorporating a wide range of inputs discussed with the Ministry of Finance, Parliament of Georgia and other key stakeholders.** The findings of this report and suggested areas for improvement have been discussed in Tbilisi with key in-country stakeholders, and final recommendations were jointly developed.
- 24. **The recommendations of this Report are based on the following guiding principles:**
 - establish and develop working level cooperation between governmental bodies involved in the corporate financial reporting and auditing reforms and regulations;
 - build and improve existing mechanisms of information exchange;
 - build capacity among the regulators and preparers of financial statements to implement and apply standards in practice, and ensure compliance;
 - promote the application of principle based rules as promulgated by the IFRS and the Conceptual Framework;
 - balance short term needs - such as training regulators, auditors and preparers of financial statements and increasing the availability of financial statements - with long

term priorities - such as raising the quality of financial information and audit services in Georgia.

25. **Implementing the report's recommendations will require for the Government to:**
 - identify longer-term strategy and shorter-term actions,
 - designate institutions and individuals responsible for CAP implementation, and
 - assess the need for resources to support implementation.
26. **The Government chose to prepare transposition tables to facilitate harmonization of the existing legislation with the relevant aspects of the EU *acquis communautaire*.** These tables are based on the template developed and applied by the European Commission for tracking the progress of EU member states in transposing the EU Directives into their national legislation.
27. **Reforms in the area of financial reporting and auditing will affect many: business community, auditors, investors, regulators.** It will be important to maintain dialogue and consultations with key institutions involved in these reforms, including: legislature (Parliament of Georgia), policymakers (Ministry of Finance), regulators (National Bank of Georgia, Insurance State Supervision Service of Georgia), representatives of private sector and the accounting profession via professional associations and audit firms.
28. **The Ministry of Finance should take the lead on developing legislative proposals and coordinate the reform process in harmonizing the existing legislation with the relevant aspects of the EU *acquis communautaire* on financial reporting and auditing.** Close coordination among the Ministry of Finance, accounting professional organizations, key institutions in the area of external auditing and other in-country stakeholders will be crucial in reform implementation. The Ministry of Finance may consider establishing a working group to coordinate the transposition tables and produce the draft legislation needed to align current legislation more closely with the EU Accounting and Audit Directives.
29. **The World Bank supports Georgia's reform efforts, and provides assistance under an existing regional program.** The regional program on Strengthening Auditing and Reporting in the Countries of the Eastern Partnership (STAREP), which includes Georgia, delivers a range of activities focusing on enhancing accounting education systems, improving institutional frameworks for corporate financial reporting, fostering the adoption of EU-compliant standards, building closer international ties, and sharing good practices between key institutions. The program began in October 2013 and will run until 2018, during which time Georgia will benefit from regional activities and targeted in-country engagements focusing on implementing the recommendations of this report.
30. **The STAREP regional program will provide tailored support to Georgia in taking corporate financial reporting reform forward.** The program will in particular assist in prioritizing activities dedicated to legal framework harmonization with the EU Accounting and Audit Directives, but also including capacity strengthening and knowledge sharing events, providing Georgian counterparts with a unique opportunity to build on the EU experience in this field.

I. Introduction

1. **Reports on the Observance of Standards and Codes (ROSC) Accounting and Auditing (A&A) assess accounting and auditing practices in participating countries.** They form part of a World Bank and International Monetary Fund joint initiative to review the quality of implementation of twelve internationally recognized core standards relevant to economic stability and private and financial sector development (the ROSC Program). Since its inception in 2000, the ROSC A&A program has concluded evaluations of the A&A environment in more than one hundred countries around the world. ROSC A&A reports have been produced for all countries of the Europe and Central Asia Region, except Russia.
2. **This assessment was undertaken at the request of the Government of Georgia and builds on the previous Accounting and Auditing ROSC that was prepared in 2007.** The objectives of the 2007 ROSC were to: (i) enhance the business climate and bolster domestic and foreign direct and portfolio investment in the private sector; (ii) stimulate growth in the SME sector by facilitating access to credit from the formal financial sector, with a gradual shift from collateral-based lending decisions to decisions based on financial performance; (iii) support banking sector stability, mitigate the risk of crises due to loan collection problems, and help mobilize domestic savings; and (iv) achieve greater financial transparency in the corporate sector, both State and private-owned, allowing shareholders and the public to assess management performance and influence its behavior. The ROSC found weaknesses and made a range of recommendations to the existing statutory framework; in the adoption of international accounting and auditing standards and their monitoring and enforcement; and in the provision of modern relevant education and ongoing professional development (more detail is available at annex 1).
3. **This ROSC A&A Update seeks to:** (i) contribute to the government's strategic objectives of raising the effectiveness of the accounting and auditing profession and its regulation, (ii) improve corporate governance, especially around financial reporting and accountability; (iii) enhance the quality of statutory audits, thus, raising credibility of corporate financial reports; (iv) help the Government alleviate the administrative burden currently imposed on SMEs with the need to produce accounts in accordance with rather sophisticated requirements; and (v) assess progress made by Georgian accounting and auditing professional bodies as well as Georgian regulatory agencies with respect to implementing the recommendations of the original ROSC A&A, agreed with the Government in 2007. All of these objectives are fully in line with the recently signed Association Agreement between Georgia and the EU.
4. **This report covers the accounting, audit, and financial reporting frameworks as a whole, paying particular attention to the financial sector, state owned enterprises, SMEs and audit regulation - key areas that are important in the current economic context of Georgia.** With respect to SOEs, the report focuses on the existing requirements, standards enforcement, and use of financial reports and statutory audit findings by the Government in its decision making and monitoring of SOEs. This report also discusses SMEs existing financial reporting requirements, and the need to simplify the requirements for the small and micro businesses. Finally, the report reviews the audit oversight function and a quality assurance system soon to be employed by Georgia, and provides recommendations to raise the quality of audit services through the strengthening of audit oversight.

Box 1: Georgia's Partnership with the World Bank

Georgia joined the World Bank in 1992 and the IDA in 1993. The Bank has provided financing for 57 projects in different sectors totaling over US\$1.95 billion of IDA credits and grants and IBRD loans, of which about 92% has already been disbursed. Approximately 63% of Bank financing for Georgia is for investment projects, while 37% is directed to budget assistance through DPOs.

The new Country Partnership Strategy for FY 2014-2017 envisages a new lending envelope of about US\$1.18 billion, which is roughly 30% higher than the program delivered under the previous CPS (US\$823 million in FY10–13). Georgia has graduated from IDA effective July 1, 2014. The Government has confirmed its interest in maximizing IBRD borrowing.

Analytical and Advisory Activities (AAA) of The World Bank remains essential to the Georgia Partnership program implementation, providing the underpinning for Development Policy Operation –supported reforms and complimentary to lending. The AAA helped in understanding growth dynamics, poverty and public sector performance and played a key role in proposing development solutions. The AAA program is aligned with lending, whereby key analysis nourished the design of operations and prioritize reforms and engagements.

A. Country Context

5. **Georgia is located along a strategic corridor connecting Europe with Asia - south of the Caucasus mountain range, with Russia to the north, Armenia and Turkey to the south, and Azerbaijan to the east.** Georgia became an independent state in 1991 after the disintegration of the former Soviet Union. Georgia has a population of 4.5 million and has a total area of 69,700 square kilometers. The capital city is Tbilisi with a population of approximately 1.5 million. Approximately 85% of the country is mountainous with the highest, Mount Shkhara, at 5,068 meters (16,627 ft). The state's authority is based on the principle of separation of legislative, executive and judicial powers, with a parliamentary system of governance since 2013. Under the new constitution the Prime Minister has the full executive authority over domestic and foreign policy. The highest legislative authority is the Parliament (150 deputies), which has the right to enact laws.
6. **Georgia has taken steps to strengthen significantly market access and establish closer economic ties with the European Union.** It initialed an Association Agreement with the EU at the Vilnius summit in November 2013; with completed signing of the Association Agreement and Deep and Comprehensive Free Trade Area (DCFTA) on June 27, 2014. After finalizing the Agreement, Georgia further committed to high standards of accounting, auditing and corporate governance established by the European Union's *acquis communautaire*. This historic step represents an important opportunity for Georgia to strengthen its cooperation with Europe on political, economic, social and security issues, and to benefit from bilateral free trade.

B. Economic Context

7. **A period of robust growth came to an end in 2008 when Georgia suffered the “twin shocks” of the global economic crisis and the conflict with Russia.** Growth slowed in the aftermath to 2.3% in 2008 and the economy contracted by 3.8% in 2009. Since then, due in part to the fiscal stimulus undertaken in 2009, Georgia has recovered and recorded steady growth above 6% in 2010-2012. From 2010, the government consolidated the fiscal framework, reducing the overall deficit to 2.8% in 2012. Economic growth is projected at an average of 5.5% a year over the medium term depending on a number of factors, including improved economic ties with the EU, improved relations with Russia (which will benefit trade and tourism), and the robust reform program outlined in the Sustainable Development Strategy, which will support growth in private investment and reduce reliance on public capital spending. Growth prospects depend on Georgia’s ability to leverage the DCFTA and Association Agreement with the EU, which will improve market access and encourage FDI. A trade sustainability impact analysis commissioned by the EU suggests a potential increase in GDP growth of 4.3% in the long-run. This will call for labor and capital reallocations to more productive sectors, involving capacity building on regulatory approximation particularly in trade facilitation, technical barriers to trade, and intellectual property rights and upgrading of and investment in human capital.
8. **Georgia is a lower-middle income country with GDP per capita of US \$3,597 as of 2013¹¹.** The largest share in the sectorial structure of GDP is held by Trade services (17.3%) and Industry (17.2%), followed by Transport and communication services (10.7%), Public administration (10.1%), Agriculture, forestry and fishing (9.3%), Construction (6.7%) and Health and social work (5.8%). The most significant industries are food processing and the production of mineral water, soft drinks and alcoholic beverages. Manufacturing of metal & chemical products and electrical equipment still remain important industries for the country. The economy is generally import-dependent.
9. **The Georgian economy is dominated by large enterprises producing around 80% of the country’s GDP, and employing 61% of official labor force¹².** Micro entities and SMEs contribution to the Georgian economy is lower than global norms: they account for 39% of formal employment and 19% of GDP; and their contribution to value added is equally low, estimated at 20%. More than 58,000 business entities are registered in Georgia but, in 2013, less than 48,000 are believed to be in operation. Of these operating companies, 94% are defined as micro, small and medium-sized entities, and only 6% (or 3,500 enterprises) are classified as large enterprises in Georgia. This balance has remained mostly unchanged over the past six years.
10. **Georgia’s business environment has improved significantly since 2006.** In 2013 Georgia ranked 8th worldwide with respect to the ease of doing business (Doing Business 2014 Index), the highest in the region¹³. It was ranked 112th in the same report for 2006. Procedures for paying taxes (ranked 29th) and trading across borders (ranked 43rd) have been simplified. Obtaining credit is easier than in many other countries of the world (ranked 3rd). Improved access to credit through implementation of a central collateral registry with an electronic database accessible online, an amendment to the civil code allowing a replacement of

¹¹ National statistics Georgia website www.geostat.ge

¹² National statistics Georgia website www.geostat.ge

¹³ Doing Business 2014: <http://www.doingbusiness.org/data/exploreeconomies/georgia>

collateral, and a new law on personal data protection led to improvements in Doing Business rankings for insolvency (from 92 DB 2013 rank to 88 DB 2014 rank).

11. **Unemployment remains high despite Georgia's robust growth performance and is the main development challenge.** With economic transformation in Georgia, some of the older industries died, shedding their labor force. New industries grew during the same period, but have not been able to absorb the workforce as effectively because net job creation has been low. Unemployment peaked at 17% in 2010 and then fell to 15% in 2012. Georgia has the potential to increase sustainable and inclusive growth through a strengthened focus on private sector-led job creation and effective public spending but lack of access to finance for SMEs (employing 39% of the workforce) hampers their potential to increase employment in the country.
12. **While its pioneering business environment policies gave the country global recognition as a top performer on the Doing Business indicators and made it a more attractive destination for FDI, they were insufficient to bring about the desired revival of manufacturing, transformation of agri-business and growth of export-oriented sectors.** New growth sectors, especially in tourism and other service sectors, have not been able to generate formal employment as effectively as a robust agri-business or manufacturing sector would have. The majority of the work force – more than 55 percent – is employed in agriculture (mostly self-employed in family subsistence farming), but the sector contributes to only 8.2 percent of GDP. Low productivity levels in agriculture have contributed significantly to high rural poverty. Improving agricultural productivity and facilitating the movement of labor from agriculture into higher productivity activities are essential for strengthening economic opportunities in rural areas.

C. Financial Sector

13. **The financial sector is comprised mainly of banks, insurance companies and microfinance organizations.** The Georgian banking sector dominates the financial sector, with very high market concentration, low penetration and mixed ownership structure. Banks remain the most important financial institutions in Georgia accounting for 75% of financial system assets. At the end of 2013, there were 21 commercial banks, including two branches of foreign banks, operating in Georgia.
14. **The banking system has returned to pre-crisis performance levels, showing solid profitability, strong liquidity, and a solid capital base.** Credit to the private sector and households increased by 20% in 2013 (as compared to 12.8% in 2012), and reached 37% of GDP in 2013. During 2013 the banking sector assets grew to 66.1% of GDP as compared to 59.2% of GDP at the end of 2012.
15. **The quality of the banking sector loan portfolio, as reported by the NBG, remains stable and banks' profitability is among the highest in the Europe and Central Asia region.** The share of nonperforming loans is declining gradually from 17.9% in 2009 to 7.5% in December 2013. The return on assets and return on equity stood at 2.5% and 14.6%, respectively, at the end of 2013 as compared to 1.0% and 5.8% at the same period of 2012.
16. **The banking sector has sufficient liquidity, supported by the growth of client deposits, and the NBG increased the refinancing of banks.** Liquid assets to total assets remained at

27.5% at the end of 2013 (just a slight increase from 27.3% in 2012). The loan-to-deposit ratio further improved from 106.7% at the end of 2012 to 102.9% in December 2013. Client deposits increased steadily in 2013, recording 26% growth in 2013 as compared to 11% growth in 2012. Nonetheless, savings in the economy remain rather low and are among the lowest in the ECA region, despite the fact that the share of deposits grew from 31% of GDP in 2012 to 38% in 2013.

17. **The role of the insurance sector is growing both in terms of written gross premiums and assets.** According to the 2013 data, there were 14 insurance companies (currently 13, as one of them is facing insolvency) active in the market. There are five market leaders accounting for 82% of total written gross premiums, and 81% of total market assets. Of these five companies only one is wholly owned by a bank.
18. **The Georgian capital market remains shallow. Developing the domestic capital market will ease constraints for firms, by providing an alternative source of funding.** Since 2009 most corporate issuers and the state were placing securities internationally. Since 2013 the government became an active player in the domestic market, with more than 90 percent of issues purchased by commercial banks. Government securities are more attractive than many other investment activities, including MSME lending. There are no private investment¹⁴ or equity funds registered in Georgia, while corporate mutual investment schemes and venture capital financing are not yet developed¹⁵.
19. **The inactive stock market, already challenged by the small size and high transaction costs, is not attractive to equity and debt investors.** There are ten brokerage firms, one corporate security depository, one stock exchange and three independent private registrars in the market. Local blue chips and companies looking to attract investments prefer to tap international markets, further undermining the functioning and purpose of the local market.

D. State-owned Enterprises

20. **According to business survey statistics, the state owned enterprise sector in Georgia is relatively small, contributing 7% of GDP in 2012 and accounting for about 10% of total formal employment.**¹⁶ The 2004-10 privatization program led to significant decrease in public enterprise employment: from 144,000 employees in 2004 to 60,000 employees in 2012. Although the share of SOEs is small in terms of output, their contribution to investment in fixed capital is oversized at 24% of total corporate investment in 2012. This is essentially due to intensive investment and the high cost nature of the sectors in which the large SOEs operate: energy, transport and large infrastructure projects. Other SOEs operate in the health sector, municipal services, agriculture, tourism and manufacturing sectors.
21. **The five largest and most strategically significant SOEs in Georgia account for up to 90% of total SOEs assets in the country and are grouped under the extra budgetary Partnership Fund**¹⁷. The combined profit of these five SOEs amounted to GEL 63.5 million in 2012, or about 0.2% of GDP. Four out of five SOEs are making profits. Based on

¹⁴ Investment funds operating in Georgia include Co-Investment Fund, SEAF Growth and SEAF Regional Development (already closed), registered off-shore.

¹⁵ As published in Country Economic Memorandum 2013.

¹⁶ Georgia PER 2014: <http://documents.worldbank.org/curated/en/docsearch/projects/P143721>

¹⁷ JSC Partnership Fund: http://www.fund.ge/eng/who_we_are/4

negotiations with the government, these companies paid dividends of GEL 6.7 million in 2012 to the Fund. Their consolidated financial data also showed a positive return on assets and return on equity in 2012. The only exception was the Georgian State Electrosystem (GSE) which was not profitable. Sensitivity analysis impacting the operating income and other costs and income of the SOEs reaffirms the robustness of their operations.

