AUDITING IN GEORGIA: DIRECT REGULATION OR SELF-REGULATION

ANNOTATION

There are different approaches to the problems in the field of regulation of audit and accounting supervision among experts from different countries.

Over the years, the accounting and auditing professions have been subject to various forms of supervision. The actual result of the success also turned out to be unequal.

Auditing in Georgia began after the declaration of independence and the transformation of the command economy. The establishment of a market economy required proper accounting and auditing for enterprises. Controlling accounting, reporting and auditing activities was a new challenge for Georgia.

How did Georgia meet this challenge? Are current methods and forms of regulation relevant to the requirements of the time and how does it help develop a free market economy? - These questions are relevant.

The present paper discusses how this issue is regulated in the US. Sharing the experience of a country with such a developed market economy as the US is useful and important for the reform of the accounting, reporting and auditing system in Georgia and all the countries of the former Soviet Union where the administrative-command economy system existed and where the market infrastructure is still weakly developed.

Keywords: audit; Audit regulation; Auditing standards; Audit oversight system; Professional certification.

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აუდიტი საქართველოში: პირდაპირი რეგულირება თუ თვითრეგულირება

ზაზა ტრიპოლსკი
სოხუმის სახელმწიფო უნივერსიტეტის დოქტორანტი

ანოტაცია

აუდიტისა და აღრიცხვის ზედამხედველობის რეგულირების სფეროს პრობლემებზე სხვადასხვა ქვეყნის ექსპერტთა შორის განსხვავებული მიდგომები არსებობს. წლების განმავლობაში ბუღალტრული და აუდიტორული პროფესია ექვემდებარებოდა ზედამხედველობის სხვადასხვა ფორმას. წარმატების ფაქტობრივი შედეგიც არათანაბარი აღმოჩნდა.

საქართველოში აუდიტორული საქმიანობა ქვეყნის დამოუკიდებლობის დეკლარირებისა და სოციალისტური ეკონომიკის ტრანსფორმაციული პროცესების შემდეგ დაიწყო. საბაზრო ეკონომიკის დამკვიდრებამ საწარმოებისთვის სათანადო ბუღალტრული აღრიცხვას და აუდიტი მოითხოვა. ბუღალტრული აღრიცხვის, ანგარიშგების და აუდიტორული საქმიანობის კონტროლი საქართველოსთვის ახალი გამოწვევა იყო.

როგორ შეხვდა საქართველო ამ გამოწვევას? არის თუ არა რეგულირების ამჟამინდელი მეთოდები და ფორმები დროის მოთხოვნებთან შესაბამისი და როგორ ეხმარება იგი თავისუფალი საბაზრო ეკონომიკის განვითარებას? - ეს კითხვები აქტუალურია.

წარმოდგენილ ნაშრომში განხილულია თუ როგორ რეგულირდება ეს საკითხი აშშ-ში. ისეთი დონის განვითარებული საბაზრო ეკონომიკის მქონე ქვეყნის გამოცდილების გაცნობა-გაზიარება, როგორიცაა აშშ, სასარგებლო და მნიშვნელოვანია ბუღალტრული აღრიცხვის, ანგარიშგების და აუდიტის ზედამხედველობის სისტემის რეფორმისთვის საქართველოში და ყოფილი საბჭოთა კავშირის ყველა ქვეყნისთვის, სადაც არსებობდა ადმინისტრაციულ-მბრძანებლური ეკონომიკის სისტემა და სადაც საბაზრო ინფრასტრუქტურა ჯერ კიდევ სუსტად არის განვითარებული.

საკვანძო სიტყვები: აუდიტი; აუდიტის რეგულირება; აუდიტის სტანდარტები; აუდიტის ზედამხედველობის სისტემა; პროფესიული სერტიფიცირება;

„The audit profession should operate with radical transparency, as if in a glass box, be clear about its social purpose and embrace innovation and collaboration."

Matthew Taylor, RSA (Royal Society for the Encouragement of Arts, Manufactures and Commerce) Chief Executive and British Former Political Strategist

In Georgia market economy launched after independence of country, from 1991 year. Market economy needs proper accounting and auditing of a business entities. In 1997 established Council of Auditing Activities by the Parliament of Georgia. Council formed according to State law about auditing activities. This Council abolished in 29th of June 2012 year.

