

## SESSION II: FINANCIAL DISCLOSURE AND AUDIT

### *AUDIT REFORM IN RUSSIA*

Presentation on by

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Esteemed Ladies and Gentlemen!

<sup>1</sup>The role of information disclosure in the sphere of corporate governance and its significance for creating a favorable investment climate both in the world community as a whole, and in Russia in particular is of paramount importance today. The possibility of financial (accounting) disclosure is particularly acute for us today. It is being done, in particular, in the auditing process.

Audit has attained quite solid positions in Russia over ten years of its development. A certain community of people – the auditors – has formed. Most of them possess a high scientific and practical potential and, according to their social status, represent that very middle class whose successful progress, in the opinion of many Russian politicians, is one of the important conditions of stabilization of the overall economic situation in the country.

The Russian auditing organizations, the backbone of which consists precisely of such specialists, are already capable of competing with the largest transnational auditing companies. This is vividly demonstrated by the active participation of the domestic auditing organizations in the audits of the World Bank projects in Russia.

I am very pleased to point to the general positive tendency in public opinion about the necessity and usefulness of audit. Thanks to broad explanatory work and illustrative examples of improvement of the financial and economic situation of the audited organizations, the opinion that audit is a mere waste of money has largely changed in favor of the attitude accepted in the whole world to this necessary and important form of market activity.

At the same time, the current period of development of the auditing profession in Russia is quite marginal. To begin with, the Draft Federal Law “On Auditing” has already been adopted by now, i.e. the governmental version of the draft has been approved on the conceptual level. Secondly, the formation of the package of Russian auditing rules (standards), worked out on the basis of international auditing standards, has been practically completed. The International Auditing Standards have for the first time been officially translated into Russian. Thirdly, active work is underway to improve the process of certification of auditors, their training and advanced training. A number of legal acts were issued on individual problems of audit. It is also necessary to mention a considerable invigoration in the life of the Russian professional auditing community.

I would like to dwell on these strategic aspects of development of the Russian aspect.

This draft law has been elaborated by a working group involving representatives of professional auditing organizations, their regional branches and practicing auditors, in particular, the Russian Auditing Chamber and the Union of Professional Auditing Organizations.

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<sup>1</sup> The views expressed in this paper are those of the author and do not necessarily represent the opinions of the OECD or its member countries. This paper is subject to further revision.

The need to improve legislative support of audit in the Russian Federation was called about by the fact that the acting Provisional Rules of Audit in the Russian Federation, having played a timely and important role in development of audit in Russia, no longer reflect the present-day situation on the auditing market in full measure, as they lag behind reality in a number of crucial aspects.

On the stage of development, this draft law was coordinated with the interested ministries and agencies. Moreover, the draft was prepared on the basis of the accumulated experience of audit regulation, taking into consideration the proposals of a number of regional representations of professional auditing organizations, including the Russian Auditing Chamber.

The draft law was prepared on the basis of four previous drafts. Moreover, it adopted all positive provisions from the Provisional Rules of Audit in the Russian Federation, approved by the Russian Presidential Decree of December 22, 1993, #2263. The draft was based on the contemporary state of development of the system of market relations in Russia, on the practice of the leading Russian auditing organizations and, in a certain measure, the experience of audit in foreign countries, adapted to the Russian conditions.

All interested parties were attracted to elaboration of the draft law: representatives of professional auditing organizations, scientific and state bodies, practicing auditors. Besides that, the draft law has undergone expertise at the prominent international associations of professional auditors of Sweden, France, and other nations. The draft law received a positive conclusion of the world's oldest professional auditing association – the Institute of Chartered Accountants of Scotland (ICAS).

The draft law draws a conceptual border around the legal space of audit and extends the possibilities of professional auditing associations in certain matters of regulation of audit. This policy is now being persistently conducted, and I will dwell on it later.

The draft defines the notions of auditing activity and audit, mandatory and initiative audit, independence of auditors, Russian auditing rules (standards). It fixes the bases of confidentiality of information obtained in the process of auditing, and identifies the notions of insurance of civil legal responsibility and fundamentals of quality control, certification and licensing of auditing activity.

The document stipulates, in particular, that the objective of audit is the expression of opinion on reliability of accounting (financial) statements of the audited persons and compliance of their accounting practice with the Russian legislation. In our opinion, this definition is more correct than the one offered by the Provisional Rules, which stipulate that the main objective of audit is the establishment of reliability of accounting (financial) statements of economic entities and compliance of financial and economic transactions carried out by them with normative acts of the Russian Federation.

The draft law specifies the status of the Russian auditing rules (standards). It also introduces the notion of rules (standards) of professional auditing associations and rules of auditing organizations. It establishes the subordination of these three sets of rules (standards).