22. **The government undertakes significant quasi-fiscal operations through large SOEs, which potentially understate the fiscal deficit and overall debt.** Exact costs are not available but the government provides subsidized utilities to the population (gas, electricity, transport) through its five largest SOEs, for which they are not compensated. In addition, these SOEs undertake investment projects on behalf of the government, also without any additional support from the Government. Revenues and costs related to carrying out these Government mandates need to be mainstreamed into the budget, potentially increasing the fiscal deficit. Additional costs could surface from SOEs for which data is not currently available, especially those under the Ministry of Economy and Sustainable Development, several of which are bankrupt. Some of the largest SOEs are highly indebted and assumption of SOE debt would also increase the Government debt.

E. Importance of sound corporate financial reporting infrastructure

23. **Improved corporate sector financial reporting and auditing, along with the appropriate disclosure of financial information, can contribute to further economic development and improve access to finance.** Timely and reliable financial information enables an enterprise to improve its managerial and governance decisions, raises its credibility as a trade and investment partner, borrower, and facilitates the dialogue with stakeholders and potential investors domestically and internationally.
24. **High quality financial information improves the investment climate, business environment and availability of credit for enterprises.** Reliable financial information allows banks to make better informed credit decisions, thereby relaxing collateral requirements and improving access to finance. Improving accounting, auditing and financial reporting practices alone is not enough to solve the country's problems, but can significantly contribute to the economic stimulus and raising public confidence in financial reporting and mechanisms that protect the public interest.
25. **The lack of credible and trustworthy financial information is a key factor in lenders requiring high collateral** (on average, for up to 223% of loan value as reported in *Enterprise Surveys 2013*¹⁸), and it restricts access to financing for SMEs in agriculture and manufacturing sectors. High collateralization requirements resulted in lending in Georgia being mainly provided to trade companies, households and real estate operations.
26. **A lack of transparency of firms, including financial information and ownership, combined with the rare practice of auditing financial statements pose significant difficulties for lenders.** According to Enterprise survey data¹⁹, only 28% of Georgian companies prepare financial statements and have them audited (even then they are of mixed

¹⁸ <http://www.enterprisesurveys.org/data/exploreeconomies/2013/georgia>

¹⁹ <http://www.enterprisesurveys.org/data/exploreeconomies/2013/georgia>

quality and not always based on international reporting standards). The existing framework for protection of property rights inhibits additional risk-taking for lending and investment in Georgia. Access to, and quality, of enterprise data, especially of joint stock companies, remains a major challenge.

II. Institutional Framework

A. Statutory Framework

Framework for Accounting and Financial Reporting

27. **The legal and institutional framework for corporate financial reporting in Georgia is evolving slowly with recent changes to key laws.** Since the publication of the 2007 A&A ROSC, a new accounting and auditing law, and various amendments to the banking, insurance and securities regulatory framework have been passed. Positive changes to the laws include clarification of applicable accounting, auditing and ethical standards for different types of entities, requirement for a register of statutory auditors, and improved public access to audited financial statements of banks. These changes are important steps toward building a robust corporate financial reporting framework.
28. **The Law of the Republic of Georgia On Entrepreneurs establishes the nature and organizational requirements, including basic corporate governance arrangements, of all commercial entities in Georgia.** The law identifies six types of business formations²⁰. This report will focus on the two types of entities in which shareholders have limited liability, as they offer reduced protection to investors, creditors and other stakeholders:
- *Limited Liability Companies (LLCs)* (approx. 137,900²¹) – have no minimum capital requirements and a maximum of 50 shareholders. Shares cannot be publicly traded and the company's liability is limited to the nominal share capital.
 - *Joint Stock Companies (JSCs)* (approx. 2,240) – also have no minimum capital requirements and the company's liability is limited to its nominal share capital. However, they have unrestricted shareholder membership, with the possibility of different classes of shareholders, and may be publicly traded.
29. **The 2012 A&A Law expands the differentiated approach to accounting requirements and clearly outlines the applicable accounting standards for different classes of entities.** One major improvement of the new Law is that it exempts individuals defined by the Tax Code as micro or small business from any financial reporting requirements. The new accounting standards requirements become effective June 1, 2015. Until then temporary standards of accounting and other requirements established by regulatory bodies continue to govern financial reporting standards in Georgia. A summary of current and future accounting standards requirements are in Annex 2.
30. **Further efforts are needed to align the legal and institutional framework with international good practices and the EU Accounting Directive.** Addressing remaining gaps and inconsistencies will enhance the quality of financial information provided to creditors; improve the accountability of businesses to key stakeholders; and protect the interests of stakeholders and other interested third parties who do not have access to undisclosed information. Requirements include: (i) independent monitoring of the

²⁰ The six types of commercial entities in Georgia are: 1) sole proprietors, 2) general partnerships, 3) limited partnerships, 4) limited liability companies (LLC), 5) joint stock companies (JSC), and 6) cooperatives.

²¹ Figures for the number of LLCs and JSCs are as at March 1, 2014 and were obtained from the National Statistics Office of Georgia's website (www.geostat.ge).

accounting and auditing profession; (ii) adequate filing and publication requirements to ensure the availability of quality financial information; (iii) proper enforcement of the accounting standards; and (iv) refinement of reporting requirements for public interest entities, including SOEs, other large undertakings, as well as small and medium enterprises (SMEs) and micro entities.

31. **Under the signed Association Agreement with the EU, Georgia has committed to implement the requirements of the following EU Directives** insofar as they relate to public limited liability companies, within three years of Agreement entry into force:
- a. Directive No 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings²²;
 - b. Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards;
 - c. Directive No 2006/43/EC of the European Parliament and of the Council of 17 May, 2006 on statutory audits of annual accounts and consolidated accounts, as amended by the Directive No 2014/56/EU of the European Parliament and of the Council of 16 April 2014.
32. **Scheduled application of the referenced Directives shall be implemented by Georgia within three years for the public limited companies.** The country will have one year to establish, clarify such requirements applicable to other types of companies, and agree those with the Association Council.
33. **A number of areas will require substantial reforms to align Georgian legislation with the EU *acquis communautaire* in corporate financial reporting and auditing, including:**
- (i) definition of entities by type, including public interest entities²³,
 - (ii) establishing proper accounting, reporting, auditing requirements and respective publication guidelines based on type of entity, allowing SMEs to reduce their reporting burden;
 - (iii) harmonization of varying definitions of reporting entities among different pieces of legislation;
 - (iv) significantly strengthening monitoring and enforcement mechanisms to ensure compliance with the standards and requirements;
 - (v) introducing public audit oversight and audit quality control mechanism to support public confidence in the statutory audit function;
 - (vi) implementing a system for approval and registration of statutory auditors and audit firms; and
 - (vii) establishing clear requirements and enforcement of professional education and training for accounting and audit profession.

34. **A more coherent approach to the reform process is required.** Inconsistencies and gaps in the legal framework arise because new laws, amendments, decrees and other regulations

²² Directive No 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings repeals and succeeds the Fourth Council Directive No 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies, and the Seventh Council Directive No 83/349/EEC of 13 June 1983 on consolidated accounts, referenced in the Association Agreement, Annex XXVIII.

²³ As defined by EU Accounting Directive and EU Regulation No. 537/2014 regarding the statutory audits of PIEs.

are added without sufficient reconciliation with previous laws, including removal of rescinded legal requirements or extinct institutions. One example is the National Bank of Georgia's decree regulating the external audit of banks which refers to an auditor as someone holding an auditor's certificate issued by the Audit Council, although the Audit Council no longer exists²⁴. These and other inconsistencies, along with frequent changes cited by stakeholders, increase the risk that financial reporting requirements will not be applied appropriately or consistently due to a lack of clarity.

35. Some aspects of a good corporate governance framework that enhances accountability and transparency of entities' financial reporting are in place, but could be strengthened.

- The Entrepreneur Law requires shareholders to approve the audited financial statements of JSCs, and elect the auditor in the annual general meeting. JSCs must have a supervisory board to oversee management (directors); supervise the company's accounting records; inspect the annual reports; and call general meetings. To improve the quality of financial reporting and maintain appropriate relationship with the auditors, the statutory requirements outlining the responsibilities and liabilities for the probity of financial statements should be enhanced.
- While current company law in Georgia states that directors of LLCs and JSCs, and members of the supervisory boards of JSCs are responsible for the probity of financial statements, joint and several liability is established only for management. The chairman of the supervisory board and the company designee who signs the financial statements are individually liable. This is not in line with international good practice, including in the EU, where members of the board are collectively responsible for the probity of financial statements.
- In addition, except for banks, there is no legal requirement for JSCs to establish an independent audit committee to monitor the integrity of financial statements. While, some countries require audit committees for publicly listed companies, others such as they EU require all public interest entities to establish an audit committee, with responsibility including but not limited to: reviewing significant financial reporting requirements and internal financial controls; providing recommendations on the appointment and dismissal of auditors; monitoring auditor independence and objectivity; and setting guidelines for provision of non-audit services by the auditor.

36. Some entities that would be classified as public interest entities²⁵ in other jurisdictions, including in the EU, and subjected to more robust financial reporting requirements, have simplified reporting requirements in Georgia. All LLCs are required to apply the IFRS for SMEs (although they may apply IFRS), and are not required to have an annual audit conducted, or file or publish their financial statements. Some of these entities may be considered as significant to the Georgian economy based on their share of certain sectors or industry, size, number of people they employ, legal status, or nature of their commercial activities.

37. Georgia will need to define public interest entities and large undertakings, which will be subject to more robust financial reporting and disclosure standards, and statutory

²⁴ The 2012 A&A Law allows auditors' qualification certificates issued by Audit Council under the Parliament of Georgia, remain valid until January 1, 2018.

²⁵ Public interest entities as defined the EU Accounting Directive, are credit institutions, insurance companies, listed entities, and other entities, which due to the nature of their business, size, number of employees or their legal status, have a wide range of stakeholders.

audit requirements. Increasing the level of transparency and accountability for large LLCs given their limited liability status and significance to the Georgian economy, would be in line with previous recommendations, and further align the financial reporting framework in Georgia with EU Association Agreement and good international practices.

38. **Financial statements of regulated entities are publicly available to varying degrees.** Banks, insurance companies and JSCs reporting to the NBG's non-banking supervision department, are required to file their audited financial statements with their respective regulators. However, requirements to publish financial statements vary (Annex 3 provides details of the filing and publication requirements). Stakeholders have the most access to bank's financial statements but there is no general requirement for non-regulated entities to file or publish their financial statements, and as a result the public does not have easy access to financial statements in Georgia. This lack of readily available financial information hinders decision-making, lowers the quality of underwriting and impacts the risk management process of other stakeholders, such as investors or creditors. These inconsistent publication practices are out of line with the EU Accounting Directive and the EU Transparency Directive²⁶, tilting the balance in favor of confidentiality over transparency.
39. **There are strong linkages between tax and accounting requirements, which may adversely affect financial reporting requirements.** The 2012 A&A Law uses Tax Code definitions of micro and small businesses, to determine sole proprietors that are exempt from financial reporting, and of related parties, to determine auditor independence for statutory audits. The Tax Code states that where taxpayers have an option to use cash or accrual accounting one of these must be selected and consistently applied, and that the same method must be used for both financial reporting and tax purposes. This results in financial reporting being overridden by tax reporting, especially in smaller entities. References in the 2012 A&A Law to the Tax Code inadvertently encourage application of tax reporting requirements in general-purpose financial statements.
40. **Government leadership and broader stakeholder collaboration are needed to achieve reform momentum in aligning the legal and institutional frameworks for corporate financial reporting with the EU Accounting and Audit Directives,** and international good practices. The current reform process is lagging behind, and lacks clear leadership. The Georgian government, in particular, the Ministry of Finance should take the lead on developing legislative proposals to harmonize the existing legislation with the relevant aspects of the EU *acquis communautaire* on financial reporting and auditing.
41. **Reforms in the area of financial reporting and auditing will have wide reaching impact.** There is, therefore, a need to include all stakeholders and align reform efforts amongst the government, regulators, judiciary, profession, academia, and business community. The Ministry of Finance may consider establishing a working group to coordinate the transposition tables and to produce the draft legislation necessary to align with the EU Accounting and Audit Directives.
42. **The requirement to use Georgian translations of international accounting and auditing standards, IFRS and ISA, has been delayed due to the time lag in translating regular updates of the standards and relevant pronouncements.** Translation of international

²⁶ Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013, amending Directive 2004/109/EC of the European Parliament and of the Council on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market.

standards has been delegated to the Georgian Federation of Professional Accountants and Auditors (GFPAA), the only Georgian professional accountancy organization with membership of IFAC. Translation of standards lags behind due to a lack of GFPAA funding and technical expertise. The market reports significant delays²⁷ and certain issues with quality of translation, which impact widespread use of up-to-date translated standards by most members of the profession.

- 43. **The 2012 A&A Law allows use of the original, English language version of the standards** when amendments and pronouncements have not been translated into Georgian language.
- 44. **Georgia may benefit from allowing the original English version of full IFRS to be used, and concentrate resources on translating the IFRS for SMEs.** This step will ensure the timely and high-quality translation of the IFRS for SMEs, used by the overwhelming majority of entities in Georgia²⁸, and eliminate the time consuming and technically complex task of IFRS translation.

SMEs

- 45. **The 2012 A&A Law introduces differentiated financial reporting requirements, including adoption of the IFRS for SMEs.** Starting from June 1, 2015, the IFRS for SMEs may be applied by any entity not classified as: (i) micro business (as defined by the Tax Code); (ii) entities subject to supervision of the National Bank of Georgia; or (iii) other types of entities as specifically defined by the Government of Georgia. This is a major improvement and simplification for small and medium entities, as under the previous version of the Accounting Law any entity not classified as micro had to apply full IFRS for their general purpose financial reporting which was difficult to accomplish in practice.
- 46. **The 2012 A&A Law exempts sole proprietors defined as micro or small businesses under the Tax Code from financial reporting requirements.** However, it increases the financial reporting requirements for other sole proprietors and small businesses (see Annex 4 for definitions). In order to reduce the administrative burden of excessive financial reporting requirements on micro undertakings and SMEs, thresholds for business entities need to be refined. The 2013 EU Accounting Directive provides good guidance on how this can be implemented.
- 47. **Although, the IFRS for SMEs is less complex than full IFRS, it may not be suitable for micro and small companies with few employees.** Application of the IFRS for SMEs requires professional skill and judgment, which may not be available to the staff of micro- and SMEs. No data exists on the number of entities affected by this change in the 2012 A&A Law, but many of the small entities that are now required to apply the IFRS for SMEs are unlikely to be able to do so. The impact of this requirement will result in increased cost for SMEs to hire expertise to enable them to comply and risks inconsistent application and preparation of financial statements, or non-compliance with the Law.

²⁷ The latest available translations are as follows: IFRS 2004 adopted with 2010 translated but not registered; and ISA 2004 adopted with 2009 translated but not registered. The following standards which are now applicable in Georgia are in various stages of translation: IFAC's Code of Ethics, the IFRS for SMEs, and IFAC's International Standard on Quality Control 1 (ISQC1).

²⁸ Starting June 1, 2015, as per 2012 A&A Law.

Banks

48. **Commercial banks are regulated by the National Bank of Georgia.** NBG is also responsible for supervision of the securities market, micro-finance institutions and credit unions. Responsibility for insurance regulation was transferred to a separate agency in April 2013. The Law on the National Bank of Georgia and the Law on Activities of Commercial Bank provide the legal framework for the supervisory regime.
49. **The 2012 A&A Law requires that all entities subject to NBG supervision must apply IFRS.** Therefore, all commercial banks in Georgia use IFRS for preparation of their general purpose financial statements.
50. **Banks are subject to additional regulatory requirements set by the NBG, many of which lay the foundation for a more robust financial reporting framework.** These include:
- **Governance.** Banks are required to establish an Audit Committee responsible for oversight of the internal and external audit functions. When properly implemented (as is the case in larger banks in Georgia) this has the potential to raise both quality and reliability of bank's financial reporting and the audit of bank's financial statements.
 - **Financial Reporting.** Banks are required to publish quarterly balance sheet and income statements, and to correct and republish inaccuracies in published financial statements within 10 days of notification from the NBG (although no cases of this regulation being enforced were identified). This increases the financial transparency of banks, contributing to market discipline and enhancing public confidence.
 - **Convergence of Prudential and Financial Reporting.** In addition to IFRS, commercial banks are also subject to separate requirements for prudential supervision purposes. These requirements differ from IFRS in a number of ways including loan loss provisioning, fixed assets valuation, scope of consolidation of subsidiaries etc. (discussed further in Section III of this report). The NBG has been working on converging the IFRS and prudential reporting, which will take approximately three years.

Insurance Companies

51. **Insurance companies in Georgia are required to prepare financial statements according to IFRS under the 2012 A&A Law.** Insurance companies are also subject to prudential reporting requirements. Prudential reporting requirements and IFRS differ significantly in several areas, including with respect to reserves calculations, bad debt provisions, consolidation of subsidiaries.
52. **In 2013 the Insurance State Supervision Service of Georgia (ISSSG), a new dedicated regulator, was established for supervision over the insurance sector,** taking over regulatory function from NBG. The regulatory framework for insurance companies needs to be further strengthened to raise quality of financial information and improve the level of transparency in the insurance sector.
53. **The financial statements of insurance companies in Georgia are not easily accessible to the public.** Insurance companies are required to have their annual financial statements audited and submitted to the regulator. Insurance companies are also required to publish their financial statements but no timeframe is specified for this. Of the thirteen insurance

companies operating in Georgia, audited financial statements for only four were available on the companies' websites.

