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**Accounting and Auditing reforms in transition economies:
The case of Azerbaijan**

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MAIN ABBREVIATIONS AND ACRONYMS

ABTC	Azerbaijan Bank Training Center
ACAA	Association of Certified Accountants of Azerbaijan
ACCA	Association of Chartered Certified Accountants
ANB	Azerbaijan National Bank
BSE	Baku Stock Exchange
BTC	Baku-Tbilisi-Ceyhan (pipeline)
CoAA	Chamber of Auditors of Azerbaijan
CIPA	Certified International Professional Accountant
EBRD	European Bank for Reconstruction and Development
ENP	European Neighborhood Policy
FSU	Former Soviet Union
GDP	Gross Domestic Product
IASB	International Accounting Standards Board
IAASB	International Auditing and Assurance Standards Board
IASC	International Accounting Standards Committee
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
ISA	International Standards on Auditing
NAS	National Accounting Standards
NASBO	National Accounting Standards for Budgetary Organizations
NASCO	National Accounting Standards for Commercial Organizations
NBA	National Bank of Azerbaijan
PCA	Partnership and Cooperation Agreement
PIE	Public Interest Entity
ROSC	Report on the Observance of Standards and Codes
SME	Small and Medium-Sized Enterprises
SOCAR	State Oil Company of Azerbaijan Republic
SOFAZ	State Oil Fund of Azerbaijan Republic
USAID	United States Agency for International Development
USSR	Union of Soviet Socialist Republics

Abstract

The purpose of this paper is to study accounting and auditing reforms in Azerbaijan Republic after the collapse of the Soviet Union. This includes analyzing the historical accounting practices, reforms towards free market accounting, the current situation with the convergence to IFRS and ISAs and also identifying whether the present laws and regulations in the country support this transition process or not. The thesis work aims to examine the accounting education and competence in Azerbaijan and the role of Big 4 accounting firms in promoting international standards and accounting education. In addition the paper compares the similar situation of certification of accountants in Azerbaijan with those of a neighbor post-soviet country.

Keywords: International Financial Reporting Standards (IFRS), Azerbaijan, accounting reforms, transition period, ROSC team, auditing, former soviet countries, the Big 4, accounting education

The Purpose and Problem statement

This master thesis analyzes the accounting and auditing reforms in the Post-Soviet world. It is the very interesting issue, because comparing with the rest of Europe and Asia the former soviet countries have extra challenges in this process. They are not only trying to adopt international accounting and auditing standards, but also move away from command economy which is not an easy task. The regulatory bodies, laws and regulations on accounting in the post-soviet countries were developed over a long period of communistic rule. Although after the independence from USSR those countries have become members of important international organizations like the World Bank, Council of Europe, IFAC and others, reforms in accounting remains unsatisfactory and these countries are some way away from the complying with IFRS and ISAs (ROSC, 2006).

Azerbaijan was chosen as the case study country to examine. Some research works have been published on Russia, as the major country of former Soviet Union, but there has been no independent research on Azerbaijan about this topic (McGee , 2008).Therefore, this thesis work aims to fill in this gap. Azerbaijan is a country with a transition economy that has a big intention to converge with the international accounting and auditing standards. It got independence from the

Soviet Socialistic Union in 1991. The country used to belong to communistic regime for 70 years where the intervention of the government in all spheres of economy was very much significant. This has definitely influenced accounting and auditing practices in Azerbaijan. Through previous few decades, accounting was seen only as the matter of “clerical book-keeping” and was compulsory for all the state enterprises. There was no concept of “fair presentation” or “true and fair view” in that economy. The previous Soviet system did not require professional accountancy in the Western sense. Reporting requirements were heavily rules-based and primarily consisted of completing structured forms. The main aim of accounting and reporting system of that period was the provision of financial statistics for use in higher level budgets. And this was often in terms of quantities rather than quality or value. A soviet-style national chart of accounts was used for the reporting reasons in which made the process even more standardized and routinized that it regressed to bookkeeping (Nobes & Parker, 2008, p. 246). At that time in Azerbaijan accounting records were much more important than financial statements themselves.