The insurance of civil responsibility of auditing organizations and individual auditors was a novelty. The draft law stipulates that such insurance shall be carried in the order and on terms established by the corresponding federal law.

A Federal Body for state regulation of audit is introduced in the regulatory system, i.e. the draft does not envisage the functioning of the previously assigned Commission for Auditing under the Russian President and the currently operating central certification and licensing commissions of the Russian Finance Ministry and the Bank of Russia. Article 17 envisages the creation of a Council for Auditing at

the Federal Body, with a controlling vote fixed with the acting auditors, who could therefore actively participate in the preparation and adoption of key decisions.

The decision to introduce the institution of accredited professional auditing associations is in line with the modern requirements of development of the profession. In the future, these associations will play a significant role in raising the participation of practicing auditors in the regulation of auditing and a more efficient control over the quality of audit.

Certification is defined as the appraisal of the quantitative and qualitative composition of the association and its compliance with certain professional criteria by the relevant state authorities. Independent, unbiased appraisal would enable to find professional associations, genuinely capable of constructively participating in solving questions of regulation of the auditing activity in the Russian Federation. The draft law does not restrict the possible number of certified professional organizations. Precisely this democratic approach would provide all professional associations with equal starting opportunities for exercising their activity.

The associations' interest in obtaining such status is apparent, as the state shall confirm the professional level of the association, and certain official organizations shall hand over part of their responsibilities. Moreover, its authority and renown shall increase in the auditing and accounting community both in Russia and abroad.

There is also an obvious benefit for the other participants of the auditing market. Practicing auditors and auditing organizations would receive an opportunity to find such a professional association, which would heed to the interests of their participants in deed rather than in word, practice modern methods of work and effective regulation of relations within the profession. As for the clients of auditors and auditing organizations, a recommendation of a prominent professional association of a certain auditing organization, enjoying state recognition, would assure them that the audit would be held on a high professional level by qualified specialists with duly understanding of the auditor's ethics.

As for the state authorities, such approach would enable further activity of a certified professional association to vividly demonstrate its potential and actual possibilities, and employ a differentiated approach in the future, both to the transfer of additional functions to them and to the expediency of retaining the already existing functions of concrete certified professional associations. Their introduction and, most importantly, effective performance would become a starting point of further improvement of the legislation.

During the elaboration of the draft law, the authors relied on the present-day development level of the system of market relations in Russia, the practice of the leading Russian auditing organizations and a vast auditing experience of foreign countries. The latest changes in legislation have been scrutinized in order to avoid contradictions during the preparation of the draft law. In particular, in connection with the adoption of the Federal Law of September 25, 1998, #158-FZ "On Licensing of Individual Activities."

I have already mentioned that the authors of the draft law have attempted to upgrade the existing system of regulating the auditing activity. For example, the draft law does not specify individual forms of audit, as it was done in the Provisional Rules (item 23). This is largely connected with the authors' desire to approximate the draft law to international standards.

I am happy to point out that such professional auditing companies as the Russian Auditing Chamber and the Union of Professional Auditing Associations not only participated in the elaboration of this draft law, but also actively supported it during the preparation for the first reading and at the first reading itself. The results of the first reading are quite impressive: 358 "for," 28 "against," and 0 "abstained." I am sure that the persisting active position of professional associations will contribute to

final adoption of the Draft Federal Law “On Auditing” and the further effective formation of the auditing management infrastructure.

At present, the State Duma is engaged in systemizing the amendments and comments submitted for the second hearing of the Draft Law “On Auditing.” According to forecasts, the second reading should be held in December this year. The Russian Federation Government, the Administration of the Russian President, responsible ministries and agencies, and the deputies display interest in a thorough deliberation of this draft law before its second reading, for the purposes of adopting a legislative act, most fully conforming with the professional interests and the interests of the state.

The improvement of the quality of audit remains one of the most pressing issues. Simultaneously with the introduction of audit, competition is growing on the market of these services in Russia, while the requirements set by users of auditor’s reports increases. The customers demand more often that the auditors abide by the auditing rules (standards). In the present-day economic conditions, they need reliable and objective information on the financial situation of their enterprise and the state of its accounting. In other words, they need high-quality audit, rather than a formal auditor’s conclusion confirming the authenticity of financial statements. This is what makes the control over the quality of work of auditing organizations and auditors so important.

At the moment, the Russian Finance Ministry has developed a considerably logical and wholesome system of organization and holding of inspections of auditing organizations and auditors, as well as a system of preventive control. However, they shall also undergo serious changes after the forthcoming amendment of the legislative base, and this constitutes a principled and open position of the Russian Finance Ministry.

