



The experience of Georgia: speedy enforcement of the quality assurance system - how to avoid faults and to strengthen the successes

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Disclaimer

The views expressed are those of the speaker and do not necessarily reflect the views of the audit regulator, its members, or staff.

Introduction



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Previous work Experience in audit:

- PwC Isle of Man
- PwC UK
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Audit and financial reporting oversight in Georgia

Audit and financial reporting oversight in Georgia – Part 1 of 3

- Historically IFRS and ISAs mandated by law, but with almost no credible enforcement;
- Requirements were strict and to an extent not practical given the then existing enforcement mechanism;
- Audit was regulated at PAO level with weak enforcement mandate;
- Driven by Georgia's aspiration towards the EU, the new law on accounting and audit was ratified by parliament in June 2016 with an immediate effect;
- In sync and compliance with the EU directives 2006/43 and 2013/34;
- The Service for Accounting Reporting and Audit Supervision (SARAS) was established in accordance with the new law in September 2016;
- SARAS became IFIAR member since 2017;
- SARAS is governed by a board of stakeholder representatives. In total 7 voting members.

Audit and financial reporting oversight in Georgia – Part 2 of 3

- Main functions of SARAS include:
 - Auditor registration and maintenance of the register;
 - Audit firm registration and maintenance of the register;
 - Oversight of auditor certification process;
 - Oversight of auditor CPD process;
 - **Audit quality monitoring for auditors and audit firms (at minimum once every three years for PIE auditors and once every 6 for others);**
 - Enforcing financial reporting requirements (for all private sector legal entities, not only for PIEs), and
 - Creation and maintenance of a public reporting portal for financial and non financial reports, etc.

Audit and financial reporting oversight in Georgia – Part 3 of 3

- Professional standards which are prescribed by the law:
 - Financial reporting:
 - IFRS Standards (as issued by IASB);
 - The IFRS for SMEs Standard (as issued by IASB);
 - The IFRS for SMEs Standard with simplified disclosures (as issued by IASB and modified by SARAS);
 - Standard for Micro entities (to be issued by SARAS).
 - Audit and related services:
 - International Quality Control, Auditing, Review, Other Assurance and Related services by IAASB of IFAC (ISQC 1, ISA etc).
 - Ethics:
 - The Code of Ethics of Professional Accountants (IESBA of IFAC)
 - Education (certification, CPD etc):
 - International Education Standards (IAESB of IFAC)



The inspection process and grading system

Grading system

The scope:

- Review of audit files to cover every audit engagement leader for ISA compliance;
- Review of audited financial statements for compliance with the respective financial reporting framework (IFRS, IFRS for SMEs, etc);
- Review of quality control systems for ISQC 1 compliance

The key factors are:

- Materiality of individual findings;
 - How systematic the findings are; and
 - Existence of ethical violations.
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- We have a 6 category grading system:
 - Category 1 – Only unsystematic and immaterial issues identified, strong entity level quality controls;
 - Category 2 – Material but unsystematic issues;
 - Category 3 – Material and systematic (warrants fast remediation);
 - Category 4 – Very material and systematic;
 - Category 5 - Very material and systematic together with ethical violations; and
 - Category 6 - Very material and systematic, with serious ethical violations.



May audit PIEs

The inspection process

- A notification letter is sent to the audit firm 1 month (or 3 months) in advance;
- On day 1 of the inspection fieldwork the firm is informed about the selection, the respective audit files are copied in two copies (one for the firm and one for us) and the original file is locked;
- After the fieldwork is finalised, the preliminary report gets submitted for the internal quality control peer review;
- The preliminary report is communicated to the firm with a suggestion to meet and discuss;
- After that the final report is issued to the firm (confidential and not for public use);
- A publicly available decree is issued to inform the public about the final result (ie the grade) and information about any sanctions or prohibitions;
- The firm has 30 days to dispute the report and the decree with SARAS governing board.



Mission and vision

Mission

	<u>Unemployment</u> <u>rate</u>	<u>Monetary policy</u> <u>rate</u>
Switzerland	3%	-1%
Japan	3%	-0.1%
EU	9%	0%
UK	4%	1%
USA	4%	2%
G 20 average	6%	2%
BRICS average (excludin	6%	6%
Georgia	12%	7%
Russia	5%	7%
Turkey	11%	8%

Correlation	64%
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Source: Trading Economics (April 2018)

<https://tradingeconomics.com/>

To facilitate economic growth, and maximize employment opportunities in Georgia, by providing capital markets with relevant and reliable financial and non-financial information for effective capital allocation.