During the period of activity, the Council delegated rights to non-governmental professional organization-GFPAA (The Georgian Federation of Professional Accountants and Auditors).

GFPAA implemented a wide range of professional activities: professional certification of accountants and auditors, publishing professional journals and textbooks, meetings, seminars and different training courses.

The GFPAA is a non-governmental, non-for-profit PAO in Georgia. Prior to 2016, it was the only accredited professional organization authorized to regulate auditors. The GFPAA membership is mostly comprised of audit firms, auditors employed by audit firms, sole practitioners, and consultants. The 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. The GFPAA has been an IFAC member since 2000.

The other non-governmental, non-for-profit organization is the GFAAFM (The Georgian Federation of Auditors, Accountants and Financial Managers).

The GFAAFM, established in 2011, unites small and medium audit practices, bookkeepers, accountants and tax advisors, who join the organization on a voluntary basis. It is the successor body of the Audit Council of the Parliament in Georgia, which before 2005 had been authorized to license statutory auditors. The GFAAFM delivers trainings in various areas including tax, internal audit and financial management. It is a full member of the European Federation of Accountants and Auditors for SMEs.

The Law on Accounting, Auditing and Reporting No. 5386 adopted in June 2016 established the Service for Accounting, Reporting and Auditing Supervision (SARAS) under the Ministry of Finance as the authority responsible for audit oversight, accounting and reporting.

SARAS acts in behalf of State.

Regulation of SARAS is approved by the Ministry of Finances of Georgia in 14th of September 2016 year. (Order #223).

With the adoption of the new Law on Accounting, Auditing and Reporting (Law No. 5386) in 2016, certified accountants are now regulated by the SARAS, with certain functions delegated to recognized professional organizations.

The responsibilities of the SARAS include: (1) promulgation of international standards, including their translation into Georgian, such as IFRS, IFRS for SMEs, ISA, and IESBA Code of Ethics; (2) defining rules and requirements for auditing; (3) defining rules for audit quality control system and its monitoring; (4) monitoring quality control systems of auditors and audit firms registered in the auditors' registry; (5) defining requirements for professional certification, examination procedures and continuous education in accordance with IES, EU Directives and approving respective standards; (6) setting rules for recognition of certification programs, examination procedures and continuous education programs and their recognition; (7) overseeing professional organizations, examination bodies and other persons engaged in professional educational activities with the law; (8) maintaining the registry of auditors and audit firms, recognized training and continuous education programs, specialized examination bodies; and (9) investigation and discipline of auditors and audit firms, among other functions.

The Law on Accounting, Auditing and Reporting No. 5386 restricts the exercise of the accountancy profession to individuals and entities that meet professional certification and continuous education requirements established by the law and further detailed by the Service for Accounting, Reporting and Auditing Supervision (SARAS) under the Ministry of Finance.

The law recognizes the qualification of a Certified Accountant, who is defined as an individual certified by a professional organization in accordance with the Professional Certification Standard set by SARAS or is recognized as such under the Law No. 5386, and who can prove their qualification after certification in accordance with the Continuous Education Standard. Certified accountants must be members of one of the professional organizations.

The Professional Certification Standard defines the subjects for professional certification, the rules for carrying out the exam process, the rules for exemption from exams and tests, the documents to be submitted for professional certification and the rule on certificate issuance. Professional certification is conducted by professional organizations whose certification programs or/ and examination procedures meet the standards set by SARAS and which are recognized in accordance with the SARAS Order on Approving Procedure for Recognition of Certification Programs and Examination Process.

SARAS recognized certification programs of two professional organizations: the Georgian Federation of Professional Accountants and Auditors (GFPAA), and the Georgian Federation of Auditors, Accountants and Financial Managers (GFAAFM).

Only GFPAA is authorized to conduct examinations.

The Continuous Education Standard defines continuous

education programs and the continuous education procedures and authorizes recognized professional organizations to implement and monitor continuous education. GFPAA and GFAAFM are authorized to conduct CPD.

In order to provide **Auditing Services**, certified accountants and audit firms must be registered with SARAS. Auditors must satisfy the following requirements: (1) be a certified accountant; (2) have at least three years of supervised practical experience; (3) be a member of professional organization; and (4) comply with the IESBA Code of Ethics as evidenced by the professional organization or the auditor attesting to the practical experience. SARAS is also entitled to register an individual, who is a full member of a professional organization that is a member of IFAC from the OECD and EU member states, provided they passed a qualification test in Georgian Law.