Having an emerging oil production economy, Azerbaijan is trying to integrate to free market economy and accept international standards on financial reporting as well as on auditing. The problem here is the lack of human and financial resources to fully implement those new standards. Although the government has passed the Law on Accounting in 2004, making significant change in the whole accounting sphere, in practice the situation stays unsatisfactory. In order to be effective in the national setting, it is very essential to have the force of law or regulation backing. And that is another main problem in Azerbaijan. Because, if there is not an adequate regulatory backing, the compliance becomes very non-transparent (Hegarty et al., 2004).

In order to approach this topic the following questions were formulated to answer as the core of this thesis work

- 1. What are the main challenges Azerbaijan faces in the process of transition to IFRS & ISAs?**
- 2. What concrete steps have been made towards the reforms in accounting and auditing?**
- 3. Does the accounting education in Azerbaijan support this transition?**

Accounting Education and the problem with competence in Azerbaijan were especially examined with in more detail. The main challenge of transition countries in adopting IFRS and ISAs is usually the lack of competent and qualified staff that is able to understand these standards. In order

to train potential young professionals also the people working in accounting firms, it is important to have an adequate accounting education in the country. The thesis works aims to find out till what extent the accounting education in Azerbaijan supports the convergence with international standards, and the main problems it face.

Disposition

Chapter 1: Methodology

The chapter talks about the research and data selection methods used in this thesis work. It also explains the limitations of the methodology.



Chapter 2: Background to Azerbaijani Economy

This chapter briefly describes the current economic growth in Azerbaijan. It talks about the transition to the free market economy.



Chapter 3: Theoretical framework: Convergence of accounting standards

Theoretical framework of the thesis work discusses the expected benefit and potential obstacles of the convergence process.



Chapter 4: Accounting reforms and convergence to IFRS in Azerbaijan

The purpose of this chapter is to mainly discuss the reforms made by Azerbaijani government in order to converge with IFRS. It examines the new *Accounting Law*.



Chapter 5: Reforms in Auditing practices and regulations in Azerbaijan

Continuing the talk on reforms, this chapter mainly studies audit practices and regulations in Azerbaijan.



Chapter 6: Accounting education and certification in Azerbaijan

This chapter is a small case-study on accounting education in Azerbaijan. It aims to analyze whether the education in Azerbaijan support the transition to IFRS or not. The chapter also studies the accounting certification in Azerbaijan and Georgia.



Chapter 7: Conclusion and Further Research

This chapter brings forward all the findings of the thesis work and suggests further researches on similar topics.

Chapter 1

Methodology & Data collection

This chapter aims to discuss the research methods used in the thesis work. It talks about data selection and explains the selection of interviewees and interview limitations.

1.1 Research Strategy

1.1.1 Qualitative vs. Quantitative research method

The selection of the appropriate research approach is a very essential part of a thesis work. It should be based on the several important things like the problem of interest, resources and literature available, the skills and training of the researcher and etc. Some research works incorporate both of these methods but there are of course significant differences in the assumptions underlying these approaches, as well as in the data collection and analysis procedures used (Punch, 2005).

Quantitative approach examines the problem by testing a theory, using statistical techniques measured with numbers. The strengths of the quantitative methods are that it produces quantifiable, reliable data that are usually generalizable to some larger population. However the biggest weakness of the quantitative approach is that it decontextualizes human behavior in a way that removes the event from its real world setting and ignores the effects of variables that have not been included in the model. By contrast, the qualitative method of research aims to understand a social or human problem from multiple perspectives. Qualitative research is conducted in a natural setting and involves a process of building a complex and holistic picture of the phenomenon of interest. (Weinreich, 2006).

1.1.2 The method of choice

A qualitative research approach was used in this thesis work in order to study and analyze the accounting reforms and the obstacles in converging to IFRS & ISAs in Azerbaijan. The method requires a careful data collection and document themes in a consistent and reliable way. As the research is a qualitative kind, for the main part of the paper the analyzing and descriptive design of

research was selected because of its efficiency and handiness. In his book “Qualitative inquiry and research design: Choosing among five”, John W. Creswell stated that the descriptive method of research is about gathering information about the current existing condition of a study object. This method allows a very flexible approach when significant new matters and issues arise during the period of the study and further investigation may be carried out (Creswell, 1998).