Our mission is to facilitate capital markets and close this gap.

Vision

- To strengthen preventive controls over audit quality (ie strengthen education and professional ethics):
 - To enforce proper auditor certification requirements;
 - To closely monitor PAOs in terms of organization and delivery of CPD programs for auditors;
 - To champion and enforce application of the Code of Ethics.
- To strengthen detective controls - to strengthen quality control monitoring (ISA and ISQC 1):
 - **Short/medium term vision – to develop audit firm quality control assessment tool for wider public to fill in the information gap on audit quality so that audit quality gets valued in by the force of competition and thus facilitate the free market mechanism for the audit market.**



Macro analyses and a business case for quality audit

Macro - Key facts

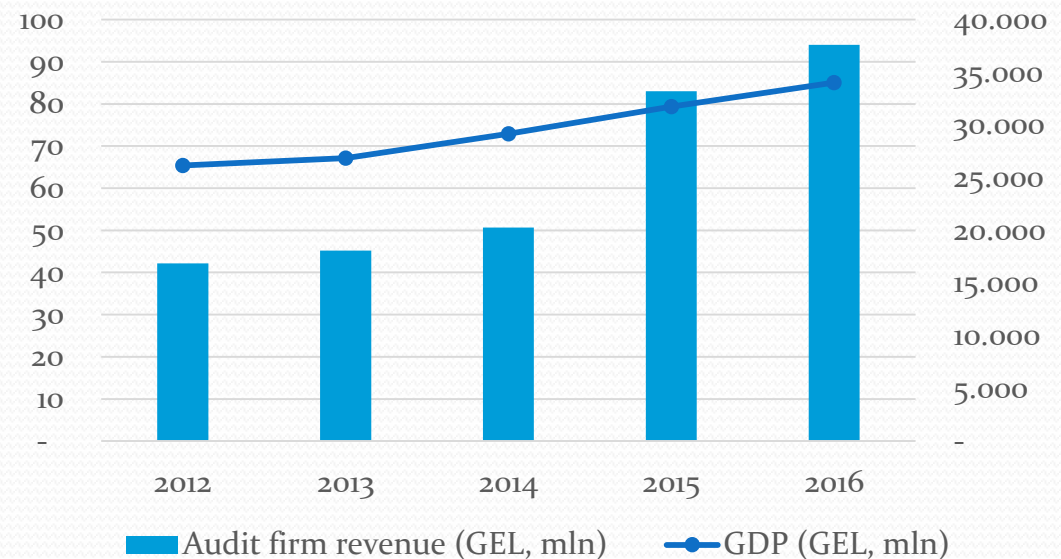
Key macro indicators			
	1Q18	2017	2016
GDP (% change)	4.9% ⁽¹⁾	5.0%	2.8%
GDP per capita (ppp)	...	10,644	10,043
GDP per capita (US\$)	...	4,079	3,865
Population (mn)	3.7	3.7	3.7
Inflation (eop)	2.8%	6.7%	1.8%
Gross reserves (US\$ bn)	3.0	3.0	2.8
CAD (% of GDP)	...	8.7	12.8%
Fiscal deficit (% of GDP)	...	3.9%	4.1%
Total public debt (% of GDP)	...	44.7%	44.4%

Source: Official data, IMF

Audit market highlights:

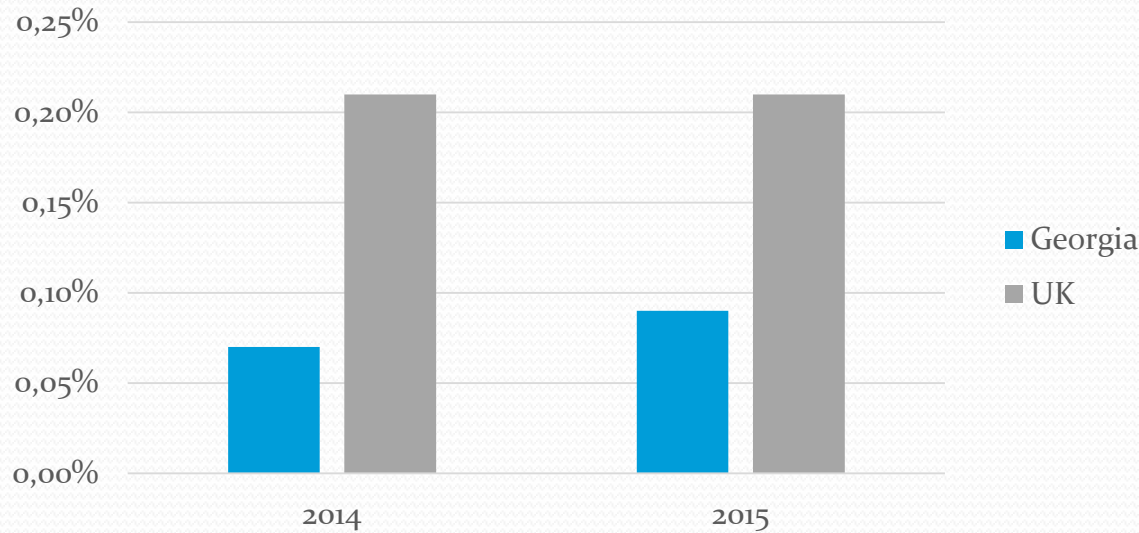
Number of registered audit firms	246
Number of registered auditors	446
Audit market concentration	Concentrated
Big 6	All are present