54. **Changes are needed to improve transparency and encourage high quality financial reporting, raising the availability and quality of insurance companies' financial statements and enhancing the protection of third parties in the sector.** The ISSSG needs to refine or expand regulatory requirements related to: i) publication of financial statements; ii) conditions for the appointment and dismissal of statutory auditors, including reporting to ISSSG in case of auditor resignation or dismissal (and the grounds for dismissal); and iii) corporate governance arrangements in insurance companies. The NBG's decree on sanctions for non-compliance with applicable standards and reporting deadlines needs to be revised to reflect the transfer of the insurance supervision functions to the ISSSG.

Joint Stock Companies and other entities regulated by NBG Non-Bank Supervision Department

55. **NBG's non-banking supervision department oversees 257 joint stock companies, required to file their financial statements.** There are approximately 2,200 JSCs in Georgia, of which 257 are required to file their financial statements with the NBG's non-banking supervision department ("reporting" entities). 126 of these "reporting" entities were admitted to trade at GSE. In the past three years only approximately 25% of "reporting" entities filed financial statements and many of those were non-compliant with IFRS. Entities are exempt from reporting requirements if they: i) have less than 50 shareholders; ii) have been inactive for 2 or more years, or iii) are in bankruptcy proceedings.
56. **The number of entities required to file their financial statements appears excessive.** The scope work for the NBG's non-banking supervision department seems too broad for quality monitoring of financial reporting and audit requirements of "reporting" entities. There is a room for limiting the number of entities requiring to file their financial statements, enabling NBG's non-banking supervision department to focus on quality control of the financial information and disclosure by large and important entities, i.e. public interest entities (PIEs).
57. **Enhancing transparency and accountability among PIEs would better protect investors and other stakeholder's interests.** The lack of transparency affects the development of the capital market, and impedes firms' ability to access capital and financing, domestically and internationally. NBG's non-banking supervision department may play critical role in enhancing transparency and information access to Georgian market and ensure that standards are applied consistently across sectors and companies of public interest.
58. **Specific areas requiring attention in the new or amended legislation include:** i) definition of PIE's in line with the EU Accounting Directive; ii) publication requirements that would ensure public access to timely financial information, (iii) requirements for the appointment and dismissal of statutory auditors, (iv) corporate governance framework; and (v) clear administrative and pecuniary sanctions for non-compliance with filing and publication requirements. In determining the necessary regulations, the securities regulator should build these requirements for public interest entities and large undertakings as advised by the EU

Accounting Directive, and be mindful of not overburdening SMEs with unnecessary administrative requirements.

State Owned Enterprises

59. **Established reporting practices for SOEs, vague in design and poorly enforced, are not providing a full and accurate projection of Government owned assets, making it difficult to assess, evaluate and manage public assets.** The financial reporting framework for SOEs in Georgia is fragmented and fairly obscure. The 2012 A&A Law states that public sector entities are subject to public sector accounting standards, except where required by the Government of Georgia to apply private sector accounting standards. Of the over 6,000²⁹ entities of public law it could not be determined how many SOEs conduct commercial activities and would therefore apply private sector accounting standards (IFRS) and be subject to statutory audits. It is not clear which SOEs prepare their financial statements according to IFRS and whether they conduct annual audits. The National Agency of the State Property Fund (NASPF) of the Ministry of Economy and Sustainable Development oversees the simplified financial reporting of 381 SOEs, the majority of which are classified as non-functional. Other SOEs report to their respective line ministries, with no established system of information exchange between these ministries and NASPF.
60. **A transparent and functioning model for good corporate financial reporting for a few SOEs is in place under the JSC Partnership Fund, a state-owned investment fund.** The Fund functions as a private holding company, requiring its subsidiaries to apply proper reporting standards (IFRS), conduct audits, and disclose their annual reports publicly. The sample IFRS financial statements reviewed as part of this assessment included three (3) Partnership Fund subsidiaries and the findings are provided in Section III.
61. **Increased transparency of SOEs, especially those conducting commercial activity, could be significantly enhanced by clearly outlining the criteria and scope for financial statement preparation, auditing, filing, publication and corporate governance requirements.** This could have a positive impact on SOEs competitiveness, more efficient resource allocation, and improved access to international financial markets, which would increase their contribution to the Georgian economy and enable them to better serve the public's interest.

Other non-regulated entities

62. **Companies, other than JSCs reporting to the NBG's non-banking supervision department, are not required to file or publish their financial statements regardless of their size and legal incorporation.** Absence of financial statements filing and publication requirements goes out of line with the EU Directive 2009/101/EC "on coordination of safeguards for the protection of the interests of members and third parties". This Directive, as well as the EU Accounting Directive, require companies to file and publish their financial

²⁹Based on data available from the National Statistical Office of Georgia as at March 1, 2014 (www.geostat.ge).

statement within a reasonable period of time, not exceeding 12 months after the balance sheet date³⁰.

63. **It is challenging for investors to access accurate, comprehensive, financial information on the corporate sector in a timely manner**, with implications for efficient resource allocation. Increased transparency will positively affect the development of capital markets and improve firms' ability to access finance domestically and internationally.

Framework for Auditing

64. **The 2012 A&A Law outlines statutory audit requirement for various entities and elaborates on the legal and institutional framework for the conduct of audit in Georgia.** Under the new law the following entities are required to have an annual audit by October 31 of the following calendar year, while others may conduct audits on a voluntary basis:
- Banks and other credit institutions subject to supervision of the NBG;
 - Insurance companies;
 - Listed companies and other "reporting" entities regulated by the Non-Banking Supervision at the NBG;
 - Some SOEs based on the Government's criteria.
65. **The government also requires audit of some SOEs, but the number and identification of all such SOEs could not be determined for this report.** The banking, insurance and securities regulators require annual audits, and the Law on Entrepreneurs also requires audits of JSCs. The Government has a right to request an audit for SOEs based on other criteria, not defined by the Law.
66. **The new regulatory and institutional arrangements for statutory audit in Georgia increased alignment in some areas of international best practice of audit regulation, such as those prescribed in the EU's Audit Directive, but falls short in other key areas.** From January 2016 statutory audits must be conducted by registered statutory auditors who are members of an accredited PAO, and they must be carried out according to International Standards on Auditing (ISA)³¹. Statutory auditors must comply with the International Ethics Standards Board for Accountants (IESBA) - an independent standard setting board operating under the auspices of IFAC. The 2012 A&A Law also includes provisions for the following areas, although implementation is still in transition³². It is important that these critical provisions of the 2012 A&A Law are implemented with no further delay.
- **Registration of auditors** – the law prescribes a two-tiered registry for registration of all auditors (one registry for those who can conduct statutory audits and another for those who are prohibited). The GFPAA is responsible for implementing and operationalizing the registries according to criteria specified in the law. Although this is an important step in protecting third parties who rely on audited financial statements, it falls short of international good practice due to delegation of this key function without provisions for

³⁰ EU Accounting Directive provides certain simplifications for small and medium-sized undertakings (Article 31)

³¹ Issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountant (IFAC).

³² As of the date of this Report, these provisions of the 2012 A&A Law have been delayed until June 1, 2015.

independent monitoring, and also because there is nothing in the law on making the information in the registries accessible to the public.

- **Code of Ethics** – the requirement for compliance with IFAC’s Code of Ethics, along with rules regarding confidentiality, is a positive development. However, the new law does not address threats to auditor’s independence, and other potential conflicts of interests, for example, arrangements governing the provision of non-audit services which are a primary area of concern in the Georgian context.
- **Quality Assurance System**– the law introduces a quality assurance system, heavily focused on audit firms’ internal quality control system for non-statutory auditors and quality control system and ISA compliance requirements for statutory auditors, the results of which are a criterion for assignment to the audit registries. The implementation and operationalization of this critical function has also been delegated to the GFPAA to oversee through the use of independent quality control system examiners. This is contradictory to the trend in international good practices to move away from complete self-regulation of the profession. Jurisdictions globally employ different approaches to audit regulation oversight involving delegating various duties to the profession but always with some degree of monitoring in place. Summary results of the quality assurance system should be published annually to increase transparency and public confidence in the audit function. Georgia will need to consider the appropriate approaches to adopt given available technical and financial resources.
- **Investigation and Discipline** – the process and procedures for dealing with complaints against auditors and audit firms’ are vague and untested. The legislative framework for audit regulation should clearly outline the authoritative body (or bodies) that can investigate reported misconduct of statutory auditors or audit firms in the conduct of audits, and apply specific disciplinary action (including penalties) scaled according to the nature and severity of the misconduct. It is especially important for this to be addressed in the Georgian environment, characterized by high non-compliance with applicable auditing standards and wide variations in audit quality. Annual publication of disciplinary actions could serve as a deterrent for misconduct and contribute to better audit quality, as well as enhance confidence in the oversight arrangements of the statutory audit.

67. **Measures strengthening auditor independence and enhancing audit quality are not addressed in the current legislation.** For example, current and recently enacted laws do not address audit firm or partner rotation, a highly debated mechanism for tackling auditor independence. While it is unclear whether it would be possible to effectively implement the new EU requirements for audit firm rotation, some consideration should be given to the feasibility of audit partner rotation. The legislative framework is also silent regarding: (i) the disclosure of audit and non-audit fees in the audited financial statements of entities, (ii) the appropriate grounds for dismissal of auditors, (iii) the requirement to communicate the resignation or dismissal of the auditor, and (iv) the reasons for dismissal of the auditor to the regulatory bodies³³ to which the entity reports or the oversight body. The level of fees charged for audit and non-audit services, and unaccountable dismissal of auditors can have an undesirable effect on auditor independence and audit quality. In addition, the requirements

³³ The NBG is the only regulatory body that requires auditors to report resignation of the auditor or termination of services.

for basic disclosures in these areas may help to reinforce auditor independence and positively impact audit quality and public confidence in audited financial statements.

- 68. **One of the most important reforms in audit regulation that Georgia will need to address concerns public audit oversight.** Public audit oversight forms an important part of key policy areas in the European Union, and is governed by the newly amended EU Audit Directive and respective Regulations, which are referenced in the Georgia-EU Association Agreement.
- 69. **The Audit Directive requires the designation of a competent authority to be in charge of the regulation and/or oversight of statutory auditors and audit firms.** The establishment of such a competent authority calls for proper organization and institutional set-up of this body; qualified and experienced management and team of experts to perform highly specialized quality assurance procedures; and appropriate funding to allow the competent authority to carry out its functions and employ highly specialized experts.
- 70. **Establishing an effective audit oversight body is vital to the future development of the audit profession and the quality of audit services:** it must be created with adequate and stable funding, staffed with personnel sufficiently experienced in auditing, and organized with a governance structure that ensures sufficient independence and competence.

B. The Profession

- 71. **The 2012 A&A Law recognizes the accounting and audit profession largely as self-regulated and independent.** Authorities are delegated to accredited professional organizations, which must be a full member of IFAC, or full member of a regional organization recognized by IFAC. These authorities include: (i) maintenance of auditors' registry for firms and sole practitioners; (ii) translation and publishing of professional code of ethics for members; (iii) quality assurance and members' professional conduct; (iv) development of accounting standards for non-profit entities; (v) handling disciplinary actions against auditors; and (vi) provision of continuing professional education.
- 72. **The 2012 A&A Law introduces clear definitions of a certified professional accountant, auditor and audit firm.** A certified professional accountant is defined as a natural person who is certified in IFRS in accordance with the professional certification standards. An auditor is a certified person who is a member of an accredited professional organization, is registered in the auditors' registry, and renders professional services. An audit firm is defined as a legal entity registered in Georgia, or a branch of the foreign legal entity operating in Georgia, registered at the auditors' registry, rendering professional services in Georgia.
- 73. **Auditors must be registered with the accredited professional organization.** This provision of mandatory registration was introduced by the 2012 A&A Law but implementation is delayed by the same Law until June 1, 2015. Mandatory licensing requirements were abolished in 2005 and are not envisaged under the new Law. A parallel auditors' list is functioning in the interim. The Investment Projects Database lists 13 audit firms that are authorized to perform statutory audits in Georgia. But from June 1, 2015, any new audit firm or sole practitioner seeking to be registered must comply with the legislative requirements in the new Law, including professional certification, membership with the

accredited professional organization, application of quality controls system, and compliance with ISAs.

74. **The total number of accountants and auditors in Georgia is difficult to accurately approximate.** It is estimated that almost 20,000 professionals are working as accountants, chief accountants, tax specialists, auditors and financial managers. Professionals are not required to become members of any professional association, unless they want to become audit practitioners.
75. **The profession is represented by three professional accountancy organizations:** the Georgian Federation of Professional Accountants and Auditors (GFPAA), the Georgia Association of Independent Accountants and Auditors (GAIAA) and the Federation of Auditors, Accountants and Financial Managers (GFAAFM). With its limited in-country capacity and number of accounting professionals, the Georgian accounting profession may benefit from collaboration among professional organizations to better represent their interests.
76. **The GFPAA is the largest professional organization by membership in Georgia.** GFPAA has strengthened its position with the local profession since the 2007 ROSC, increasing membership from circa 2,000 to over 7,000 members, including 65 audit firms – both local firms and member firms of international audit networks. GFPAA membership is mostly comprised of audit firms, auditors employed by audit firms, sole practitioners, and consultants. It has been a full IFAC member since 2000, working closely with IFAC on compliance with the Statements of Membership Obligations (SMO) - with significant progress demonstrated since the last ROSC report in 2007 (summarized at Annex 5).
77. **The existing funding model does not allow GFPAA to fully meet its obligations, including standards translation and audit quality assurance.** GFPAA is funded by membership fees and proceeds from the sale of authorized printed materials, including IFRS translated into Georgian language. This arrangement does not cover GFPAA IFRS translation expenses and is not sustainable given the expanded scope of responsibilities delegated to GFPAA by the 2012 A&A Law. Additional responsibilities, such as quality assurance reviews that must be undertaken by GFPAA every three years for registered auditors, necessary investigations and follow up procedures on respective action plans, as well as the creation and maintenance of the audit registry³⁴, all require significant financing but this is not addressed in the 2012 A&A Law.
78. **GFPAA offers a certification program under the local accountancy qualification, based on the UK Association of Chartered Certified Accountants (ACCA) qualification curricula translated into the Georgian language.** Since 2000 and up to date, 107 practitioners have completed all 13 exams and obtained their qualification as certified professional accountants from the GFPAA, a further approximately 450 students are in the process of completing the exams. The organization also offers the qualification of a certified chief accountant, offering certification in IFRS, based on 9 exams of the UK ACCA program, excluding audit related disciplines. Chief accountant certification enrolls approximately 100 practitioners per year, with approximately 850 accountants having obtained their respective qualification over the past three years. Completion rates for the professional qualification are low. Both certification programs currently include 6,000 students at different stages. Many

³⁴ These provisions of the 2012 A&A Law have been delayed until June 1, 2015.

enroll after obtaining a university degree, but do not complete for various reasons, including finding a full-time job, managing their time with other commitments, taking one paper a year etc.

79. **Some Georgian professionals enroll directly into the English-language qualifications offered by ACCA.** These are available in Georgia from various training providers and exam administrators. It is difficult to estimate the number of professionals certified by the ACCA or any other foreign professional qualification working in Georgia. The GFPAA membership includes 37 professionals holding the ACCA qualification. GFPAA fully recognizes any other certification provided by an IFAC member, and accepts such certifications to recognize the professional accountant qualification.
80. **The Federation of Auditors, Accountants and Financial Managers (GFAAFM) is also an active professional association in Georgia.** GFAAFM, the successor body to the Audit Council of the Parliament of Georgia, has approximately 250 members, including 40 firms. GFAAFM membership is largely comprised of small and medium audit practices, bookkeepers, accountants, and tax advisors. The Federation is a full member of the European Federation of Accountants and Auditors for SMEs. It provides several types of training activities for its members, including tax updates, internal audit and financial managers' courses. GFAAFM has adopted the IESBA's Code of Ethics, as required by the 2012 A&A Law, and aims to become an accredited professional organization by obtaining membership of an IFAC recognized regional professional organization.
81. **Approximately 580 auditors, authorized by the Audit Council to practice as licensed statutory auditors' pre-2005, will lose their licenses from January 1, 2018.** As described in the 2007 ROSC report, audit licensing requirements were abolished in 2005. Practitioners licensed before 2005 continue to hold their licenses under transitional provisions and may undertake audit activities. However, once the delayed provisions of the 2012 A&A Law become effective, these practitioners will have to comply with qualification and registration requirements, and must become members of the accredited professional organization to practice as statutory auditors. The respective accredited professional organization would have to devote significant efforts and resources in training and certification of these practitioners. It is worth noting that these practitioners are primarily engaged in tax advice and accounting services which do not require them to be registered as statutory auditors, and they will be able to continue to offer these services without a license.
82. **Understanding and properly applying the standards remains a big challenge for the accounting and audit profession in Georgia.** Georgia adopted IFRS-based requirements for financial reporting in 2000, but many practitioners lack theoretical knowledge and practical experience in implementing these requirements in practice. Bookkeeping and financial reporting are often conducted according to the tax rules, with minimal adjustments to reflect the accrual basis principles required by the IFRS. The level of the accounting profession, and with it the quality of financial reporting, is very dependent on the ability of Georgian accountants to understand and apply in practice the accounting principles established by the IFRS. It is therefore vital to enhance accounting education at all levels, beginning with university curricula and continuing through the provision of special accounting and audit courses to practitioners licensed before 2005.
83. **Auditor liability is not clearly regulated.** The 2012 A&A Law could be more specific. In practice, there are examples of attempts to contractually limit auditor liability to the fees

received for the statutory audit (or a multiple). It is unclear whether such practice would be upheld in a Georgian court as there appear to be no cases of legal disputes between auditor and audited company.