By this method the thesis work described the nature of a current situation in financial reporting and auditing in Azerbaijan, as it exists at the time of conducting the study and analyzed the causes and solutions of certain problems in accounting. It helped to obtain an accurate profile of things, events or situations for better understanding the case of this thesis work. The method requires a very careful data selection, which is both relevant and reliable. Creswell emphasized that with this research type, it is important that the person carrying out the research already has a good understanding of the topic being investigated before the data selection procedure is conducted. Originally coming from Azerbaijan and working 3 years in a big accounting and auditing firm there, this was the suitable method for me as an author.

1.1.3 Case Studies

Usually when the research is a qualitative type, case studies are used to examine and study certain organizations or systems. It allows researchers to better and deeper analyze the situation of one particular study object. The main case study of this thesis work is accounting reforms in Azerbaijan. But the thesis work also looks at the education problem in Azerbaijan as a separate case study.

1.1.4 Comparison method

The comparison method was used to compare the situation of accounting certification in other Post Soviet countries with Azerbaijan. By this it was attempted to determine the similarities and challenges they face in the process of forming national accounting certification that can be recognized internationally. The former soviet country that is more close to Azerbaijan in terms of development level and economical situation was chosen to compare with. Georgia was identified as the most suitable.

1.2 Data Selection

1.2.1 Primary and Secondary Data

Two kinds of data were used in this thesis work: Primary and Secondary data. As a primary data the reports of important international organizations and financial institution on Azerbaijan were used to analyze in order to describe the situation in the country. For that reason the following organizations were targeted for the primary data: World Bank (ROSC), European Bank of Reconstruction and Development (EBRD), European Union (EU), Asian Development Bank (ADB), International Accounting Standards Board (IASB), International Federation of Accountants (IFAC). All these sources are believed to be both reliable and relevant to the topic of this paper. Besides these mentioned institutions, the statistical data from the National Bank of Azerbaijan was used for illustrating the current financial situation and the growth level in the economy. The main regulation used for studying in this thesis work is the new Law on Accounting (2004) of Azerbaijani government. As a secondary data, various articles by Hegarty, Zeff, Tweedie and others on the convergence process were used in the thesis work.

1.2.2 Reliability and Relevance

Data selection process was performed for choosing the proper literature for carrying out the thesis work. Two main quality characteristics of the adequate literature are “reliability” and “relevance”. It is very important to find the balance between these two characteristics. Although some sources can be very relevant to Azerbaijani accounting, it may not be reliable enough to use.

1.3 Interviews

Interviews were used for gathering primary data for the last chapter of this work – the case study of the accounting education in Azerbaijan. The interviews were carried out with the Big 4 firm and one middle-sized accounting firm in Azerbaijan via telephone. This was used for the fourth chapter of the paper- “Accounting education and certification in Azerbaijan. The role of Big Accounting firms in promoting international standards”. The structure of the interviews is semi-structured.

1.3.1 Semi-structured interviews

This technique is used to collect qualitative data by interviewing respondents that have time and scope to talk about their opinions on a particular subject. Before conducting semi-structured interviews, the focus of the interview is decided by the researcher but there may be areas that the researcher might want to explore more during the process of the interview. The objective is to understand the respondent's point of view rather than generalizing their behavior. Because of this reason, semi-structured interviews are very flexible and the questions asked can be adjusted during the interview process. Usually this type of interviews uses open-ended questions that give more flexibility to a researcher to carry on the talk with more sub-questions.

1.3.2 Interview guide

Before conducting the interviews, special interview guides were prepared. (See Appendix 1 and Appendix 2). The guide includes the main questions that were asked to the interviewees. However, more sub-questions were formulated during the interview. There are two interview guides in this thesis work: one for the Big 4 firms, the other one for the medium-sized accounting firm.

1.3.3 Selection of interviewees

In order to keep the reliability of the interviews, it was chosen to interview the professionals with minimum 3 years of experience in the Assurance & Advisory department of the Big 4 firms and medium-size international accounting firm in Azerbaijan. One of the persons interviewed has been working in the Big 4 for more than 6 years already and is responsible not only for the assurance engagements but also for the educational trainings about IFRS to the clients of the firm. His answers were used in drawing a conclusion about the real situation of accounting & auditing reforms in practice. The other person interviewed has worked in two different Big 4 companies in Azerbaijan. The third person also had worked in the Big 4, but at the moment is a Senior Associate in a medium-size international accounting firm in Azerbaijan. Due to the technical difficulties with travelling to Azerbaijan personal interviews were not possible, therefore all the interviews were done on the telephone.