Audit firm revenues vs nominal GDP

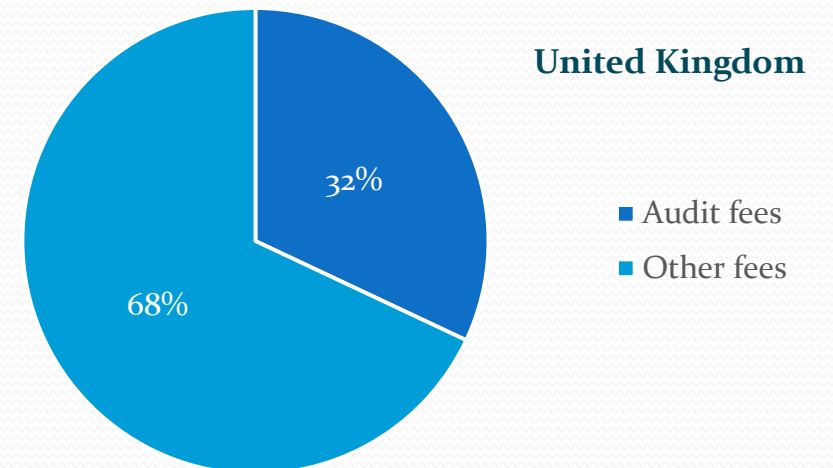
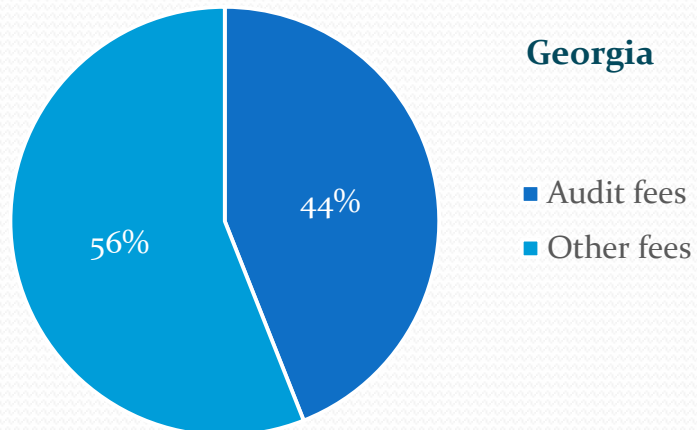
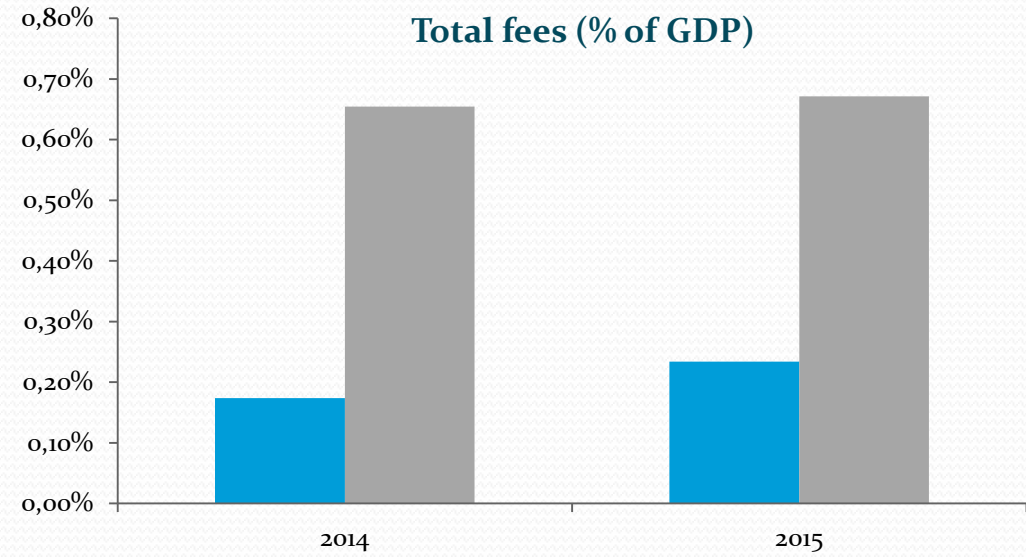