C. Professional Education and Training

Initial education

84. **Basic accountancy and audit education is offered at universities, colleges and business schools in Georgia, both as part of economics or business administration degrees and as dedicated accounting degrees.** Universities experience lower demand for the accounting and audit specialization, and greater enrollment in business and economics degrees, partially driven by the Government scholarship programs available to students studying economics. Universities also offer accounting and audit degrees in their post-graduate programs.
85. **Establishing curricula guidelines would strengthen the curricula and raise the standard in accounting and auditing education.** There are currently no minimum requirements set or approved by the Ministry of Education in terms of the content or hours of disciplines for accounting and audit degrees. Each university establishes the level of coverage of IFRS, US GAAP and ISA at its own discretion. The sporadic use of teaching materials, absence of minimum required hours in accounting and audit disciplines, and varying degree of standards coverage in curricula produce a significant gap between the level of basic education in accounting and audit, and the required use of IFRS and ISA as established by the Georgian Legislation. There is great potential for close coordination between universities and professional associations, together with the Ministry of Education, to improve and systemize the syllabus, training and other reference materials such as local-language copies of IFRS, ISA and the forthcoming IFRS for SMEs, and further raise the professional education level for students who major in accountancy. Universities should also be working closely with professional bodies and the accounting profession to develop different accounting and auditing programs appropriate to the developing needs of the business community.
86. **Universities generally lack an adequate supply of suitably qualified teachers, and accounting and auditing teaching and reference materials, especially in the Georgian language.** Adoption of IFRS, the IFRS for SMEs and ISAs as National Standards create a major challenge for universities in terms of their ability to provide relevant course curricula. Universities note the difficulty in recruiting teachers and professors who can teach IFRS and ISA and reach out to graduates, holders of U.K. ACCA degrees, and to network audit firms to attract audit practitioners into delivering the accounting and audit disciplines. Teaching materials used in universities are mainly focused on US GAAP with some coverage of IFRS and ISA. Universities mainly use accounting and auditing textbooks published in the United States of America due to their easy accessibility, and special offers provided by American publishers. Many books and texts used in teaching accounting and auditing are only available in the English language. This hinders the transfer of accounting and auditing knowledge to those students who are not proficient in English. The regular update and translation of the teaching materials requires significant financial and staff resources, which local Universities cannot afford.

Professional Qualification

87. **Professional Education and Training in accounting and audit in Georgia has improved since the previous ROSC but further emphasis must be given to continuing education, short term training and certification to meet the evolving needs of the economy and business.** Interviews held with representatives of private and state sector companies, audit firms and commercial banks indicated that the current level of university education and further professional qualifications in accounting and audit are not highly regarded by the market. Only a fraction of practitioners in Georgia obtained a recognized qualification, such as English-language U.K. ACCA, U.S. CPA; or the Georgian language ACCA. The majority of these professionals are employed by local member firms of major international networks, leading banks and large companies. The level of education in accounting and audit must increase and professionals should be encouraged to obtain and further maintain their degree, professional qualification, and practical skills through universities and programs of continuing professional education.
88. **The Georgian-language accountancy qualification has been offered by GFPAA since 2000, and is based on 13 course textbooks of the ACCA's latest syllabus.** The GFPAA offers a Georgian-language accountancy qualification and has strengthened its Georgian language ACCA course (the only professional accounting program in the country that provides extensive coverage of IFRS and ISA), increasing the number of equivalences between its own qualification system and the system of the UK based ACCA. Since 2009, successful completion of this course provides exemption from 9 of the 14 papers required for U.K. ACCA certification. Cooperation between the GFPAA and education providers has improved and GFPAA has introduced some exemptions to graduates of three Georgian universities. The course is popular in Georgia, with hundreds of individuals enrolling into the program each year; however the actual rate of completion is low with only 107 graduates since it began. Translation gaps need to be addressed to ensure that ACCA textbooks, which are revised every 3-4 years to incorporate updates, new IFRS, and changes to the U.K. ACCA course, are available promptly in the Georgian language (the 2012 English version was not published in the Georgian translation until February 2014).
89. **Some students self-study for the English-language U.K. ACCA qualification.** The U.K. ACCA qualification is well-known in Georgia. Students register individually with the U.K. ACCA administrative office in Glasgow, United Kingdom. The number of U.K. ACCA-qualified individuals in Georgia is not known but the GFPAA has 37 U.K. ACCA graduates among their membership (compared to 27 at the last ROSC). GFPAA discontinued training for the first four ACCA papers, but the training is still available from the training center associated with GFPAA, and from other third party providers. Exams are administered by the British Council and GFPAA in Tbilisi. Students must pass the exam and complete three years of relevant training to become U.K. ACCA members. This method of obtaining professional qualification is unlikely to contribute significant numbers to Georgia's accounting and auditing profession, however, due to language and cost barriers.

Continuing professional education

90. **Mandatory continuing professional education (CPD) requirements need to be imposed/enforced and more training opportunities made available.** CPD should be used as a tool for re-training professionals, especially in the context of implementation of the new

2012 A&A Law. GFPAA offers other accounting and thematic courses to members and non-members, such as training for accountants (beginners), chief accountants programs and various IFRS training courses, delivered in Tbilisi and across Georgia through its six regional and four district branch offices. From January 1, 2015, the GFPAA requires its members to maintain their competency by undertaking 40 hours of CPD each year, or 120 hours in three years, through attending GFPAA organized training or by taking courses offered by other professional organizations. Compliance with this requirement is currently low as GFPAA can usually offer only 20-25 hours training course per year due to capacity constraints. Around 20% of GFPAA members undertake no mandatory CPD training and there is no mechanism in place to monitor or enforce compliance. The other two Georgian professional organizations, who have not yet imposed mandatory CPD on their members, need to introduce and enforce requirements. GFPAA and the other two professional organizations should ensure that sufficient appropriate CPD courses and materials are available so that members can meet their CPD commitments. Training programs need to be designed, expanded and delivered to upgrade the skills of practicing accountants and address the training needs of accountancy organizations and different groups of professionals, including book keepers, financial managers and tax advisors.

91. **Existing practical experience requirements in Georgia are not yet compliant with international standards for professional certification.** IES 5 requires a minimum of three years of practical experience. IFAC and the EU require that practical experience is gained in a suitable professional environment, is relevant, monitored and supervised. Neither GFAAFM nor GAIAA currently have practical experience requirements for their members. Candidates for GFPAA membership must complete a Georgian language qualification based on translations of the U.K. ACCA syllabus, meet a three-year practical experience and undergo a final examination. But the GFPAA does not specify the required content of practical experience nor are there any safeguards to ensure that the experience obtained is consistent with the skills needed. Monitoring procedures and checks should be introduced to ensure that the practical experience gained by candidates is acceptable. Candidates should be assigned to a suitably qualified individual as a “mentor” and records of experience gained should be kept for inspection by the GFPAA prior to certification as a professional accountant. Furthermore, GFPAA should specify requirements to accredit registered training officers and set up monitoring requirements.
92. **Modern high quality accounting and audit education is essential to develop the accounting and audit profession and strengthen reporting practices in Georgia.** More emphasis should be given to continuing education, short term training and certification. GFPAA and the other two professional organizations should ensure that sufficient appropriate CPD courses and materials are available so that members can meet their CPD commitments. They should also institute monitoring procedures to verify members’ CPD compliance.

D. Setting Accounting and Auditing Standards

93. **The 2012 A&A Law requires that all Georgian entities that are subject to statutory audit, prepare their financial statements in accordance with IFRS. SMEs should**

prepare their financial statements in accordance with the IFRS for SMEs³⁵ approved by the IASB. Micro enterprises are not obliged to perform accounting. Statutory audit is required for the entities that are subject to the National Bank's Supervision and Insurance Regulator, i.e. commercial banks, insurance companies, listed joint stock companies, companies with publicly held securities, etc.

94. **Accounting Standards for banks are supplemented by prudential regulations and instructions issued by the National Bank of Georgia which differ from the “full” IFRS** (see Section III).
95. **Law on Insurance requires all insurance companies to submit annual audited financial statements to the Insurance State Supervision Service of Georgia (ISSSG).** Financial statements must be prepared in accordance with IFRS and audited in compliance with ISA. ISSSG does not take part in the accounting and auditing standards setting process but it has the authority to positively influence the quality of financial reports provided by insurance companies, and (indirectly) of the audit reports submitted by their auditors. While the standard-setting process is primarily about translation there should be the role for diverse stakeholders to encourage the ownership currently lacking in the country.
96. **Non-commercial legal entities must prepare their financial statements** in compliance with the national financial reporting standards for non-entrepreneurial legal entities developed by the Accredited Professional Organization (i.e. GFPAA) in 2004.
97. **Actual compliance with IFRS and ISA in the country is relatively low. The 2012 A&A Law stipulates that all auditors must use ISA, Code of Ethics and ISQC1,** as issued by the IFAC's International Auditing and Assurance Standards Board (IAASB). At the date of this report, an official Georgian translation of the 2010 IFRS is available³⁶. The IFRS for SMEs have been translated but not yet registered and published. As a result, access to standards is limited to those professionals with a good command of English, mainly employed by international audit network firms and large companies, while individual accountants, auditors and audit firms that do not speak English are unable to apply the latest standards published by the IASB (for IFRS) and IAASB (for ISA), or use the IFRS for SMEs once they come into effect on June 1, 2015.
98. **Effective implementation of IFRS, the IFRS for SMEs and ISA depends largely on their timely translation into Georgian language.** The 2012 A&A Law states that only an accredited professional organization which is a full IFAC member (de-facto GFPAA as the only member organization in the country) is authorized to translate and publish the latest English editions of IFRS, the IFRS for SMEs and ISA into Georgian language. Translated standards come into force only upon their registration with the National Agency of Standards and Metrology of Georgia. At the same time, Georgian law allows use of the original (English) version of ISA, IFRS and the IFRS for SMEs in the absence of the relevant Georgian translation. Translating is undertaken by individual translators contracted by GFPAA. Each

³⁵The IFRS for SMEs is a simplified set of standards developed by the IASB and designed for entities that have no public accountability. It is based on full IFRS, but simplified in two aspects: (i) valuation and measurement – the standard uses simplified approaches and those that are less costly; and (ii) reduced disclosure requirements. The standard is also supported by illustrative financial statements and disclosure checklist. In addition, the IFRS Foundation dedicates significant resources for disseminating and implementing the standard; for example a detailed set of training material is developed and publicly accessible on IASB website in many languages. The standard also aims to be static with revisions only once every three years.

³⁶The IFRS 2014 Edition has been issued by the date of the Report.

standard is reviewed by a pool of experts from local member firms of international audit networks. However, it is difficult to identify and hire translators experienced in English-Georgian translations who are competent in accounting and audit issues. The translation process sometimes leads to inconsistencies and inaccuracies in the standards text, especially when standards are translated by a group of translators with different competencies. There are instances when it is hard to derive the meaning of the text, and some cases of the incorrect translation of single definitions or phrases, making it difficult to comprehend the meaning of a standard without looking at the original text. Most of the larger network firms and big companies do not rely on local language standards and use the original published standards. The GFPAA needs to significantly improve the quality review of the translation process to provide for the effective implementation of the IFRS, the IFRS for SMEs and ISA in Georgia.

99. **The funding mechanism for translation, update and publication of IFRS, the IFRS for SMEs and ISA should be reviewed to ensure that all the amendments and updates are translated and published on a timely basis.** Translation of IFRS and ISA is not a sustained process. GFPAA has plans to translate IFRS 2014 and ISA 2014 editions; however, this process may take a long time. The Government delegated the standards translation to GFPAA without consideration of the funding. Translations expenditures are financed from GFPAA own funds and this is a heavy financial burden for the organization.
100. **Georgia may benefit from allowing the original English version of full IFRS to be used, and concentrate resources on translating the IFRS for SMEs.** The 2012 A&A Law allows use of the original, English language version of the standards. Concentrating on timely and high-quality translation of the IFRS for SMEs will cater to majority of entities in Georgia, while eliminating time consuming and technically complex translation of full IFRS.

E. Monitoring Compliance with Accounting and Auditing Standards

101. **Monitoring of accounting standards compliance in Georgia is performed by several government agencies, lack of capacity affects effective enforcement.** Respective regulators have different approaches towards standards implementation and required level of compliance, leaving gaps in enforcement and monitoring. Standards enforcement for regulated companies is undertaken by: (i) National Bank of Georgia for all commercial banks; and for public companies (through NBG non-banking supervision department); (ii) Insurance State Supervision Service for all insurance companies; and (iii) the National Agency of State Property and respective line Ministries for SOEs. These agencies have varying degrees of supervision scrutiny and institutional capacity to perform the respective enforcement of standards. The lack of capacity to implement regulators enforcement authority results in little or no effective enforcement.
102. **Low level of coordination between regulators, and insufficient capacity to monitor standards compliance, results in weak enforcement of accounting and auditing standards in Georgia.** Quality assurance systems with strict enforcement mechanisms need to be implemented, with extensive training provided for the supervisory staff at enforcement agencies.
103. **IFRS expertise at the Banking Supervision Department of NBG appears sufficient to ensure proper oversight and standards enforcement in the banking sector.** In 2014, the

NBG established a specialized IFRS unit, coordinating banking system transition to IFRS and alignment of regulatory reporting with IFRS.

104. **During 2014, NBG conducted gap assessment between local accounting principles and IFRS, identifying major inconsistencies between those two reporting frameworks.** The most important issues covered during assessment were:
- Loan loss provisioning practice under IAS 39;
 - Fixed asset valuation;
 - Quality of IFRS financial statements, including disclosure notes.
105. **Since 2007 A&A ROSC report, NBG made significant progress in collaborating with external auditors,** with the objective to enhance efficiency of supervision by outsourcing assurance tasks to auditors and to enhance quality of financial statements published by banks. To further enhance communication with auditors, NBG introduced pre- and closing audit meeting practice where supervisors and external auditors exchange information.
106. **IFRS capacity at NBG's Department for Non-Bank Supervision needs to be advanced.** Currently, filed financial reports are checked for the existence of the primary statements, while content verification or compliance with the standards is not performed. Submitted reports are scanned and filed by the regulator. Listed companies are not required to publish their financial reports, and none were identified as being publicly available. In order to enable the non-banking supervision department to effectively carry out accounting standards enforcement and monitoring of PIEs, its institutional functions and expert potential should be re-aligned accordingly.
107. **The Insurance State Supervision Service of Georgia has sufficient IFRS knowledge, but is understaffed.** The ISSSG is in charge of insurance market supervision, including enforcement of the accounting standards, but has insufficient staff to carry out both regulatory supervision and IFRS enforcement functions. Their Financial Department collects IFRS based financial statements, and verifies that financial statements are audited by the registered audit firm. ISSSG is establishing a formal process of communication with the auditors, to be able to scrutinize and question issues raised by the auditors in their reports. The Financial Department's present capacity is sufficient for the existing scope of supervision activities but will require institutional strengthening once prudential requirements are fully implemented, and the Service fully engages in regular supervision audits. Insurance companies generally comply with the regulator's filing requirements. However, as insurers are not obliged by the 2012 A&A Law to publish financial statements, few companies choose to publicly disclose their financial reports on their web-sites.
108. **Financial reporting of regulated enterprises is not effectively enforced, including those reporting to the National Bank of Georgia, the National Agency of State Property and line Ministries.** The quality of information submitted by reporting entities is often poor. In many cases, financial reports are not submitted and agencies spend their time and resources on identification of reporting entities' existence, and collection of basic financial information.

The review of selected financial statements filed with these regulators verified that the quality of submitted financial information is often poor.

109. **No mechanism or enforcement tools exist to ensure that companies not regulated by any of the above agencies comply with the 2012 A&A Law.** IFRS financial statements appear to be primarily prepared and disclosed by commercial banks, subsidiaries of foreign companies and businesses that work with international partners, investors and lenders. Entities that are not regulated, and / or are not considered to be listed companies, under Georgian legislation do not have to file or publish their financial statements.
110. **Accredited professional organizations will have responsibility for enforcing auditing standards through respective quality control reviews and investigative procedures.** In accordance with the 2012 A&A Law accredited professional organizations are required to monitor the quality of auditors' services and their compliance with ISA from June 1, 2015.
111. **Standards compliance and ISA understanding remains a big issue for smaller firms and sole practitioners in Georgia.** Compliance with auditing standards and understandings of professional ethical obligations vary across audit firms. The larger firms associated with international audit networks benefit from their network support, training and expertise, while smaller local audit firms do not receive adequate training or support on auditing standards, which they find difficult to apply.