1.3.4 Limitations

There have been some limitations in the interviewing process. First of all, not all Big 4 firms have business in Azerbaijan. There are only 3 of them as of writing this thesis work. The employees of the two out of these three firms were interviewed. In order to see the situation in the medium-size international accounting firms, a professional in one of these firms, which is a full member of the IFAC's Forum of Firms^{*}, was interviewed. For the confidentiality reasons, the names of the firms that the interviewed professionals work for are not revealed in this thesis work. It was possible to conduct more than 3 interviews, but in order to maintain the reliability of the information, only professionals of Senior Associate level and above were interviewed.

^{*} Formally established in 2002, the Forum of Firms (FOF) is an association of international networks of accounting firms that perform audits of financial statements that are or may be used across national borders. Members of the Forum voluntarily agree to meet certain requirements as detailed in the FOF Constitution. Commitment to the obligations of membership in the Forum contributes to raising the standards of the international practice of auditing in the interest of users of the profession's services. www.ifac.org

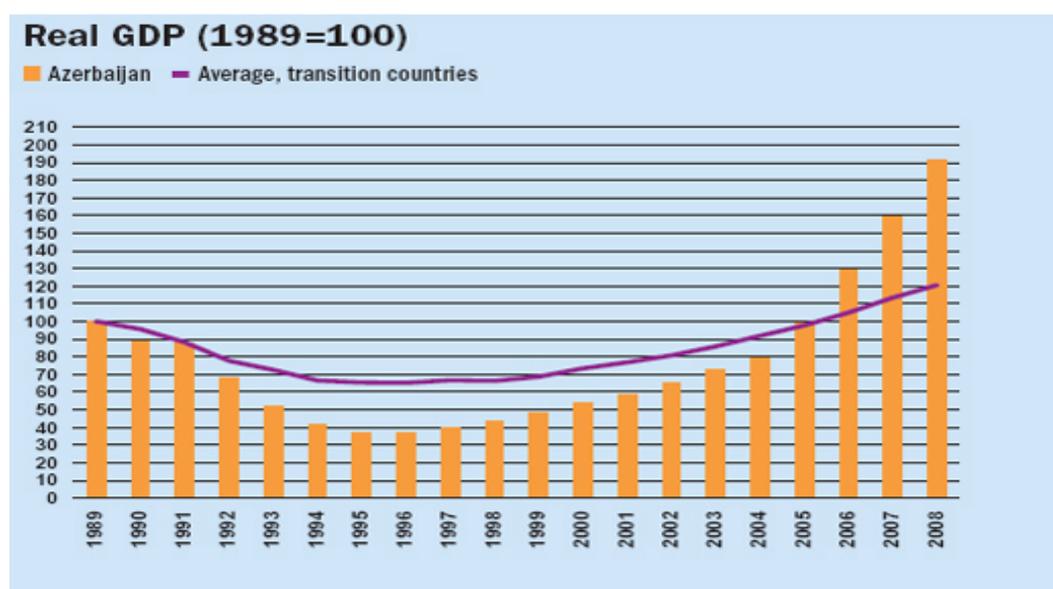
Chapter 2

Background of Azerbaijani Economy

The purpose of this chapter is to give the readers understanding about the current economical and financial situation in the country, which in its turn influences the financial reporting and auditing culture and practices. The chapter discusses expanding oil and gas industry, banking and non-banking financial sector, also securities market in Azerbaijan.

2.1 Macroeconomic indicators

Azerbaijan Republic has a population of 8.6 million and gross domestic product of 380 billion as of end of 2008. The growth rate of GDP substituted 110% which is mainly due to the booming oil & gas industry and growing oil export in the country (National Bank of Azerbaijan 2008). Currently the oil sector accounts for about 54 percent of GDP and three quarters of industry (EBRD, 2007). However the non-energy sector also featured double-digit growth in 2008, driven by growth in the construction, banking, and real estate sectors. Inflation in the country remains high due to rising international food prices, surging oil exports and a substantial fiscal expansion that has fuelled domestic demand (EBRD, 2008). As everywhere else in the world, the current global financial crisis presented some challenges for the Azerbaijani economy as well, as oil prices have fallen down since mid-2008 and local banks faced more uncertain international financial environment (CIA- The World Fact Book, 2009).