SARAS is responsible for the establishment and implementation of a **quality assurance (QA)** review system. Reviews are conducted every three years for public-interest entities and every six years for other types of companies.

Professional organizations are involved in: (a) the certification and continuing professional education of their members; (b) administering qualification exams when recognized as specialized examination bodies; and (c) investigating and disciplining their individual members, except for audit firms, in accordance with the procedures developed in agreement with SARAS.

As it seems, the role of the non-governmental, non-for-profit professional organization was significantly restricted after formation of SARAS. The main player in the sphere of regulation and supervision of auditing and accounting is the State. The professional non-governmental organizations are only implementers of continuing professional education. They lost their functions.

Was establishment of SARAS a fact of direct control from State Authorities and the State monopoly? Was it Ignore of non-governmental professional organizations role?

What is better, strictly control by the State Authorities or a hybrid of oversight of the State and non-governmental professional organizations?

I think that strictly supervision by the State is not appropriate response on attitude of free market economy and free civil society.

Let's briefly overview experience on this field in US.

Why US?

Because US is a sample of the most developed civilization, most developed free market economy, free civil society and proper regulation of balance between the State and non-governmental sector, between a public and private activities.

Over the years the accounting profession has been subject to various forms of oversight with varying degrees of success. Nevertheless, it used to be self-regulating. But a series of financial scandals involving once prominent companies such as Enron, WorldCom and Parmalat lead the authorities to consider whether the accounting profession's self-regulatory oversight system was appropriate to meet the necessary objectives. These corporate failures had shown that the self-regulatory system did not produce credible results and "had the potential to undermine investor confidence in the integrity of the securities markets" (The Treasury, 2006).

As a consequence a number of countries have reviewed their arrangements for independent oversight of the auditing profession. The United States, for example, has introduced tough external audit regulation under the Sarbanes-Oxley Act of 2002 (Named after its authors, the democratic senator Paul S. Sarbanes and the republican delegate Michael Oxley). Canada has also introduced a regulator with extensive powers, including a national inspections unit as independent monitor of major audits, while the British and Australian solutions are based mainly on oversight rather than on full regulatory control (Malthus and Scoble, 2005).

However, all these oversight bodies are needed to protect the public and the credibility of financial information.

Given the corporate scandals of recent years, the audit profession is now in the forefront of the minds of investors, businesses, regulators and others. Financial reporting, corporate governance and accounting and auditing practices must keep up with the needs of these groups. Effective regulation of the audit profession is one means of ensuring that the profession and the private sector keep pace with these challenges. The purpose of this essay is to discuss the need to strike a right balance between self-regulation and government regulation. Broadly defined, regulation refers to the making and implementing of rules which direct or constrain the behavior of a person or group of people being regulated. It is important to acknowledge the role of the profession in the evolution of its regulation. In most developed nations, the licensing and regulation of the accountancy profession was founded through the initiative of practicing professional accountants who often sponsored legislation to set minimum requirements to be designated as a professional public accountant.

Historically, leading practitioners then established a code of professional conduct and, eventually, accounting, auditing and other practice standards. Through much of the 20th century, the requisite knowledge of professional practice standards that protected the public resided nearly exclusively with professional practitioners who founded professional associations to promote their profession and its standards. This led many government regulators who had the legal authority to mandate compliance to choose to adopt the standards of the professional associations by reference or as acceptable interpretations.

Over time and in many countries, such as the United States, this approach evolved into a sophisticated system of government-sanctioned self regulation that for many years was considered adequate, efficient and protected the public. Regulation of the audit profession has typically been included as part of the overall regulation of the accountancy profession and has covered the following areas:

- Education and admission standards;
- Audit standards;
- Ethical standards; and Disciplinary action.

Where the regulation has been carried out primarily by the profession, it is often referred to as "self-regulation" and when it is carried out by the government, is often just "direct regulation". There is no pure model of either self-regulation or direct regulation. The profession rarely regulates without some form of government mandate to do so, and similarly, the government rarely regulates without some form of interaction with the profession.