III. Accounting Standards as designed and as Practiced

A. Accounting Standards as Designed

112. **As noted in the previous ROSC, the process for the translation of international standards is lagging behind and the quality of translations needs improvement.** Although full IFRS is the required reporting standard for all entities except small businesses, the latest available Georgian translation is IFRS dating from 2010. Therefore, entities that rely on the Georgian translated standards, which are in the majority; apply IFRS that does not include changes implemented by the IASB since 2010. Furthermore, users of the translated standards indicated that the quality of the standards is low because technical terms from the English version are lost in translation and as a result the translated standards are difficult to understand and apply.
113. **The identified “translation gap” will remain unless both the quality of translation is improved, especially with respect to the accurate translation of technical concepts and terms, and significant delays in translation are addressed.** The 2012 A&A Law states that it is mandatory for Georgian entities to use translated IFRSs prepared and published by the GFPAA and registered with the National Agency of Standards and Metrology (NASM). Although the law states that English versions of IFRS may be used, the extent of reliance on the Georgian translation by most entities means that the quality of application of IFRS is likely to be a persistent feature of the corporate financial reporting environment. This leads to lack of comparability of the financial statements of entities that have access to up-to-date IFRS and those that do not. This lack of comparability impedes users and regulators decision-making ability when assessing different entities, even among those in the same sectors.
114. **Typical differences between prudential and general-purpose financial reporting requirements for banks normally arise due to different purposes of such reporting.** Users of financial statements need to be aware of the following major distinctions:
- **Scope of Consolidation.** Prudential regulations state that banks are only allowed to consolidate related entities that conduct activities of a banking nature. However, *IFRS 10 Consolidated Financial Statements* requires that parent companies consolidate all entities that they control. Some banks in Georgia have multiple subsidiaries spanning the insurance and corporate sectors. Application of prudential requirements to general-purpose financial statements would result in the omission of subsidiaries from a bank’s Statement of Financial Position along with related income and expenses in the Statement of Profit and Loss and Other Comprehensive Income. Users of the financial statement would be unable to determine the economic relationships between banks and their non-banking subsidiaries and the overall performance of the group. This was evidenced in one sample IFRS financial statement reviewed for this assessment, a bank did not include its fully owned insurance subsidiary in its general-purpose consolidated financial statements.
 - **Loan Loss Provisioning.** Differences between the two reporting frameworks for loan loss provisioning arise due to the different objectives of prudential and general-purpose

financial statements. The NBG's loan loss provisioning uses a methodology based on the credit worthiness, an asset classification system, and days past due. This approach contrasts with the incurred loss model prescribed in *IAS 39 Financial Instrument: Recognition and Measurement*. Under IAS 39, the allowance for loan loss is calculated as the difference between the asset's carrying amount and the present value of estimated cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. To ensure system wide consistent application of IFRS standard and particularly IAS 39, NBG is in process of developing specific impairment guidelines under IAS 39.

115. **Specific financial reporting regulations for insurance companies differ from IFRS due to typical difference between financial and regulatory reporting.** Normally, such differences relate to: the calculations of provisions for claims incurred but not reported (IBNR); calculation of impairment provision for insurance accounts receivable (written versus earned); and capitalization of investment in subsidiaries.

B. Observed Reporting Practices

116. **This updated A&A ROSC assessed the compliance gap by review of a sample of 24 sets of financial statements including:**
- 14 sets of audited financial statements, which purport to be prepared in accordance with IFRS; and
 - 10 sets of audited financial statements, which purport to be prepared in accordance with Georgian accounting requirements.
117. **The review of financial statements prepared according to IFRS revealed clear correlation between the quality of financial statements prepared under IFRS and entities' sector, size, and access to international finance or capital.** The ROSC team reviewed 14 sets of financial statements purported to be in accordance with IFRS, from seven (7) banks, three (3) insurance companies, and four (4) corporates (3 of which were SOEs). Compliance in the banking and insurance sector declined significantly with size³⁷, whereas compliance with IFRS in the corporate sector financial statements were more consistent regardless of size. The two entities in the sample with the most extensive disclosures and the highest degree of IFRS compliance were banks with access to international finance or capital.
118. **The number of accountants knowledgeable and competent in applying IFRS is limited.** Almost all stakeholders interviewed pointed to high demand for a limited supply of skilled accountants who can apply IFRS. Given the large number of entities required to prepare IFRS or the IFRS for SMEs financial statements and the available supply of skilled accountants in Georgia, it is unlikely that the compliance gap will lessen in the short term without ameliorative measures. Such measures would need to encompass both demand and supply sides that take into account the scope of entities required to apply international standards without additional guidance, and alignment of the accounting curriculum and professional training to better prepare professional accountants to apply a principles-based reporting framework.

³⁷ Size in the banking sector was based on total assets and total liabilities, whereas gross premiums written were the size determinant for insurance companies'.

119. **Most entities had consistent non-compliance with IFRS in some key areas, even if the non-compliance presented itself in different ways.** Recurring areas of non-compliance included significant accounting policy; related party disclosures; property, plant and equipment; impairment; fair value; and financial instruments risk disclosures. More information on common areas of non-compliance is presented at Annex 6.

Banks

120. **The overall quality of bank financial statements was fairly high for larger banks, while less so for smaller banks.** Access to in-house expertise for preparation of IFRS financial statements is more common in larger banks, while smaller banks tend to have little or no in-house IFRS expertise and are heavily reliant on auditors for assistance. Only one of the four reviewed small³⁸ banks had an unqualified auditor's opinion, with the others having qualification or emphasis of matter paragraphs concerning related party transactions, material uncertainty negatively classified credit portfolio, or unconfirmed commission revenues.
121. **The sample bank financial statements prepared according to IFRS showed common areas of non-compliance with the standards.** Some specific standards featured often in non-compliance, suggesting that preparers have difficulty understanding and applying them. These are included at Annex 6.

Insurance

122. **The level of compliance in the three insurance companies' financial statements purported to be prepared in accordance in IFRS was low, with a decline in quality as the size³⁹ of the company decreased.** Often the nature and scope of the disclosures provided in the financial statements were limited, and in general it would be difficult for a user to rely only on the information in the financial statements to obtain a clear understanding of the companies' financial position, performance and cash flows. All three companies were first time adopters of IFRS, and the auditors' issued unqualified with other matters or qualified opinions on the financial statements. The low quality of the financial statements could be attributed to the lack of familiarity with IFRS. Areas of non-compliance ranged from basic to more complex requirements in the standard. Some selected examples of non-compliance are included at Annex 6.
123. **In general, there appears to be insufficient skills and understanding of the standards, required to prepare IFRS-based financial statements among insurance companies.** Management of some of the companies that were interviewed indicated that they received significant assistance with preparation of financial statements, and at least one interviewee stated that auditors prepared and audited their financial statements as part of a package deal. The insurance regulator is exploring options to expand technical expertise in IFRS among its staff in order to enhance supervisory capacity for monitoring insurance companies' compliance with IFRS. Building capacity in the insurance sector is a high priority especially as phase II of the IASB's revision of *IFRS 4 Insurance Contracts* is almost complete. The

³⁸ There were reviewed financial statements of seven banks including four small banks out of twenty one banks operating in Georgia. For the purpose of this review the small banks in the sample were defined as having total assets of less than GEL 100,000,000.

³⁹Based on gross premium written.

revised IFRS 4 will require significant technical and information system requirements to comply.

SOEs and other (non-financial) enterprises

124. **The financial statements of three SOEs and one private sector entity were of reasonable quality.** The auditors issued unqualified opinions on three financial statements, with an unqualified opinion with emphasis of matter paragraph for one SOE related to a change in accounting policy and restatement of prior period financial statements audited by another auditor. SOEs had a tendency to summarize texts from the standards without explaining how a particular accounting policy was implemented by their organization. In addition to the areas of non-compliance noted for banks, the financial statements of SOEs and the private sector entity were more likely to be non-compliant with *IAS 16 Property, Plant and Equipment*. Non-compliance with IAS 16 included issues with: recognition of profit or loss on disposal of property; depreciation of assets under construction; and incorrect movements between revaluation surplus and equity. Other common areas of non-compliance are included at Annex 6.
125. **The SOEs had significant non-cash contributions and distributions with their only shareholder (the Government), not covered by any specific IFRS.** Many of these transactions had a significant impact on the Statement of Changes in Equity and fixed assets. The disclosures related to these transactions were often unclear and would make it difficult for users to gain a firm understanding on the complete nature, recognition and measurement of the transactions and hence the overall financial operations of the entity.

Review of Financial Statements Prepared According to Georgian Accounting Standards⁴⁰

126. **Financial statements purportedly prepared in accordance with Georgian Accounting Standards appear to be similar in quality to those reviewed for the 2007 ROSC.** The compliance gap for the 10 sample financial statements of entities using the Georgian accounting standards remains huge. 10 enterprise sector companies were selected for the sample review. Most financial statements were obtained from the National Bank of Georgia and were incomplete, having no disclosure notes and no audit reports. Generally, the quality of financial statements continued to be weak and not in compliance with statutory requirements. In most cases, it would be difficult for the users of these financial statements to make any decision based on the quality of the financial information provided. The details of financial statements review can be found at Annex 6, specific areas of concern follow:
- **Accompanying notes to Financial Statements:** Two reviewed financial statements lacked any accompanying notes to financial statements, which would include the information about the basis of preparation of financial statements and accounting policies used. All reviewed financial statements to some extent missed particular disclosures to financial statements, namely notes for inventories, trade and other receivables, charter capital, revenue, cost of sales, financial risk management, fair value of financial

⁴⁰ Georgian Accounting Standards represent the Georgian translation of IFRS dating from 2009 as required by the Accounting Law 1999 (for details, please refer to the Table 1, Section II.A *Statutory Framework*).

instruments, tax liabilities, related parties transactions, business segments, etc. This absence significantly reduces the usefulness of the financial statements.

- **Significant Accounting Policy:** With few exceptions, there were no descriptions of significant accounting policies in regard to revenue recognition, trade and other payables, provisions for liabilities and charges, foreign currency translation, employee benefits, impairment of accounts receivable, prepayments, useful life of property, and plant and equipment. Two entities did not disclose significant accounting policies at all.
- **Format of Financial Statements:** Four entities prepared their financial statements based on the illustrative financial statements format elaborated by the former National Steering Committee in 2004 and did not exclude line items which were irrelevant to the companies' operations, showing the full format with zero in redundant lines. This indicates a basic misunderstanding of the use of such formats and illustrates the preparers' fundamental lack of understanding of the financial statements and applicable standards. Two financial statements did not identify the statement of the financial position date and the period covered by financial statements. Only two financial statements were audited, of which one audit report was not prepared in line with ISA. The audit opinion also failed to indicate which accounting standards had been applied in preparing the financial statements.

127. **The quality of financial statements prepared in accordance with Georgian Accounting Standards appears low compared to international standards.** In the absence of complete information and details sufficient for a proper analysis and understanding of a company's financial position, performance and cash-flows, financial statements do not provide useful information for shareholders, investors and lenders to make informed corporate, investment, or credit decisions.

IV. Auditing Standards as Designed and as Practiced

128. **According to the 2012 A&A Law it is mandatory for all auditors and audit firms to use standards promulgated by the various standards boards of IFAC in conducting statutory audits.** Specifically, they are required to use the following standards, translated by the GFPAA and registered with the National Agency of Standards and Metrology (NASM):
- *International Standards on Auditing;*
 - *Code of Ethics for Professional Accountants;*
 - *ISQC 1 Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Service Engagements.*
129. **The 2012 A&A Law states that English versions of the standards may be used but it is not made clear under what circumstances this applies.** While it appears that the standards are legally binding once issued by the relevant standard boards, the requirement to use translated and registered versions seems contradictory given lengthy delays in the translation process.
130. **Delays in translating international standards lead to a “standards gap”.** ISA 2009 is the latest available Georgian translation, so applicable standards are outdated. The translation process is slow and the quality of translation is considered to be low which makes it difficult for them to be applied correctly.
131. **In general, there is limited demand for good quality financial reporting in Georgia, and this is accompanied by a correspondingly low demand for high quality audits.** This is mainly because most Georgian businesses are privately owned, and bank lending is heavily collateralized with little reliance on audited financial statements for loan decisions. Some of the users of financial statements prepared according to IFRS are international investors and financiers in local entities, and non-domestic parent companies of Georgian subsidiaries. The requirement for statutory audits in the 2012 A&A Law will result in approximately 300⁴¹ entities conducting annual audits of their financial statements. Regulators and some users of these financial statements perceived that the quality of financial statement audits of many of these entities was not very high.
132. **There are certain characteristics of the current environment that contribute to the widely held perception of low audit quality in Georgia.** These include:
- **Arrangements for licensing auditors** are out of line with the updated EU Audit Directive and are not sufficiently robust due to the unsupervised self-regulatory system described in Section II of this report.
 - **Knowledge, competence and experience of the profession.** The education and training of professional accountants, at university and post-university levels, is insufficient to ensure that all auditors have the necessary theoretical knowledge to conduct high quality risk-based audits. As indicated in Section II.C, the mandatory CPD requirement is not enforced and many auditors do not update their knowledge and skills

⁴¹ The Government of Georgia has not indicated which SOEs will be subject to statutory audits so they are not considered in this estimate. The estimate includes 21 banks, 14 insurance companies, and the 257 “reporting” entities of the securities regulator.

regularly. This is especially relevant given the frequent changes in the regulatory environment in Georgia.

- **Quality assurance and quality control** systems are not in place. Proper internal control arrangements are vital to high quality audits. There are currently no systematic inspections of quality control arrangements in audit firms, and as a result there is little assurance of adequate quality control. GFPAA is initiating quality controls for 20 audit firms to begin in 2015. Such quality assurance reviews will become mandatory from June 1, 2015 when the delayed provisions of the 2012 A&A Law will come into effect.
- **Technical Resources** is an acute area of need in small and medium practices, as they generally do not have access to audit methodologies and analytical software available in Georgian language.
- **Dismissal of auditors** is an area of weakness, gaps in the legislative framework (discussed in Section II) result in the possibility of auditor's compromising audit quality out of fear of arbitrary dismissal.
- **Provision of non-assurance services to audit clients** is a serious concern in the current environment in which reliance on auditors for assistance with preparation of financial statements is very high. While auditors may provide non-audit services to clients, detailed ISA and Code of Ethics guidelines govern such instances, due to possible threats to auditor independence and objectivity when auditors rely heavily on non-audit fees from their clients. For example, a Chief Accountant stated that the company paid the auditor a lump sum to provide a full suite of services including preparation and audit of the financial statement. Data provided by the profession indicated that 75% of registered auditors earn more from non-audit services than from audits. Although the data could not provide details on the ratio of audit and non-audit services to each client, the overall picture is informative as to the potential risks to auditor independence that exist.
- **The level of audit fees** can affect the quality of an audit when fees are insufficient to cover the scope of work required. There has been a downward trend in the fees that entities were willing to pay for audits and in many instances fees, rather than audit quality, appeared to be an overriding factor in the appointment and dismissal of auditors. This is of great concern in Georgia because safeguards to mitigate the threats to audit quality are ineffective or are not currently in place. In order to balance the risk to audit quality caused by declining audit fees there needs to, at least, be: (i) effective corporate governance arrangements in entities (such as the establishment of Audit Committees), (ii) adequate quality control arrangements in audit firms, (iii) effective oversight arrangements for auditors (including disciplinary mechanisms), (iv) external quality assurance reviews of audit firms, and (v) sufficient skilled accountants to apply international standards.

133. **The level of compliance with applicable standards is highly variable and is linked to the size of the audit firm and audit client, as well as to local audits firms' membership in an international audit firm network.** There appears to be a greater degree of compliance with relevant standards in larger audit firms that are affiliated with international audit firm networks. Also, based on the sample financial statements reviewed, audit quality appeared to be higher for the financial statements of larger entities, usually audited by larger audit firms⁴².

⁴²These findings were based on interviews conducted separately with a group of audit firms and audited entities, and from the review of financial statements purportedly prepared according to IFRS.