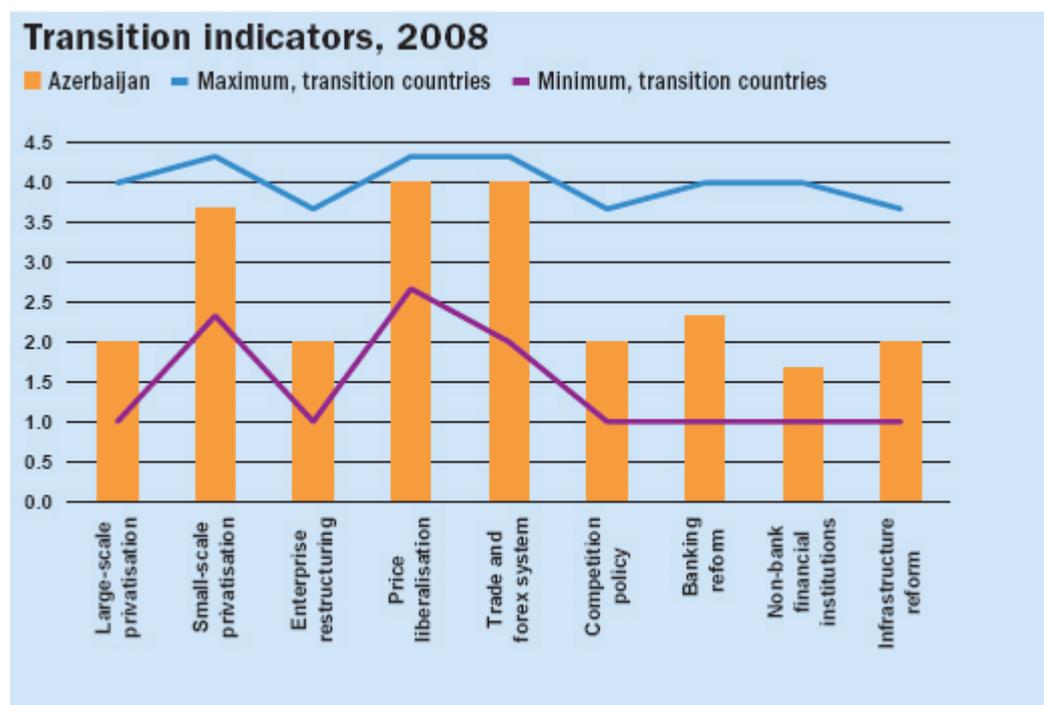


2.2 Oil Production

Azerbaijan's oil production declined through 1997, but has registered an incredible increase every year since. By building the Baku Tbilisi Ceyhan (BTC) pipeline, at a length of 1,768km, Azerbaijan's oil industry had entered a new era. The pipeline is thought to be one of the great engineering endeavours of the new millennium. "The BTC oil export pipeline" transports crude oil from offshore oil fields in the Caspian Sea to the Turkish coast of the Mediterranean, from where the crude is further shipped via tankers to European markets (British Petroleum, 2009). The export via the pipeline remains approximately 1 million barrel per a day (IHS, 2007). Due to this successful project and expanding oil industry, while the average economic growth was around 10 per cent during 2002-2005, the real GDP grew at more than 26 per cent in 2005 and reached an unprecedented 35 percent in 2006, making Azerbaijan the fastest growing economy in the world (EBRD, 2007).

2.3 Privatization

Privatization process and the transition to open-market economy in Azerbaijan are still very far from being perfect. A privatization law passed in January 1993 but hadn't been started to be implemented fully until the following year. Privatization plans envisioned sales, auctions, and joint stock enterprises. Although the privatization of small and medium size enterprises is almost complete, for large scale companies the process hasn't still been achieved. A lot of main profitable big enterprises in the country are owned by the government, like the State Oil Company. This fact also slows down development in the financial and banking sector. Because there are a lot of non-performing and below market rate loans to these state owned firms (ROSC, 2006).