In general, the International Federation of Accountants (IFAC) member bodies, the professional institutes, act under a delegation from their respective governments. The government has given legal recognition to the profession and has given the professional institute a set of roles and responsibilities and some form of reporting requirement. These responsibilities can include admission criteria, continuing education requirements, disciplinary provisions, standard setting and so on. Reporting requirements often take he form of annual reports by the professional body. Under self-regulation then, the government has delegated the responsibility for regulation to the profession and the profession regulates itself within that framework and then reports on its activities. There can be a greater or a lesser degree of government monitoring and oversight. Direct regulation, for example, through the establishment of an audit oversight body, simply means that the government itself has assumed responsibility to regulate part, or, rarely, all of the profession.

However, like self-regulation, this regulation is taking place within a set of roles, responsibilities and reporting arrangements that have been set by government and established in legislation. To be successful, the regulator needs to have an effective working relationship with the profession. In discussing methods of regulation, it is important to remember that accountancy is a profession. That means that professional accountants have an overriding responsibility to the community in which they live, not just to their current clients or to themselves.

So even in circumstances where there is total direct regulation, there is still a need for the profession to regulate the activities and conduct of its members to ensure that this responsibility to the community is fulfilled. The only caveat is that this regulation needs to be efficient and effective. Whatever regulatory framework is used, be it administered by the profession or government, it must give the regulator appropriate incentives to act in the public interest.

Regulators must have a clear, overarching purpose and the ability to resist any moves towards regulation that are self-interested or motivated by special interest groups. Serving the public interest means having regulations that achieve their aim of being effective and efficient without imposing unnecessary costs. The benefits of the regulation – that is, its effectiveness in protecting the public interest – must exceed its costs. The International Organization of Securities Commissions (IOSCO) has undertaken work in this area and has developed a series of principles for regulators.

These principles hold that:

- The responsibilities of the regulator should be clear and objectively stated;
- The regulator should be operationally independent and accountable in the exercise of its functions and powers;
- The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers;
- The regulator should adopt clear and consistent regulatory processes; and
- The staff of the regulator should observe the highest professional standards, including appropriate standards of confidentiality.

The choice between self-regulation and direct regulation primarily depends on who can meet the IOSCO principles and carry out the required functions most efficiently. For example, a professional body often has considerable expertise regarding the profession so it may be better placed to regulate where this expertise is needed. As well, the professional body's separation from government can mean that it can react faster and more flexibly than a comparable government agency. In those countries where the profession needs to be strengthened, granting the profession self-regulatory powers can assist it in gaining the necessary expertise.

Direct regulation can be the most appropriate solution if there is a need for the regulator to be completely independent of the profession, or if it is considered inappropriate for the profession to carry out certain functions. Taking into account these factors and differences in history, culture, commercial law and varying stages of economic development, we see at a national level a huge diversity of regulatory approaches. In IFAC's view there is no "one size fits all" answer to the issue of how to regulate the audit profession at the national level. A cornerstone of our free enterprise system is "freedom of choice. Consumers are free to choose what they wish to purchase and from whom. This simple concept is the powerful engine that drives economies in free markets. At the same time, there is an appropriate role for government oversight in the free market process to ensure that the consuming public is not being misled or defrauded by unethical business practices. IFAC recognises that the role of governments, as well as the role of the profession, will vary, but they should be guided by the principle of striking the right balance – to protect consumers without comprising free enterprise and without inflicting undue costs on the profession or the public.

It is critical that, regardless of whether there is self-regulation, direct regulation or some combination, that both the profession and the regulator act in the public interest and that the benefits of regulation outweigh the costs.

THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS (AICPA)

The American Institute of Certified Public Accountants (AICPA) is a non-profit professional organization representing certified public accountants (CPA) in the United States. The organization is integral to rule-making and standard-setting in the CPA profession, and serves as an advocate for legislative bodies and public interest groups.

The American Institute of Certified Public Accountants (AICPA) was founded in 1887, under the name American Association of Public Accountants, to ensure that accountancy gained respect as a profession and was practiced by ethical, competent professionals. The AICPA exists to provide its more than 418,000 members with the resources, information, and leadership to provide CPA services in the highest professional manner.

From its earliest iteration in 1887 to as late as the 1970s, the AICPA was the only body setting generally accepted technical and professional standards for CPAs in a number of areas. In the 1970s, the Financial Accounting Standards Board (FASB) took over responsibility for setting generally accepted accounting principles (GAAPs). However, the AICPA still retains its standards-setting responsibilities in such areas as professional ethics, business valuation, financial statement auditing, attest services, and CPA firm quality control.