134. **Entities revealed that they relied on auditors to prepare their financial statements, due to the challenges of preparing financial statements according to IFRS and lack of in-house expertise.** This is not in compliance with ISA 200 *Overall Objective of the Independent Auditor and the Conduct of an Audit in Accordance with ISA*, ISA 210 *Agreeing the Terms of Audit Engagements* and the Code of Ethics. ISA 210 requires auditors to be independent of the entities that they audit. In addition, ISA 210 states that a precondition for continuance or acceptance of an audit is management's agreement that preparation of the financial statements in accordance with applicable financial reporting framework is management's responsibility. Furthermore, the current practice is not in compliance with the Code of Ethics' objectivity requirement due to the inherent conflict of interest in auditing financial statements prepared by the same auditors. Until the shortage of skilled accountants improves, these areas of non-compliance are likely to remain.
135. **Compliance with ISA 315⁴³ and ISA 330⁴⁴ requires resources that are beyond the reach of many firms and results into a low level of compliance with these standards especially among SMPs⁴⁵.** SMPs represent the largest segment of providers of audit services in Georgia, and while the exact number of SMPs could not be ascertained due to incomplete data, they represented over 80% of the firms that were registered members of the GFPAA at the end of December 2013. Although an assessment of the audit methodologies used by auditors and audit firms was outside the scope of this report, auditors that were interviewed collectively expressed concerns about non-compliance by SMPs with these standards. The inability to conduct risk-based audit by a large proportion of audit providers is understandable given the limited technical resources and small number of professional staff in SMPs. This further highlights the need for access to audit methodologies and analytical software available in the Georgian language. Non-compliance with ISA 315 and ISA 330 means that users who rely on an auditors' opinion do not have assurance that the auditor identified and sufficiently assessed the risk of material misstatements in the financial statements.
136. **Many auditors referred to non-compliance with ISA 230 *Audit Documentation*.** Auditors of newly accepted clients need to review matters of continuing significance and therefore rely on audit documentation for this purpose. Since audit documentation is one source of evidence that an audit complied with ISA, a lack of audit documentation (i) raises serious questions about how the audit engagement team planned and performed the audit, (ii) undermines the ability of supervisors to direct and supervise audit work, (iii) impedes the carrying out of future audits due to the lack of records related to matters of continuing significance, and (iv) impedes the conduct of quality control reviews and inspections. Audit documentation is one of the basic components of conducting an audit, so non-compliance may be considered an indicator of the competence of professionals conducting the audit, and the quality of the audit overall.
137. **The nature and scope of misstatements identified in the financial statements that were reviewed, identified instances of non-compliance with ISA 450 *Evaluation of Misstatements Identified during the Audit*.** The standard requires that auditors communicate all misstatements to management, unless otherwise prohibited, and request that they be

⁴³ ISA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

⁴⁴ ISA 330 *The Auditor's Responses to Assessed Risks*

⁴⁵ According to IFAC's Information Paper 2010 *The Role of Small and Medium Practices in Providing Business Support to SMEs*, "SMPs which are distinct from second tier and large accounting organizations (including Big Four) are defined as accounting practices whose clients are mostly SMEs, external sources are used to supplement limited in-house technical resources, and contain a limited number of professional staff."

corrected with further subsequent courses of action depending on management's response. The misstatements found in some of the audited financial statements included, but are not limited to: omission of a wholly owned subsidiary from a consolidated financial statement of a group; incorrect inclusion of restricted amounts in cash and cash equivalent; omission of cash flows identified elsewhere in the *Statements of Cash Flows*; and booking of deferred tax assets with sustained losses and the absence of disclosures or explanations. Non-compliance with ISA 450 reduces users' confidence in the auditor's opinion that the financial statements present fairly the financial condition of the entity, especially in the absence of a qualified audit opinion.

Regulated Entities

138. **Regulatory arrangements need to be strengthened to improve audit quality for regulated entities.** The NBG, ISSSG and the securities regulator rely on auditors' opinions to determine the quality of entities' financial reporting, and hence the level of confidence that regulators and users can place in the information contained in general-purpose financial statements. The NBG passed additional regulations to mitigate threats to audit quality. As a result bank governance arrangements must include establishment of an Audit Committee, bank auditors are charged with reporting matters of material significance to the NBG as well as communicate resignation or termination of the auditor. However, all regulators need to focus on some important areas to further address issues with auditor independence and audit quality, such as:

- **Appointment of auditors.** First, regulators may consider establishing a list of auditors from which entities subject to their supervision can choose the statutory auditor. In determining the criteria for appointing auditors to the list, regulators should consider an audit firm's internal control arrangements, audit methodology and available resources. Second, the time frame within which the auditor should be appointed should also be subject to regulation to give auditors enough time to conduct the audit and for the firm to meet filing and publication requirements.
- **Dismissal of auditors.** Regulated entities should be required to report reasons for dismissal of the auditor in addition to communicating resignation or termination of the auditor.
- **Working closely with auditors.** If it is not already case, regulators may consider requiring auditors to report matters of material significance in the general-purpose financial statements, for example changes in accounting policies or transactions that have a material impact on the financial position of an entity or raises entity's exposure to risk. This requirement would need to be carefully balanced with the auditor's ethical requirement of confidentiality with respect to their clients. There would be benefit in regulators generally working more closely with auditors, especially during the process of building technical capacity and expertise in the application of IFRS.
- **Enforcement.** In order to engender a culture of compliance with relevant accounting and auditing standards, it is important for regulators to design and enforce sanctions that hold auditors and regulated entities accountable. This is necessary to improve the quality of financial reporting and audit quality and contribute to building capacity to apply the applicable standards.

V. Perception of the Quality of Financial Reporting

139. **There is limited demand in Georgia for good quality financial information, leading generally poor quality of financial statements and dominance of tax reporting.** This situation has changed little since the 2007 A&A ROSC due to limited capacity and activity in the Georgian stock market, and the modest amount of foreign investment in the country. There is evidence, however, that awareness and acknowledgement of the importance of good quality financial reporting is rising as some companies access foreign stock markets and raise financing outside Georgia.
140. **General perception exists that financial sector regulated entities, including commercial banks and insurance companies, produce good quality financial information.** This opinion is partially supported by historically strong prudential supervision conducted by the National Bank of Georgia. Users of corporate financial information, however, shared a belief that financial reports prepared by non-regulated entities remain of a low quality and omit critical disclosures required by the standards.
141. **Lack of publicly available financial information increases the perception among potential investors and general public of businesses producing low quality and non-transparent information.** Only commercial banks are required to publish their financial statements. Other entities are not obliged by any regulation to publicly disclose their financial statements, and it is challenging to find available financial information on any business other than banking.
142. **Lenders are not making more use of general purpose financial reports provided by potential borrowers.** Despite the recommendations of the 2007 A&A ROSC, most of the financial information required by banks for processing loan applications continues to be sourced from tax reports, while lending decisions are primarily driven by the availability and value of collateral, business forecasts and site visits.
143. **Overall perceptions of the quality of audit services in Georgia by different stakeholders have diverged further since the 2007 A&A ROSC.** The views of representatives of various regulators, commercial banks, educators, accountants, and other users of corporate financial information suggests that the quality of services rendered by international audit networks is widely trusted, while the quality of audits performed by the local firms and sole practitioners are believed to lack standards compliance and raise independence concerns. This perception, and the absence of a quality assurance framework, provide auditors with little incentive to improve the quality of their work.

VI. Findings and Areas for Improvement

A. Principal Findings

144. **Overall progress in implementing the recommendations of the 2007 A&A ROSC has been relatively slow, though some positive changes have been made.** Key reforms included, inter alia: (i) adoption of the new Accounting and Auditing Law; (ii) introduction of IFRS and the IFRS for SMEs for regulated entities; (iii) statutory audits to be conducted in accordance with ISA; (iv) statutory auditors comply with the Code of Ethics issued by IESBA; and (v) recognition of the accounting and audit profession as self-regulated and independent. These changes are important steps toward building a robust corporate financial reporting framework.
31. **The implementation of several important provisions of the 2012 A&A Law have been delayed until June 1, 2015.** The delayed articles include: (i) adoption of the IFRS for SMEs; (ii) requirements for the registration of statutory auditors; (iii) a requirement for auditors to comply with IFAC's Code of Ethics; (iv) initiation of mandatory quality assurance reviews for statutory auditors; and (v) measures related to investigation and disciplinary actions towards auditors. It is important that these critical provisions of the 2012 A&A Law are implemented as envisaged with no further delay.
145. **The Georgian Government has begun to make progress in reforming its statutory frameworks for corporate financial reporting.** These important legislative changes demonstrate the Government's commitment toward building a robust corporate financial reporting framework in Georgia.
146. **The continuing support of the Government is crucial for reforms to succeed.** There have been difficulties encountered in the introduction and implementation of new accounting and auditing standards, as well as their enforcement. Little progress has been made in ISA and IFRS practical implementation. There is relatively little demand for high quality general purpose financial statements and, further undermining the supply of such information, limited monitoring and enforcement capacity, etc.
147. **To align its legislative framework with the EU *acquis communautaire*, as envisaged by the Association Agreement, Georgia will have to continue reform of its audit legislation.** Audit quality must remain a priority of the reform agenda to support public confidence in the statutory audit function. Changes in legislation should set out clear requirements and enforcement mechanisms on: (a) education and training, (b) approval and registration of statutory auditors and audit firms, (c) ethical principles and auditor independence, (d) auditing standards, (e) quality assurance, (f) public oversight, (g) the appointment and removal of auditors, and (h) audit committees for public interest entities
148. **One of the most important reforms in audit regulation that Georgia will need to address concerns public audit oversight.** The Directive provides certain degree of flexibility in audit regulation. Georgia should use the time allowed under the Association Agreement to learn more about this policy area from international experience, explore the obligatory requirements of the Audit Directive and consider the implementation of optional provisions for a later stage.

149. **The main findings of this ROSC are that:**

- **The current statutory framework in Georgia is significantly less developed compared to the EU *acquis communautaire*.** While the new regulatory and institutional arrangements for financial reporting and statutory audit in Georgia increased alignment in some areas with international good practice there is a still room for improvement.
- **Georgia needs to make key changes to align its legal and institutional framework with the underlying EU Directives that prevail in the European Union with whom Georgia signed the Association Agreement.** Specifically: the profession continues to be self-regulating with important oversight responsibilities without being subject to independent oversight; filing and publication requirements are inadequate to ensure the availability of quality financial information; the reporting requirements for SMEs need refinement in order to avoid over-burdening SMEs; reporting and publication requirements for SOEs need improvements to allow for proper disclosure, publication and audit of accounts. Remaining gaps and inconsistencies that still exist need to be addressed in order to: i) enhance the quality of financial information provided to creditors, ii) improve the accountability of businesses to key stakeholders, and iii) protect the interest of stakeholders who do not have access to undisclosed information.
- **The 2012 A&A Law requires the use of international accounting and auditing standards.** Most notably the adoption of the IFRS for SME and adoption of ISAs represent significant improvements towards a better financial reporting framework. The Law obliges all Georgian entities that are subject to statutory audit to prepare their financial statements in accordance with IFRS. Starting June 1, 2015 all SMEs should prepare their financial statements in accordance with the IFRS for SMEs as approved by the IASB. No specific standards have been designed or adopted for micro entities.
- **The 2012 A&A Law requires that all statutory audits be carried out in accordance with ISA and that statutory auditors comply with the Code of Ethics issued by the IESBA of IFAC.** Institutional arrangements regarding the appointment of statutory auditors and the conduct of audits have been improved substantially and are currently more aligned with good international practices in audit regulation, including those prescribed in the EU Audit Directive.
- **The implementation of several provisions of the 2012 A&A Law has been delayed until June 1, 2015,** including: (i) adoption of the IFRS for SMEs; (ii) requirements for the registration of statutory auditors; (iii) a requirement for auditors to comply with IFAC's Code of Ethics; (iv) initiation of mandatory quality assurance reviews for statutory auditors; and (v) measures related to investigation and disciplinary actions towards auditors. It is important that these critical provisions of the 2012 A&A Law are implemented as envisaged with no further delay.
- **The process for the translation of international standards is lagging behind and the quality of translations needs improvement.** The 2012 A&A Law assigns the responsibility for standards translation to an IFAC-accredited professional organization. As of the date of this report, there is only one such organization in Georgia and since 2008, it has had sole responsibility for translating and publishing the latest editions of

IFRS, the IFRS for SMEs and ISA in the Georgian language. This process in its current form is not sustainable due to insufficient funding and lack of technical resources.

- **Demand for high-quality financial statements is limited.** The Georgian capital market remains rather shallow, with banking sector dominating the financial sector. Georgian banks give very little value to proper financial reports furnished by potential and existing borrowers, mainly relying on loan collateral.
- **The quality of financial statements is uneven across different sectors and types of entities.** These financial statements lack many of the key attributes of good quality financial statements, such as explanatory notes. A detailed review of sample financial statements revealed little to no improvement in the quality of the financial statements since the previous ROSC.
- **Most regulatory and enforcement agencies lack technical expertise and human resources to properly execute their supervisory and enforcement functions.** Monitoring and enforcement of accounting standards in Georgia remains decentralized and performed by multiple agencies, each responsible for their field of regulatory compliance. Different regulators have different approaches towards standards enforcement and required level of compliance, leaving gaps in supervision, enforcement and monitoring. The mandatory implementation of IFRS by regulated entities remains a challenge.
- **There was no progress achieved in regard to public disclosure of financial statements since the 2007 A&A ROSC Report.** Financial statements of commercial banks can be accessed through their internet pages. Access to the financial statements of other regulated entities is difficult, even though they are required to be publicly disclose these. There is no requirement for non-regulated entities to file or publish their financial statements regardless of their size or legal incorporation. As a result, the public access to financial statements in Georgia remains limited.
- **The accounting and auditing profession in Georgia has made some progress since the 2007 A&A ROSC Report.** Through reorganization of previously existing institutions and establishment of new functions, the profession has become largely self-regulated and independent. The 2012 A&A Law introduced precise definitions of a certified professional accountant, auditor and audit firm.
- **The support of Georgian Government is crucial to succeed in reforming and strengthening accounting and auditing practices in Georgia.** The recently signed EU Association Agreement calls for raising the standard in financial reporting, audit quality and regulation, and business accountability. These steps will require close and formal cooperation between relevant Government institutions, such as Ministry of Finance, Central Bank, various regulators, etc., and professional organizations. Increased cooperation will help enable effective monitoring and enforcement of accounting and auditing standards, and address the quality of audit services and education needs of the accounting profession.
- **Most audit regulatory functions have been delegated to accredited professional organizations that are members of an internationally recognized professional**

body. The 2012 A&A Law delegated the following functions and regulatory enforcement obligations to accredited professional organizations: (i) translation and timely updates of the standards; (ii) development of the simplified accounting standards for micro entities; (iii) initial registration of auditors, and maintenance of such registry⁴⁶; (iv) conducting audit quality reviews⁴⁷. Sustainable funding sources need to be established to ensure that translation and timely updates of the standards and other related functions can be carried out free from undue influence and bias.

- **GFCAA remains the only organization in Georgia meeting the delegation criteria of the 2012 A&A Law, and achieving compliance with some IFAC established SMOs.** GFCAA needs to improve its current organizational structure and arrange for sustainable funding arrangements to continue performing its Government delegated functions and progress its compliance with IFAC SMOs.
- **The Georgian accounting profession is represented by three professional bodies, greater collaboration among these organizations may better represent their interests and leverage limited resources and capacity in the country.** The largest professional organization, GFCAA, is responsible for accounting and auditing standards translation and enforcement. The other two Georgian professional organizations are seeking international accreditation to provide a greater spectrum of services and full regulatory support to their members. Increased collaboration among professional organizations and leveraging of limited resources may lead to better representation of the accounting profession in the country.
- **Accounting and auditing education at all levels requires strengthening and modernization.** The current level of theoretical knowledge and practical skills among accountants is low, and requires significant investment to improve the standard of professional education and continuous professional development. Modern high quality accounting and audit education is crucial for further development of the accounting profession in Georgia. Better education for current and future generations of accountants and auditors will strengthen reporting practices and improve the quality of financial information in Georgia.

B. Areas for Improvement.

150. **These policy based proposals seek to help Georgia further strengthen its corporate financial reporting framework and thereby support overall economic growth and development in the country.** Since the last A&A ROSC, some Georgian entities improved transparency in their financial reporting and have been able to access international capital and finance markets. In general though, there remains a low level of quality financial reporting in Georgian entities. The linkage between financial reporting quality and growth is often understated but “better reporting quality improves project identification and selection, lowers the cost of capital translating into faster growth.”⁴⁸ Legal and accounting reforms that strengthen accounting practices have also been found to boost financial intermediary

⁴⁶ This provision of the 2012 A&A Law has been delayed until June 1, 2015.

⁴⁷ This provision of the 2012 A&A Law has been delayed until June 1, 2015.

⁴⁸ Li, Feng., and Shroff, Nemit. 2010. *Financial Reporting and Economic Growth*. SSRN:<http://ssrn.com/abstract=1265331> or <http://dx.doi.org/10.2139/ssrn.1265331>

development and thereby accelerate economic growth.⁴⁹ Financial reporting systems that are applied, monitored and enforced effectively, can greatly support growth in all countries, including Georgia.

151. **The Government of Georgia has demonstrated its commitment to improving its corporate financial architecture**, as evidenced by the recent passage of the 2012 A&A Law and the recent EU Association Agreement. The focus now must move to developing the capacity to fully implement and enforce the changed structural framework, and raising the professional level and capacity of accountants, auditors and regulators in Georgia. All involved with financial reporting – accountants, auditors, regulators, lenders, investors and other users of financial statements, including the general public - will gain from the successful implementation of the recommendations.
152. **Based on the A&A ROSC assessment, the following improvements are needed to eliminate gaps and inconsistencies which threaten to undermine the progress made to date, and to equip Georgia with a modern and effective institutional framework for corporate financial reporting:**
- Define public interest entities in Georgian legislation. To be consistent with the EU Accounting Directive, these should include: (i) entities traded on a regulated market; (ii) credit institutions; (iii) insurance undertakings, and (iv) undertakings that are of significant public relevance due to the nature of their business, their size or the number of their employees.
 - Introduce and harmonize definitions of public-interest entities, large, medium, small and micro undertakings by size of their business and type of ownership across various pieces of legislation, including the 2012 A&A Law, to eliminate any lack of clarity, and facilitate standards compliance and enforcement.
 - Require all companies significant to the Georgian economy, i.e. PIEs and large undertakings as defined by the Accounting Directive, to publish their audited unabridged financial statements before the annual general meeting or within a reasonable period of time, which shall not exceed 12 months after the balance sheet date, either through the internet or by providing copies free of charge, so that shareholders are better prepared to decide on the approval of these statements.
 - Establish a sustainable funding support mechanism to allow the accredited professional organization(s) to perform the following functions, delegated by the Government, effectively and on a timely basis, free from undue influence and bias: (i) translation and timely updates of the standards; (ii) development of the simplified accounting standards for micro entities; and (iii) initial registration of auditors, and maintenance of such registry.
153. **With respect to the Accounting and Auditing Standards**, the following improvements will support and strengthen achievements since the previous ROSC report:

⁴⁹ Levine, R., Loayza, N., Beck, T. 2000. *Financial Intermediation and Growth: Casualty and Causes*. Journal of Monetary Economics 46, 31-77.