The existing methodologies of inspections were elaborated on the basis of experience of the Auditing Commission of Sweden, The Joint Monitoring Department of the Institute of Chartered Auditors of Scotland, England, Wales, and Ireland (JM,U), and the experience gained during the inspections of auditing organizations recommended for tenders held by the World Bank.

Control over the quality of work of auditing organizations and auditors on the part of regulating bodies should not be regarded as restriction of freedom of entrepreneurial activity and independence of auditors. Experience, including international one, shows that a lack of control over the activity of auditors in the long run leads to all-permissiveness and violation of the very roots of audit by dishonest representatives of the profession. But this is something that can by no means be allowed, either in the interests of the state or in the interests of the auditors and their customers.

It is necessary to reiterate that the Draft Law “On Auditing” pays close attention to problems of quality control. It stipulates that auditing organizations and individual auditors shall create and support an internal system of quality control of their audits. Requirements set to such system shall be regulated by the Russian auditing rules (standards).

The Provision on Licensing of Individual Forms of Auditing in the Russian Federation, approved by the Russian Government Resolution of April 27, 1999, #472 (item “a”), envisages that new licenses to an auditing organization and an individual entrepreneur, who had exercised auditing activity in the established order before the adoption of the present Provision, shall be issued on condition of absence of facts of unqualified audits or auditing services in the period of validity of the previous license (regardless of the form of auditing). The aforementioned facts shall be established by monitoring the observance of the licensing requirements by the licensee, and the quality of audits, in accordance with the auditing rules (standards), approved by the Commission for Auditing under the Russian President.

Speaking about the quality of audit, It is necessary to highlight the problem of the Russian auditing rules (standards). The elaboration of these rules (standards) was organized by the RF Finance Ministry TSALAK jointly with the Financial Scientific Research Institute of the Russian Finance Ministry in 1995.

Initially the auditing rules (standards) were worked out on the basis of the principle of necessity of normative and methodological support of the most important spheres of activity of auditing organizations and individual auditors. Such standards as the “Order of Drawing Up an Auditor’s Conclusion on Accounting,” “Audit Planning,” “Letter of Consent of an Auditing Organization to Audit,” “Auditing Evidence,” “Audit Documentation,” “Audit Selection,” have been elaborated and approved.

On the next stage, work was conducted in accordance with the Action Programme for the period of 1998-1999 on the audit of accounting (financial) statements of economic entities in accordance with the auditing standards worked out on international the basis, prepared by the Russian Finance Ministry of assignment of the Russian Government of January 4, 1998, #Ach-P13-00058. This Programme enabled to employ a system approach to development of standards and methodological support of audit in Russia. Today, the work on this Programme is completed.

The entire process was conducted with participation of the most experienced practicing auditors, representatives of educational and research institutions of economic profile, rather well familiar with the international auditing standards, as well as foreign specialists. The first edition of the auditing rule (standard) was prepared by two independent groups of authors, while further development was conducted on the basis of the better draft.

The existence of domestic auditing standards stimulates a more unbiased appraisal of practical activity of auditors and helps reveal dishonest or insufficiently qualified representatives of the auditing profession.

In our opinion, both the list of these standards and their contents must not be a fixed doctrine. If such need arises in the future, there should always be a possibility both for the existence of the old auditing rules (standards) and the creation of new ones.

The availability of an official translation of the International Auditing Standards, the presentation of which took place on October 26 in Moscow, will enable to most fully approximate the Russian auditing rules (standards) to the international norms in the future. We are also sure that the translation of the International Auditing Standards will be used for development of the new Russian auditing rules (standards).

On the whole, it is necessary to stress that the Russian Finance Ministry met with much interest the first official Russian-language publication of the International Auditing Standards and the Ethics Code of the International Federation of Accountants, prepared under the guidance of the International Accounting Reform Center and, which is extremely important, with direct participation of the Russian specialists on audit.

It would not be an exaggeration to say that this edition was a significant event for development of the Russian audit. The possibility of employing the International Auditing Standards may in a certain measure characterize the level of professionalism of auditors and auditing organizations. We are sure that the knowledge and, if necessary, practical application of the International Auditing Standards in Russia would expedite the integration of the Russian audit into the international auditing community, raise the authority of the Russian audit, reinforce the market mechanisms in the Russian economy and exert a positive influence on its progress.