2.4 Financial Sector

2.4.1 Banking

The banking sector itself is dominated by two half state-owned banks: International Bank of Azerbaijan and Kapital Bank. Other than that there are 44 banks which are mainly small and medium banks. Although there are signs that the Government is considering restructuring and privatizations, as in the case of Kapital Bank, there is not yet a clear strategy towards a substantial reduction of state ownership in the sector. Consolidation among the private banks has so far been slow mainly due to unwillingness of dominant shareholders to be diluted and their ability to support organic growth so far, although this is expected to change during the new strategy period as the banks become larger. The National Bank of Azerbaijan (NBA) has developed key legislation in the past few years improving the legal and regulatory framework in the banking sector, and strengthened its capacity as the regulator of the financial industry. The regulatory framework in Azerbaijan has been brought closer to international standards, and the enforcement of laws and regulations is continuing to be strengthened. Increasing inflation during the last two years resulted in greater exposure of local banks to foreign exchange and interest rate risks (EBRD, 2007).

In recent years the European Bank of Reconstruction and Development (EBRD) has started an active strategy plan in Azerbaijan. EBRD owns ¼ of shares of few main banks in the country, and also continues lending funds and syndicated loans to commercial banks in Azerbaijan. The Bank also acquired a 30 percent shares in a private insurance company (MBASK) in 2005. The investment and supplementary TC had the objective to improve corporate governance, introduce internationally accepted insurance practices and to enhance competition overall. EBRD has also provided debt and equity financing to Unileasing in early 2007, a subsidiary of Unibank in the leasing sector (EBRD, 2009b). EBRD is emphasizing programs and activities that support industrial restructuring, privatization, the creation and strengthening of infrastructure, financial reforms, foreign investment inflows and environmental repairs. The Bank has also been providing assistance to a number of organizations to improve their accounting and financial reporting capabilities. Furthermore, EBRD is currently considering providing assistance to the State Securities Committee to improve securities laws and regulations in line with international practice (Athukorala & Reid, 2002).

2.4.2 Securities Market

The securities market in Azerbaijan also is at an early stage of expansion. Baku Stock Exchange company (BSE) is the main stock exchange in Azerbaijan. BSE trades short-term treasury bonds, common stocks (primarily from former state-owned enterprises that have been privatized, including food and beverage, construction and banking companies), and foreign currency future (BSE, <http://www.bfb.az/index.php>). Due to the lack of transparency and accountability foreign and domestic investment was hold back. Recently, in 2004 the government passed the “Accounting Law” which made it mandatory for public interest entities (PIE), including publicly traded companies, to submit their audited financial statements in accordance with IFRS. The Law aims to strengthen corporate financial reporting regime, improve transparency, corporate governance and lead the development of the securities market in the future (ROSC, 2006).

2.5 Summary of the challenges

Wrapping up, Azerbaijan continues to face major challenges in the transition period which include:

- Trying to develop the non-oil and gas sectors of the economy to ensure the sustainable development throughout the country including rural areas and cities outside the Baku (capital) and reducing the level of poverty through long-term economic policies and incentive schemes.
- Fighting corruption, improving the business environment, strengthening administrative capacity, developing local private sector and attracting foreign capital to it
- Improving financial sector of the country as an effective tool for shifting revenues from oil industry into non-oil sectors and supporting diversification of the economy for sustainable future growth
- Developing a practical and prudent monetary and fiscal expenditure policy for the efficient long-term management of oil and gas revenues and reducing the risk of inflation
- Restructuring the infrastructure of public sectors like telecommunications, transportation, electricity, gas, water, sewerage, waste treatment, as well as cleaning the heavily polluted environment (EBRD, 2007).

Chapter 3

Theoretical Framework: Convergence of accounting standards

This chapter is a theoretical framework for the main problem questions of the thesis work. It talks about the concept of convergence of accounting standards by analyzing its expected benefits to the global financial market. The chapter also discusses obstacles and difficulties in the process of convergence.

3.1 The concept of Convergence

3.1.1 The main idea of convergence

The convergence of international accounting and auditing standards is the main goal of today's financial market. The global financial crisis of 2008-2009 has had an important impact on the attitude to the harmonization process in the accounting world. It somehow reminded everyone of the Enron scandal several years ago. The crisis made standard setting boards to re-look through their work and strategies and see what can be done in order to make the convergence process more efficient and by that reduce the risk of a future credit crisis.