- Enhance the standards translation process for IFRS, the IFRS for SMEs and ISAs to ensure sustainability of timely and quality translations. Consideration should be given to potential funding support from the Government and other sustainable sources of funding.
- Develop and adopt further standards, for example simplified accounting standards for micro entities.
- Develop an ISA compliant standard audit methodology and audit manual for small and medium audit practices, which would improve the quality of the audit profession of Georgia as a whole and lead to an increase in public confidence in the reliability of the information contained in financial statements.

154. **With regard to quality control and enforcement mechanisms**, the report suggests the following improvements:

- Identify and designate an existing regulatory body(-ies), or department(s) within the existing regulators, to enforce the accounting standards and reporting compliance for PIE and large undertakings. This body(-ies) should be equipped with standard enforcement mechanisms and respective enforcement authority.
- Centralize the filing of SOE financial statements in a single agency within the existing authority. The existing system of SOEs reporting to either the National Agency of State Property or their respective line Ministries creates duplication and does not allow the Government to have a consolidated view of assets and companies in which the state holds capital.
- Establish a new body, or designate an existing one, to become the competent authority in charge of the regulation and/or oversight of statutory auditors and audit firms, as required by the Audit Directive. The Directive provides for significant flexibility in audit regulation, requiring only a limited level of obligatory provisions for implementation. Georgia should use the time allowed under the Association Agreement to learn more about this policy area, drawing on the experience of other countries, exploring the obligatory requirements of the Audit Directive and considering the implementation of optional provisions for a later stage.
- Continue increasing the regulator's institutional capacity to monitor and enforce compliance with financial reporting requirements. These institutions should have adequate resources to perform in-depth reviews of corporate financial statements and related audit reports.
- Enhance collaboration between the Government and the accounting professional associations to strengthen compliance with IFRS, establish quality control over audits, ensure timely translation of standards, and raise the quality of continuing professional education.
- Significantly strengthen the mechanisms to monitor compliance with the standards, and application of appropriate sanctions for non-compliance, within the respective agencies – including for accounting NBG, ISSSG, National Agency of State Property etc. and for auditing GFPAA. This will improve transparency and accountability to stakeholders. The absence of enforcement diminishes the requirement to follow the

standards, creating a perception among Georgian companies that they are non-mandatory.

155. **Finally, with regard to professional education and continuing development, the following enhancements** will raise the professional qualification of accountants and auditors in Georgia, and build public trust in the profession:

- Strengthen accounting academic curricula and align university programs with professional training and examination requirements of the accredited professional organizations in the field of accounting and auditing. Enhance continuing professional education and training, in line with IFAC's education standards.
- Introduce and coordinate minimum requirements for university-level education in accounting and auditing, based on International Education Standards for Professional Accountants, set and coordinated by the Ministry of Education, and ensure consistent application among universities in Georgia.
- Require professional accountants to follow training programs to improve and update their knowledge of the standards and good practices in the field of accounting and auditing. Professional organizations and leading audit and accounting companies should consider offering comprehensive training courses for bookkeepers and accountants working with IFRS or the IFRS for SMEs.
- Improve professional development training for professional auditors. To raise the quality of audit services among existing practitioners, GFPAA should consider developing an ISA compliant standard audit methodology and audit manual, and offer comprehensive training courses to its members.

Annexes

Annex 1: Implementation of the Recommendations from the 2007 ROSC Accounting and Auditing

	Recommendations	Category	Comments
1	Legal entity and/or consolidated financial statements to be audited only when there is a public interest for such an audit.	Statutory Framework	<i>Outstanding</i>
2	All statutory audits to be conducted in compliance with ISA.	Statutory Framework	<i>Addressed</i> in the new 2012 A&A Law where statutory audit of financial statements should be conducted in compliance with ISA.
3	All auditors and/or audit firms to be registered for audit with a professional organization.	Statutory Framework	<i>Addressed</i> in the new 2012 A&A Law where all audit firms should be registered with the professional organization that is the full member of IFAC. However, the provision of the mandatory registration was delayed until June 1, 2015.
4	Elaborate mechanism for professional organization(s) to perform the following functions effectively and on a timely basis, free from undue influence and bias: <ul style="list-style-type: none"> • translation of IFRS; development of the reduced ‘temporary accounting standards’ • translation of auditing standards, 	Statutory Framework	<i>Addressed</i> in the new 2012 A&A Law that includes all those provisions. However, the implementation is still in transition.

	Recommendations	Category	Comments
	<ul style="list-style-type: none"> • adoption of an ethical code or standards for auditors and/or accountants, • the registration of auditors, • the monitoring of the quality of auditor's work, • the recognition of audit qualifications, and • investigation of complaints relating to certified auditors. 		
5	Increase the accountability of preparers of financial statements. In order to enhance directors' accountability, all board members should be collectively responsible, both in law and in practice, for the probity of legal entity and consolidated financial statements. This should discourage excessive reliance on auditors in the preparation of financial statements.	Statutory Framework	<i>Not Addressed</i> Relevant laws and regulations remained unchanged.
6	Requirement for <i>public interest entities</i> to make their audited legal entity and consolidated (if any) financial statements readily available to the public within a reasonable period after the balance sheet date.	Statutory Framework	<i>Outstanding.</i> Relevant laws and regulations remained unchanged.
7	The enhancement of the existing translation process resulting in a sustainable translation process in Georgian language whereby the official translation of IFRS is readily available and affordable across the country. This translation process should also be leveraged in the context of the translation of ISA.	Accounting Standards	<i>In progress.</i>
8	The policymakers and regulators revisit the relationship between prudential and general purpose financial reporting in the financial sector.	Accounting Standards	<i>Outstanding.</i> Relevant laws and regulations remained unchanged.
9	The NBG and the ISSSG should develop prudential filters for regulatory capital with a view to adjust regulatory own funds for changes appearing in the accounting equity of financial institutions applying IFRS.	Accounting Standards	<i>In progress.</i> Relevant laws and regulations remained unchanged

	Recommendations	Category	Comments
10	The enhancement of the existing translation process resulting in a sustainable translation process in Georgian language whereby the official translation of ISA is readily available and affordable across the country. This translation process should also be leveraged in the context of the translation of IFRS.	Auditing Standards	<i>In progress</i>
11	In the medium term, the development of an ISA compliant standard audit methodology and audit manual for the smaller audit practices which would then allow the audit profession of Georgia as a whole to improve the quality of the auditing function.	Auditing Standards	<i>Outstanding.</i>
12	Subjecting all auditors and audit firms to a system of quality assurance. The results of the external quality assurance system should be instrumental in the registering organization's decision whether to continue the registration, or issue it subject to restrictions and/or conditions.	Monitoring and Enforcement of Accounting and Auditing Standards	<i>In progress.</i> Addressed in the new 2012 A&A Law that includes all that provision. However, the implementation is still in transition.
13	Structuring the quality assurance system for auditors such that the monitoring visit cycle should be linked to the level of public interest in the firm's clients.	Monitoring and Enforcement of Accounting and Auditing Standards	<i>Outstanding</i>
14	The establishment of an effective system of investigations and sanctions for potentially serious misconduct relating to audit.	Monitoring and Enforcement of Accounting and Auditing Standards	<i>Outstanding</i>
15	Systematic follow-up by the ISSSG, NBG or the NSC upon receipt of a qualified auditor's report relating to the financial statements of one of their regulated entities. The results of the NSC, NBG and ISSSG's reviews of the financial statements of regulated entities should be communicated where relevant directly to the audit registering body.	Monitoring and Enforcement of Accounting and Auditing Standards	<i>In progress</i>

	Recommendations	Category	Comments
16	The establishment of a reliable claims database that will help insurers and supervisors confirm the right price for various categories of products in accordance with The International Association of Insurance Supervisors' Guidance Paper No. 1, <i>Insurance Regulation and Supervision for Emerging Market Economies</i> .	Monitoring and Enforcement of Accounting and Auditing Standards	<i>Outstanding</i>
17	The enhancement of the NBG's, the NSC's and the ISSSG's relationship with statutory auditors to mutual advantage. The supervisors may also consider requiring the statutory auditor to carry out specific assignments or issue special reports to assist the supervisors in discharging their supervisory functions.	Monitoring and Enforcement of Accounting and Auditing Standards	<i>Outstanding</i>
18	The development of a mutually acceptable approach to the audit of technical reserves. Without a functioning life insurance industry, Georgia may not have the actuarial capacity or sufficiently advanced technical insurance needs to justify onerous actuarial certification requirements. The Georgian Association of Actuaries and Financial Analysts should incorporate this approach in to their actuarial qualification.	Monitoring and Enforcement of Accounting and Auditing Standards	<i>Outstanding</i>
19	The ISSSG take responsibility for the supervision of insurance companies' marketing information and policy wordings to ensure consistent high standard, of open and transparent information for the public. This information was required to be submitted to the ISSSG prior to the recent simplification of licensing arrangements.	Monitoring and Enforcement of Accounting and Auditing Standards	<i>Outstanding</i>
20	In the short to medium term, that the NBG, NSC and the ISSSG employ more staff who are familiar with IFRS and encourage those staff to stay up to date with IFRS as it evolves. The supervisors should also consider arranging internships for staff with overseas peer institutions. The aim for all the regulatory bodies should be a regime of enforcement which incentivizes firms	Monitoring and Enforcement of Accounting and Auditing Standards	<i>Outstanding</i>

	Recommendations	Category	Comments
	to comply by making the rewards of compliance greater than the costs of non-compliance.		
21	<p>The establishment of a registration requirement for all individuals who wish to obtain the right to conduct audits in Georgia. If this registration is administered by professional organizations, as is proposed under the draft Law, then the professional audit qualification of each organization should be required by the Law to comply with IFAC Education Standards i.e. it should comprise an examination of professional competence and a requirement for suitable and adequate relevant professional experience and should:</p> <ul style="list-style-type: none"> draw upon International Education Standards established by the International Accounting Education Standards Board of IFAC, in particular IES 8, <i>Competence Requirements for Audit Professionals</i>, IES 6, <i>Assessment of Professional Capabilities and Competence</i> and IES 5, <i>Practical Experience Requirements</i>. include procedures for the approval of individuals who hold adequate foreign accounting qualifications subject to a test of the relevant laws and regulations of Georgia for audit purposes. include procedures for holders of the existing audit certification issued by the Audit Council and existing GFPA members such that they should meet all, or substantially all, of the requirements for the main qualification to obtain the qualification (such transitional procedures are proposed in the draft Law). <p>Such a qualification procedure is comparable to existing practice in EU Member States under the Eighth Company Law Directive.</p>	Development of the Accounting and Auditing Profession	<i>In progress</i>

	Recommendations	Category	Comments
22	The establishment of a publicly-available electronic register of auditors and audit firms so that interested parties can determine rapidly whether an auditor or an audit firm has been registered for audit.	Development of the Accounting and Auditing Profession	<i>Outstanding</i>
23	<p>The GFPAA continues its key role in leading the accountancy and audit profession in Georgia. In this context, the GFPAA should:</p> <ul style="list-style-type: none"> • Seek to include as associate members all of those working as accountants and in particular all ‘chief accountants’, • Make studying for qualifications as accessible as possible, especially for those who have learnt under previous regimes, by emphasizing that such learning is ‘updating’ knowledge rather than starting from no knowledge base. • Encourage all members to maintain and enhance their professional competence through CPD. • Regulate the audit profession to the extent delegated to it by the Law 	Development of the Accounting and Auditing Profession	<i>In progress.</i> GFPAA continues its role in leading the accountancy and audit profession in Georgia, however, it lacks enforcement mechanisms in regard to proper regulation of the audit profession and effective maintenance of CPD.
24	<p>Encouraging ‘chief accountants’ and other preparers of financial statements at Georgian companies to improve their understanding of IFRS, accrual accounting, and their application to their work within the financial reporting framework in Georgia.</p> <p>On the demand side, policymakers could incentivize company management to invest in such ‘retooling’ through a combination of positive incentives and deterrent incentives (e.g., liability for the probity of financial statements). In the context of State Owned Enterprises (SOEs), the State, acting as a shareholder, could take the lead and ensure that accountants in SOEs enroll in ‘retooling’ programs. Companies should also be encouraged to support employees’ training and study towards accountancy qualifications.</p>	Education and Training	<i>Outstanding</i>

	Recommendations	Category	Comments
	On the supply side, private sector accountancy education centers could also be incentivized to open in Georgia through specific measures. Their offering should however be tailored to the needs of Georgian companies. The core concepts, such as the accrual basis, the separation of reporting for tax purposes and financial reporting, and the interaction of financial statements, management accounting and cash flow accounting, should be central to the education of the profession.		
25	The GFPAA provide a recognized qualification which ‘chief accountants’ and other accountants in industry would aspire to, which would be affordable and within their capabilities. The absence of such an intermediate qualification risks disenfranchising the majority of the current accountancy profession in Georgia.	Education and Training	<i>Outstanding</i>
26	<p>Better integration of the range of accountancy education and training. In this context, the GFPAA should:</p> <ul style="list-style-type: none"> • work with the ACCA to bring the quality of its ‘Georgian ACCA’ qualification up to as close to the standard of the English-language ACCA as possible through improvements to the examinations, which should be set in a similar manner and to a similar standard as the ACCA English-language exams. In addition, the GFPAA should support its members (and others) who wish to take English-language qualifications. • work closely with the universities and other providers of higher education to coordinate syllabuses such that, where appropriate, exemptions can be granted for stage one (or conceivably stage two) examinations in the GFPAA’s professional qualification. Close cooperation gives advantages for all – students benefit from reduced time and cost, the universities gain through improvements in course quality and the GFPAA/profession 	Education and Training	<i>Partially addressed.</i> Cooperation between the GFPAA and education providers has improved since the previous ROSC, as the former introduced some exemptions for its Georgian-language ACCA qualification to graduates of three Georgian universities. The GFPAA has also strengthened its Georgian language ACCA course increasing the number of equivalences between its own qualification system and the system of the UK based

	Recommendations	Category	Comments
	benefits from attracting more able students into the profession who can graduate to full membership more quickly.		Association of Chartered Certified Accountants (ACCA).
27	Key operational staff are seconded from the supervisory agencies to similar agencies abroad for ‘on the job training’ on best international practices regarding monitoring and supervision in respective areas as well as IFRS.	Education and Training	<i>Outstanding</i>
28	The Georgian actuarial qualification offered by the Association of Actuaries and Financial Analysts should seek accreditation from, or affiliation to, an international association. This would lead to a better market understanding of the qualification’s standard.	Education and Training	<i>Outstanding</i>

Annex 2: Framework for Accounting and Financial Reporting

Encouraging ‘chief accountants’ and other preparers of financial statements at Georgian companies to improve their understanding of IFRS, accrual accounting, and their application to their work within the financial reporting framework in Georgia.