Macro - Comparison with a developed market

Aggregated audit fees (% of GDP)



Total fees (% of GDP)





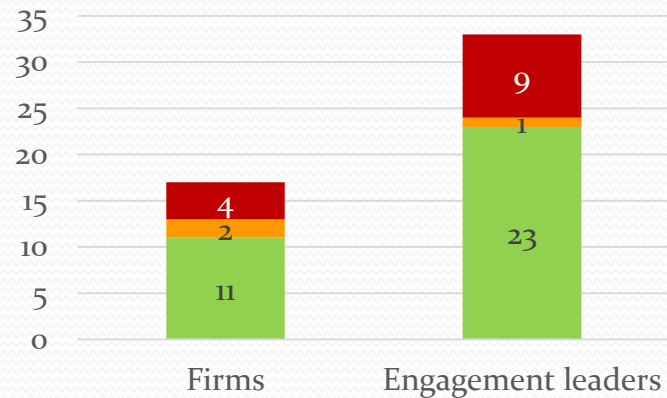
Audit quality monitoring program for 2017 and results thereon

Scope and results for 2017

- The 2017 program was based on a transitional clause of the law and only encompassed a voluntary basis of selection, ie only for firms that sought access to the PIE audit market.
- 17 applications were received in total, monitoring results are provided below.

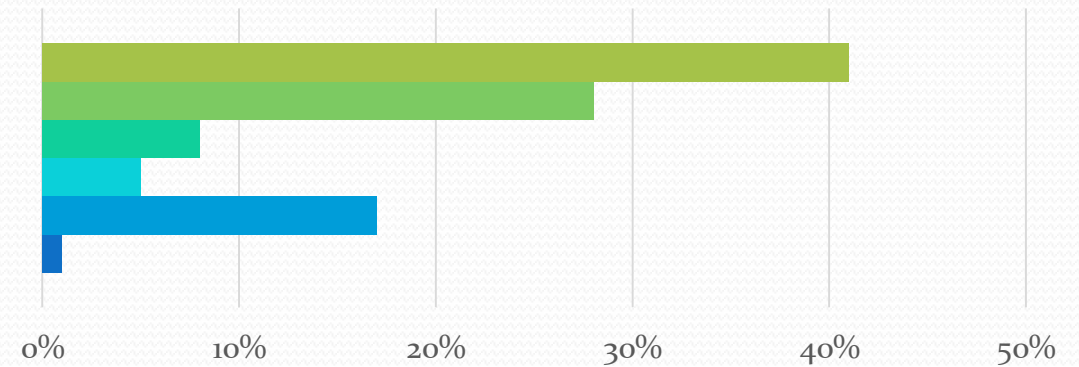
Number of monitored engagements	37
Monitored engagement partners	33
Monitored audit firms	17

Summary of results



- May audit only non-PIEs
- May audit PIEs with limitations
- May audit PIES

Areas of concern



- Audit planning
- Audit execution
- Audit completion
- Audit report
- Financial statements
- Compliance with the Law



Main challenges and key initiatives

Main challenges so far

- Underdeveloped capital markets make audit quality an abstract concept;
- No experience of effective audit quality regulation in the country;
 - Legislative infrastructure is not tuned for audit oversight (enforcement is still a challenge);
 - Lack of experience at SARAS and the SARAS Supervisory board.
 - Lack of policies, procedures and methodologies at SARAS;
- Financing through state budget (minimalist budget);
- Challenges on the labour market (profession depth).

Key actions and initiatives

- Clear mission and vision;
 - Forms a useful compass for leadership;
 - Assists in Human Capital attraction and management;
 - Streamlines external communications.
- Careful staff selection;
- Streamlining workflow (project based rather than function based);
- Performance appraisal (not formalised);
- Embedding the right culture.

Q&A

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