Generally speaking, we believe that information support is one of the conditions of normal development of auditing. It also provides evidence on the level of information disclosure. We are pleased to mention that the Russian audit is characterized with a substantial amount of specialized literature, which is being constantly renewed. This can be said above all about the “Common Audit” encyclopedia, published already for the third time. The volume of information grows with each subsequent edition, which is being revised, augmented and amended. The significance and popularity of this book can be best illustrated by the letter addressed by President of the Russian Union of Industrialists and Entrepreneurs Arkady Volsky to the Government of the Russian Federation, in which he expressed a wish to continue regular reprint of this encyclopedia in the future.

From this point of view, I would also like to mention the re-publication of the manual by A.D.Sheremet and V.P.Suyts “Audit,” recommended by TSALAK of the Russian Finance Ministry for use by pretenders during the preparation for qualification exams and by auditors in their practical activity.

It is noteworthy that at present, one of the principal problems of development of audit in Russia is the training of auditors, their certification and advanced training.

Today, 41 methodological training centers (UMC) for certification and advanced training of auditors operate within the system of the RF Finance Ministry TSALAK. 35 of them carry out certification of auditors in the sphere of general audit, 34 – in the sphere of audit of exchanges, extra-budgetary funds and investment institutions, 11 – in the field of audit of insurers.

The Russian Finance Ministry pays serious attention to improvement of the process of certification of auditors. The TSALAK decision (protocol of TSALAK session of December 30, 1999, #75) on forming independent examination commissions, including the attraction of practicing auditors as members of examination commissions on recommendations of the leading professional associations of auditors (protocol of TSALAK session of March 20, 2000, #78) has become a novelty. After this decision of TSALAK entered into force (starting April 3, 2000), the training centers presented information on the composition of teachers and professors participating in the training of contenders for 121 groups. The efficiency of qualification exams in conditions of separation of the process of training contenders from the process of forming examination commissions over the period starting April 3 is to be analyzed and discussed in the 1<sup>st</sup> quarter of 2001. But simultaneously, we believe it is necessary to launch already now the preparation of the procedure of full separation of training from the exam and the introduction of the codification procedure of the examinees, practiced in many countries.

The following training centers are currently conducting high quality training, methodological and organizational work on the training of auditors. Among them are the Moscow State University named after Lomonosov, The All-Russian Correspondence Institute of Finance and Economy, the Academy of State Service and Management of Bashkortostan, the Voronezh State University, St.Petersburg University of Economy and Finance, and some others. These educational institutions conduct constant work on development of principally new examination tickets and tests, oriented on practical auditing, and are characterized with a high level of organization in the preparation of examination and other necessary materials.

As far as the functioning of the system of advanced training of auditors and extension of the validity term of qualification certificates is concerned, I would like to say the following.

In accordance with the decision of the Russian Finance Ministry TSALAK (protocol #74 of November 25, 1999), important amendments have been introduced in the Extension Order of Auditor’s Qualification Certificates, which have entered into force from the beginning of 2000.

Firstly, it is necessary to mention the possibility of numerous extension of the validity term of the auditor's qualification certificate. This means that the certificates whose validity term expires after the initial extension may be prolonged an unlimited number of times for a three-year period without an additional qualification exam, if the auditor observes the established conditions.

The Extension Order institutes a system of advanced training as one of the mandatory conditions of extending the auditor's certificate, in other words, an obligatory annual advanced training of auditors in the total duration not less than 40 hours, regardless of the terms of issuance and extension of the qualification certificates.

In order to ensure annual advanced training of auditors, the RF Finance Ministry TSALAK has approved in October 1999 a system of special advanced training auditing courses. Over the past year, 14 special courses were prepared. Therefore, the auditors have gained an opportunity to choose the subjects of their training in the years, not corresponding to the extension term of the qualification certificate. Of course, 14 courses are definitely not enough to launch a system similar to the system of advance training of auditors abroad, but work in this direction is continued. In our opinion, it is necessary to pay more attention to the Russian auditing standards, and after the publication of the translated International Auditing Standards, it will be necessary to consider their inclusion in the process of advanced training of auditors in full measure.

Besides that, according to TSALAK decision of October 26, 2000 (protocol #85), auditors certified, besides general audit, to the audit of exchanges, extra-budgetary funds and investment institutions and (or) audit of insurers, shall undergo an advanced training course on general audit annually, in accordance with the existing order, and an advanced training course on the other mentioned forms of audit only in the year of extension of the corresponding certificate in the volume of 40 hours (in addition to the advanced training course on general audit).

Such is the current situation with the main directions of development of audit in Russia. We, as representatives of the state authorities responsible for the regulation of auditing, are pleased to point out that the participants of today's roundtable have displayed interest in development of audit in Russia. This is evidence of its active participation in the economic life of the country. We hope that in the future the Russian audit will play an even more prominent role in disclosure of accounting and financial information and improvement of the investment climate in Russia.

Thank you.