Current Accounting Standards

Entities	Legal Entity Financial Statements
Small entities	Simplified temporary accounting standards based on IFRS and prepared by the profession
All entities except small	IFRS dating from 2010
Banks	IFRS per the Banking Law
Insurance	IFRS per the Insurance Law
Listed companies	IFRS per the Securities Law
SOEs	IFRS or accounting requirements per the National Agency of the State Property Fund NASPF of the Ministry of Economy and Sustainable Development (MOESD)

Future Accounting Standards

Entities	Legal Entity Financial Statements
Individuals operating micro and small businesses as defined by Tax Code	No reporting requirement
All entities not classified as micro or other regulated entity	IFRS for SMEs
Banks, and other non-banking institutions regulated by NBG	IFRS
Insurance	IFRS
Listed companies	IFRS
Non-commercial	Local/National Accounting Standards
SOEs	IFRS or NASPF

Annex 3: Entities' Filing and Publication Requirements in Georgia

Entity	Report	Filing Requirements		Publication Requirements	
		Where	When	Where	When
Regulated Entities					
Banks	Audited annual financial statements (FS) and audit report	NBG	Within 10 days after filing audit report with NBG and no later than May 15 the year following the reporting period.	Print media, bank’s website, and NBG’s Website	Within 30 days of the receipt of the audit report.
	Unaudited quarterly balance sheet and income statement	NBG	Within 30 days of the quarter	Website	Within 30 days of the quarter
JSCs (publicly held)	Audited annual FS and audit report	NBG and Georgia Stock Exchange (GSE)	Within 90 days of reporting period	Optional	No requirement
	Semi-annual unaudited FS	NBG and GSE	Within 45 days of reporting period	Not required	No requirement
Brokerage companies, SE, Central Deposit Repository	Audited Annual FS and Audit Report	NBG	Within 90 days of reporting period	Not required	No requirement
	Quarterly unaudited FS for Brokerage Companies	NBG	Within 45 days of reporting period	Not required	Not required
Insurance Companies	Audited Annual FS and Audit Report	LEPL – ISSSG	By February 20	Not specified	No requirement
All other entities, including large LLCs					
-	-	No requirement		No requirement	

Annex 4: Reporting Requirements for SMEs in Georgia

Tax code definition of microenterprises:

Type of entity	Turnover	Inventory
Microenterprise	< GEL 30,000 (US\$17, 161; EUR12, 504)	< GEL 45,000 (US\$25,724; EUR 18, 755)
Small Business	< GEL 100,000 (US\$57,205; EUR 41, 679)	< GEL 150,000 (US\$85, 807; EUR 62, 518)

Change in reporting requirements for small businesses in new law:

Relevant Laws	Number of employees	Turnover	Inventory	Classification	Accounting Standard
Law on Entrepreneurs and Accounting Law 1999	< 20	GEL 500,000 (approx. US\$ 286,025; EUR 208, 394)		Small business	Simplified accounting standards
2012 A&A Law	1	< GEL 100,000 (US\$57,205; EUR 41, 679)	< GEL 150,000 (US\$85, 807; EUR 62, 518)	Micro entity	Not required
2012 A&A Law	≥ 2	> GEL 100,000 (US\$57,205; EUR 41, 679)	> GEL 150,000 (US\$85, 807; EUR 62, 518)	SME	IFRS for SME

Annex 5: Summary of GFPAA Compliance with IFAC Statements of Membership Obligations

SMO 1 - Quality Assurance (QA): GFPAA established procedures for quality assurance reviews to be conducted for its members-audit firms, currently, under their own initiative through peer review services. The late changes implemented by the 2012 A&A Law, require that quality control reviews are to be carried out by the accredited professional organizations, which qualify and meet certain requirements, including being IFAC member, presently only GFPAA. The accredited professional organizations were assigned the authority to establish and implement the quality review procedures, and maintain an auditors' registry. GFPAA developed and approved the respective Regulation on Quality Control System Monitoring, ready for implementation starting January 2015, when the delayed provisions of the 2012 A&A Law come into effect. Once the procedure becomes mandatory, GFPAA shall require significant financial and staff resources to devote to quality assurance reviews. GFPAA currently is in the process of identification respective specialists to carry out quality reviews. To test their preparedness, GFPAA conducted three voluntary quality reviews during 2012-2013. This step did not reveal any significant deviations from ISA, and assisted GFPAA in refining their Regulation on Quality Control System Monitoring. Going forward, GFPAA and the Government of Georgia agree that the formal Audit Public Oversight should be established, as required by the EU Audit Directive, however, respective changes to the local legislation will need to be introduced to adopt this concept in Georgia.

SMO 2 – International Education Standards (IESs): GFPAA cooperates with selected **local** universities in providing the initial professional education. For the professional certification, candidates for GFPAA's membership have to complete a Georgian language qualification based on translations of the U.K. ACCA syllabus, meet a three-year practical experience and undergo a final examination. The continuing professional education (CPD) requirement of at least 40-hour program each year/ or 120-hours in three years' time will become mandatory for all members on June 1, 2015 with the respective delayed provisions of the 2012 A&A Law coming into effect. At the same time, GFPAA has very limited enforcement tools to monitor this compliance.

SMO 3 - International Auditing and Assurance Standards (IAASB) pronouncements: beginning January 2013, all statutory audits must be carried out according to ISA. GFPAA is presently responsible for translating, updating and publishing ISA and other relevant IAASB pronouncements. The respective translation process is well set up, but is not performed timely. For example, the most current ISA version translated and published dates to 2009. Moreover, the dissemination of ISA and respective training require significant improvement in order to effectively deliver the knowledge and deepen an understanding of the standards among local professionals, GFPAA members and others. GFPAA lacks authority and resources to enforce ISA compliance, as indicated above in SMO 1.

SMO 4 - International Ethics Standards Board for Accountants (IESBA) Code of Ethics: according to the 2012 A&A Law, IESBA's Code of Ethics is fully adopted in Georgia, effective 2013. At the same time, due to the delay of mandatory PAO membership for all audit firms in Georgia, GFPAA has no mechanism to control compliance with the Code by audit firms. Moreover, the audit profession shall require significant support in the Code implementation through series of publications and training courses to be conducted in Georgian language.

SMO 5 - International Public Sector Accounting Standards (IPSAS): IPSASs are not adopted in Georgia. According to the Ministry of Finance, Georgia is planning to implement IPSAS by 2020. GFPAA cooperates with the Ministry of Finance on translating and assessing the need to implement IPSAS in Georgia's public sector.

SMO 6 - Investigation & Discipline: GFPAA started developing its investigation and discipline system in line with SMO 6 requirements in 2013. On a legislative level, this function is neither clearly established nor regulated. Some disciplinary actions and penalties are established by the 2012 A&A Law for certain violations, such as fail to meet registration requirements, appoint audit partner, breach independence or confidentiality rules, however, the enforcement mechanism is not clear, and needs to be strengthened to function properly. GFPAA also needs to enhance its investigation and discipline system and procedures, as well as educate its membership on the purpose of investigation and discipline mechanisms, in order to help raising confidence in the audit profession in Georgia.

SMO 7 - International Financial Reporting Standards: Georgia adopted IFRS in 2000. Entities that are subject to the statutory audit requirements, including commercial banks, insurance companies and entities listed on a local market are obliged to prepare their financial statements in accordance with the IFRS. The IFRS for SME are coming into effect starting June 1, 2015, and will be applicable to all entities not captured by requirement to comply with full IFRS, and exceeding the definition of the micro-entity set up by the Tax Code. The 2012 A&A Law delegates the translation and publishing process to an accredited professional organization, presently, GFPAA. The GFPAA updated the translation of IFRS into the Georgian language and published them in 2010. The more recent translation updates are not yet available. IFRSs for SMEs issued in 2009 are also translated into Georgian language, but not yet published. The Article 3 of the 2012 A&A Law permits the use of English language texts of IFRS and the IFRS for SMEs.

Annex 6: Review of Selected Audited Financial Statements Prepared in Accordance with IFRS

Below are disclosed examples of selected non-compliance cases identified during the review of sample financial statements conducted during the preparation of this Report.

- **Significant Accounting Policy.** With few exceptions, significant accounting policies regarding measurement of assets and liabilities often did not include applicable discount rates, or did not highlight items that were included or excluded from such calculations. This could raise doubts as to whether the carrying amounts of assets and liabilities in the Statement of Financial Position are correct.
- **Related Party Disclosures.** Majority of the entities did not have the required categories or degree of disclosures required by *IAS 24 Related Party Disclosures*. Also, two of the three SOEs applied the exemptions in the standard for government entities, which allowed them to provide reduced disclosures. Omission of related party disclosures impedes users' abilities to understand and evaluate how an entity's financial performance, financial position or cash flows may have been affected by transactions with related parties.
- **Property, Plant and Equipment.** Almost all the entities in the sample had an issue related to measurement of property, plant and equipment as required by *IAS 16 Property, Plant and Equipment*. Considering this was generally a significant asset on the balance sheet, there is the risk that total assets in the Statement of Financial Position may be over- or under stated.
- **Impairment.** With respect to non-derivative financial assets, majority of the companies did not consider the requirement to exclude future credit losses that have not yet been incurred from their calculations of the present value of estimated future cash flows for impairment losses per *IAS 39 Financial Instruments: Measurement and Recognition* and *IFRS 7 Financial Instruments: Disclosures*. This could lead to incorrect financial asset values in the financial statements. For non-financial assets, reconciliation of the impairment allowance account, required by *IAS 36 Impairment of Assets*, was often omitted and so the reliability of the relevant charges to income was uncertain.
- **Fair Value.** Fair value disclosures were present but were limited and very general.
- **Financial Instruments Risk Disclosures.** Most entities made an attempt to provide the information required by *IFRS 7 Financial Instruments: Disclosures*. However, these were rarely complete, and in many instances the information provided was inadequate as to the nature and extent of risks arising from financial instruments.

Examples of banks' non-compliance with IFRS in the reviewed sample of financial statements:

- **IAS 1 Presentation of Financial Statements.** In many instances, accounting policies were extracted directly from the standards without apparent relevance to the banks' transaction. In other cases, accounting policies for key items in the financial statements were omitted entirely. Complete disclosure of accounting policies is important in order to enable users to fully understand the nature, recognition and measurement of items in the financial statements and of transactions that occurred during the reporting period. In addition, comprehensive disclosures allow investors and other users compare banks' financial performance within the banking sector.

- **IAS 7 Statement of Cash Flows.** Non-compliance with IAS 7 covered a range of areas such as: inclusion of restricted balances with the central banks in cash and cash equivalents; failure to specify the maturity of items included in cash and cash equivalents; omission of cash flows identified elsewhere in the financial statements; and different values for cash and cash equivalents in the Statement of Cash Flows and Statement of Financial Position. Failure to comply with IAS 7 raises questions about the fair presentation of a bank's cash flow and undermines' users confidence of the reliability of the financial statements.
- **IAS 24 Related Party Disclosures.** The disclosures were often incomplete and poorly cross-referenced throughout the financial statements.
- **IAS 38 Intangible Assets.** In general, the accounting policies for intangible assets were limited and often did not: distinguish between internally generated and other intangible assets; disclose whether useful lives were finite or infinite; state the amortization rates or methods used; or provide a reconciliation of the carrying amount at the beginning and end of the period. As a result it would be challenging for a user to assess the reliability of the figures presented in the financial statements.
- **IAS 39 Financial Instruments: Recognition and Measurement.** In addition to the areas of non-compliance highlighted in Section III, a number of banks provided inadequate information on the banks approach to assessing impairments of loans. While there was usually standard wording on banks assessing loans on an individual basis before collective loan loss assessment was conducted, there was little or no information on the thresholds for individual loan loss assessment prior to assessing on a collective basis. Given the differences between regulatory and general-purpose financial reporting loan loss provisioning, users of the financial statements need as much information as possible to understand how loan loss impairment is measured in the financial statements.
- **IFRS 7 Financial Instruments: Disclosures.** The extent of the disclosures of the various categories of risk varied across the sample bank financial statements, with some banks providing informative disclosures. In general the required disclosures on collateral held and loan concentration fell short of the requirements. Many banks did not quantify the effects of the collateral held in order to mitigate credit risk. In an environment in which banks rely heavily on collateral to mitigate credit risk, complying with the requirement to provide information on the types of collateral held as security and quantification and of the financial effect, would enable users to better evaluate bank's credit risk exposure in this respect.

Examples of insurance companies' non-compliance with IFRS in the reviewed sample of financial statements:

- Assets and liabilities were not placed in any discernible order of liquidity.
- Significant accounting policies were general, incomplete or omitted.
- Inadequate cross-referencing of notes in the financial statements. For example, one of the insurance companies did not disclose in the Note on *Loan Receivable* that 97% of all loans were to related parties, with one related party accounting for 87% of total loans or that the loan was outstanding for over a year.
- No provision for impairments on loans receivable or other financial assets.
- No amortization of deferred acquisition cost.
- Disclosures across all the categories of risk as required by IFRS 7 were limited.
- Incomplete disclosure on related party transactions.

Examples of state owned enterprises and private sector entities non-compliance with IFRS in the reviewed sample of financial statements:

- **IAS 1 Presentation of Financial Statements.** All relevant accounting policies were not always included.
- **IAS 7 Statement of Cash Flows.** There were instances of misclassification of items in cash and cash equivalent.
- **IAS 17 Leases.** The classification and measurement were incorrect at times, or the disclosures were inadequate.
- **IAS 38 Intangible Assets.** Reconciliation of carrying amounts and related amortization were sometimes omitted.
- **IAS 24 Related Party Disclosures.** The disclosures were often incomplete and poorly cross-referenced throughout the financial statements.
- **IFRS 3 Business Combinations.** In general, these entities did not comply with IFRS 3 with respect to providing information on the fair value of consideration transferred, or the disclosures on the primary reasons for business combinations and other disclosures required by the standard.

Annex 7: Priority Ranking of Suggested Areas for Improvement

Action		Timing		
		Short-term (less than 1 year)	Medium- term (1 to 3 years)	Long-term (3 to 5 years)
Statutory Framework				
1	To define public interest entities in Georgian legislation, including: (i) entities traded on a regulated market; (ii) credit institutions; (iii) insurance undertakings, and (iv) undertakings that are of significant public relevance due to the nature of their business, their size or the number of their employees, as defined by the EU Directive 2013/34/EU “on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings” (Accounting Directive).	X		
2	<p>To introduce and harmonize definitions of public-interest entities, large, medium, small and micro undertakings by size of their business and type of ownership across various pieces of legislation (including but not limited to the 2012 A&A Law, Commercial Code, Tax Code, and other regulations of various governmental and regulatory bodies), to eliminate any lack of clarity, and facilitate standards compliance and enforcement.</p> <p>These thresholds will determine the accounting, auditing and reporting requirements for various types of entities. Specifically, consider reducing the reporting requirements for small and micro undertakings, as many of them may be overburdened by new reporting requirements to apply the IFRS for SMEs that come into effect on June 1, 2015.</p>	X		
3	To establish publication requirements for companies significant to the Georgian economy, for example public-interest entities and large undertakings as defined by the EU Accounting Directive 2013/34/EU, to publish their audited, unabridged financial statements before the annual general meeting or within a reasonable period of time, which shall not exceed 12 months after the balance sheet date, either through the internet or by providing copies free of charge, so that shareholders are better prepared to decide on the approval of these statements.	X		

Action		Timing		
		Short-term (less than 1 year)	Medium- term (1 to 3 years)	Long-term (3 to 5 years)
4	To establish a sustainable funding support mechanism to allow the accredited professional organization(s) to perform functions delegated by the Government effectively and on a timely basis, free from undue influence and bias: (i) translation and timely updates of the standards; (ii) development of the simplified accounting standards for micro entities; and (iii) initial registration of auditors, and maintenance of such registry.		X	
Accounting and Auditing Standards				
5	To enhance the standards translation process to ensure sustainability of timely and quality translations, with consideration of funding support from the Government and other sustainable sources of funding.		X	
6	To develop and adopt further standards, for example simplified accounting standards for micro entities.		X	
7	To develop an ISA compliant standard audit methodology and audit manual for small and medium audit practices, which would improve the quality of the audit profession of Georgia as a whole and lead to an increase in public confidence in the reliability of the information contained in financial statements.		X	
Quality Control and Enforcement				
8	To identify and designate an existing regulatory body(-ies), or department(s) within the existing regulators, to enforce accounting standards and reporting compliance for PIE and large undertakings. This body(-ies) should be equipped with standard enforcement mechanisms and respective enforcement authority.		X	
9	To centralize filing of SOE financial statements in a single agency or department within the existing regulator. This step will avoid duplication of functions and allow the Government to get a consolidated view of the companies in which the state owns some of the capital.	X		

Action		Timing		
		Short-term (less than 1 year)	Medium- term (1 to 3 years)	Long-term (3 to 5 years)
10	To establish a new, or designate an existing, body as competent authority in charge of the regulation and/or oversight of statutory auditors and audit firms, as required by the EU Directive 2014/56/EU “on statutory audits of annual accounts and consolidated accounts” (Audit Directive). The Directive provides for significant flexibility in audit regulation, requiring only a limited level of obligatory provisions for implementation. Georgia should use the time allowed under the Association Agreement to learn more about this policy area, drawing on the experience of other countries, exploring the obligatory requirements of the Audit Directive and considering the implementation of optional provisions for a later stage.		X	
11	To continue increasing the institutional capacity of regulators to improve their ability to enforce compliance with financial reporting requirements. These institutions should have adequate resources to perform in-depth reviews of corporate financial statements and related audit reports. The staff of regulatory agencies will need training to be able to effectively enforce compliance with IFRS.		X	
12	To enhance collaboration between the Government and the professional accounting organizations to strengthen compliance and enforcement of IFRS application, establish quality control over audits, ensure timely translation of standards, and raise the quality of continuing professional education.		X	
13	To significantly strengthen the mechanisms to monitor compliance with the standards within the respective regulatory agencies: for accounting - NBG, ISSSG, National Agency of State Property etc., and for auditing – GFPAA, including application of appropriate sanctions for non-compliance. This will improve transparency and accountability to stakeholders. The absence of enforcement diminishes the requirement to follow the standards, creating a perception among Georgian companies that they are non-mandatory.		X	

Action		Timing		
		Short-term (less than 1 year)	Medium- term (1 to 3 years)	Long-term (3 to 5 years)
Professional Education and Continuing Development				
14	To strengthen academic curricula and align university programs with professional training and examination requirements at the accredited professional organizations in the field of accounting and auditing, as well as continuing professional education and training, in line with IFAC's education standards. This enhanced curricula should be endorsed by the Ministry of Education for consistent application throughout the country.		X	
15	To establish and coordinate minimum acceptable requirements for university level education in accounting and audit, taking into consideration good international practices and agreed with the Ministry of Education, and ensure such consistent application among universities in Georgia.		X	
16	To require that professional accountants follow training programs to improve and update their knowledge of the standards and best practices in the field of accounting and auditing. For GFPAA, other professional organizations, and leading audit and accounting companies to consider offering comprehensive training courses for book keepers and accountants working with IFRS and the IFRS for SME.		X	
17	To improve professional development training for professional auditors. To raise the quality of audit services among existing practitioners, GFPAA should consider developing an ISA compliant standard audit methodology and audit manual, and offer comprehensive training courses to its members.		X	

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