More recently, in 2012, the AICPA partnered with the Chartered Institute of Management Accountants (CIMA) to create the Chartered Global Management Accountant (CGMA) designation. The two organizations then went on to create the Global Management Accounting Principles (GMAPs) in 2014, in order to formalize best practices in the field of management accounting.

In 2017, the two organizations formed a third international association, the Association of International Certified Professional Accountants, which seeks to strengthen the accounting profession by combining the skills and knowledge of both public and management accountants. Despite all these developments, the AICPA and the CIMA still continue to provide all of their previous benefits to existing members.

In response to auditors across the public accounting industry consistently failing to apply a healthy amount of skepticism to clients' statements, the AICPA proposed a new standard with the goal of promoting skepticism as part of general auditing standards.

In 2020, Statement on Auditing Standards No. 143 was issued to supersede SAS no. 122, amending section 540, auditing accounting estimates, including fair value accounting estimates, and related disclosures, as well as various other sections in AICPA Professional Standards.

The AICPA is integral to rule-making in the largely self-regulated CPA profession and serves as an advocate for legislative bodies and public interest groups. It sets standards for obtaining and maintaining the CPA designation, which is earned by accountants who pass a series of accounting exams and satisfy other experience requirements, and oversees CPA practitioners to make sure they are meeting competence and performance standards.

Members of the AICPA consist of professionals in business and industry, public practice, government, and education. Offices are located in New York City; Washington, D.C; Durham, North Carolina; Ewing, New Jersey; and Lewisville, Texas.

IFIAR

The International Forum of Independent Audit Regulators (IFIAR) was established in September 2006 by independent audit regulators from 18 jurisdictions. Since its creation, IFIAR's membership has grown as a result of the establishment of new independent audit regulators in different jurisdictions around the globe, bringing together independent audit regulators from a total of 52 jurisdictions. IFIAR focuses on the following activities:

- Sharing knowledge of the audit market environment and practical experience of independent audit regulatory activity with a focus on inspections of auditors and audit firms;
- Promoting collaboration and consistency in regulatory activity; and
- Providing a platform for dialogue with other international organizations that have an interest in audit quality.

IFIAR became a Member of the Monitoring Group during 2011; the Group oversees audit and accounting related standard setting activities of the International Federation of Accountants (IFAC), monitors the activities of the Public Interest

Oversight Board (PIOB), and convenes to discuss issues and share views relating to international audit quality and regulatory and market developments having an impact on auditing.

In 2015, IFIAR's members approved a multilateral framework for information sharing, and the organization is piloting a coordinated, multijurisdictional audit inspection for gaining a better understanding of group audits. IFIAR also conducts and publishes annual surveys of its members' inspection findings.

Based on IFIAR's 2015-2017 Work Plan, the organization's key objectives for the next year are:

- Improving audit quality globally
- Implementing IFIAR's new governance structure and operations
- Strengthening IFIAR's role as the international leader on audit matters
- Facilitating learning and cooperation among IFIAR Members

The purpose of independent audit inspections is ultimately to enhance the level of audit quality. This should in turn increase the public's confidence in financial statements, thereby contributing to the more efficient operation of capital markets and greater investor protection. Improving audit quality remains IFIAR's most important objective. The most important activities within IFIAR to improve audit quality globally are:

- Continuing to press the six largest global networks for actions;
- Providing input on audit standard setting and standard setting governance;
- Conducting and reporting on IFIAR's Inspection Findings Survey;
- Publication of thought papers on matters relating to audit quality; and
- Continuing to address group audit considerations.

In compare with US, Georgia is not developed market economy country and direct comparison is not relevant in this field. But, in any case, the experience of developed market economy country is a useful and significant sample to reform of accounting, reporting and auditing supervision system in Georgia.

Primate of direct control is the main feature of country of command economy.

Reagan said, "In this present crisis, government is not the solution to our problem; government is the problem."-this wisdom means that only direct control will not be cause to wishful effects.

This is challenge for wide sphere of specialists and experts. Reforms never finished. Reform are changeable due to circumstances and must be flexible and adoptable to interest of nation.

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