The main idea of convergence- is setting a global set of high-quality accounting and auditing standards that are understandable by broad range of preparers of financial statements, users and regulators. Also, these converged set of standards must be accepted by all capital market participants and investors around the world (Erchinger & Melcher, 2007). The convergence of financial reporting standards in the world has a big importance for the future of global capital markets. If the market want to remain high quality it certainly needs the quality information. Besides that the efficient capital allocation depends on accurate, timely and comparable financial reporting (Tweedie, 2005). "High quality financial reporting contributes to promoting private sector growth and reducing volatility, through: (a) strengthening countries' financial architecture and reducing the risk of financial market crises, together with their associated negative economic impacts; (b) contributing to foreign direct and portfolio investment; (c) helping to mobilize domestic savings; (d) facilitating the access of smaller-scale corporate borrowers to credit from the formal financial sector by lowering the barrier of high information and borrowing costs; (e) allowing investors to evaluate corporate prospects and make informed investment and voting

decisions, resulting in a lower cost of capital and a better allocation of resources; and (f) facilitating integration into global financial and capital markets.” (Hegarty et al., 2004).

3.1.2 Norwalk Agreement

The necessity of convergence process created an environment in which both the FASB and the IASB could commence work on eliminating differences between U.S. GAAP and IFRS. In 2002 one of the IASB's original members, Bob Herz, was appointed as the Chairman of the FASB. This sent a message about the importance and relevance of international standards. Following this event, in September 2002 FASB and IASB had first joint meeting in order to discuss the further cooperation for setting a global set of accounting standards. At that meeting, both the FASB and IASB pledged to use their best efforts to make their existing financial reporting standards fully compatible and to coordinate their future work programs to ensure that once achieved, compatibility is maintained (Tweedie, 2005). As a result of this meeting, the FASB and the IASB published a joint memorandum of understanding, now known as the Norwalk Agreement.

According to the Norwalk the two Boards agreed to:

- a) undertake a short-term project aimed at removing a variety of individual differences between U.S. GAAP and International Financial Reporting Standards (IFRSs, which include International Accounting Standards, IASs);
- b) remove other differences between IFRSs and U.S. GAAP that will remain at January 1, 2005, through coordination of their future work programs; that is, through the mutual undertaking of discrete, substantial projects which both Boards would address concurrently;
- c) continue progress on the joint projects that they are currently undertaking; and,
- d) encourage their respective interpretative bodies to coordinate their activities (FASB, 2005).

3.2 Expected Benefits

There are many benefits that the convergence of accounting standards is promising. Especially after the financial crisis of 2008-2009, the participants of a global capital market realized that only high quality set of financial reporting standards can assist economic decision making.

3.2.1 Comparability

The convergence of financial reporting and accounting standards is a valuable process that contributes to the comparability of global investments and achieves substantial benefits for all capital markets shareholders. It enables investors to evaluate potential investment opportunities by comparing on a global basis. This of course lowers their risk of making false judgments or wrong assumptions (PricewaterhouseCoopers LLP, 2007). A lot of investors and other users of financial statements face the difficulties to compare financial statements that were prepared in accordance with different accounting standards. As the global market integrates and expands a lot of international companies enter the business world. Those companies have offices and branches in many different countries of the world, which sometimes use diverse accounting standards.

Today investors and other participants of the capital markets can engage in various financial transactions that are across their national boundaries, in order to make capital allocation and investments in a global level. It is related with the fact that communication techniques have developed to even faster stage, and markets are more linked now. All these technological changes have reduced the obstacles for investors to obtain information on various foreign investment opportunities. Because of this reason European investors can easily make an investment decision in US market, and vice-versa. At the moment large number of US investors holds securities in non-US issuers (SEC, 2008). Due to the differences of national accounting standards of the countries, the measurement of assets and liabilities, also calculation of revenue may differ significantly. In order to avoid these misjudgments because of incomparability, it is very essential to create a global set of high quality financial reporting standards that will be accepted by all the countries. The accounting standards are indeed one of the most important infrastructures of capital markets (Business Accounting Council, 2006). Therefore “the concept of convergence” is promising the comparable accounting standards that will serve in the best interest of the users and prepares of financial reports.

3.2.2 Transparency

The convergence of accounting standards will increase transparency in financial reporting. It has the power to generate a new standard of accountability and greater transparency, which are essential factors for all market participants including regulators (PricewaterhouseCoopers LLP, 2007). It is believed that the standard-setting boards like IASB and FASB will always choose the

better existing model, or improve the one that is better than all the previously existing models. Because at the heart of the IASB's efforts is the concept of convergence. For both IASB and FASB convergence carries a specific meaning. Their goal is to identify the best standards around the world and build a body of accounting standards that constitute the "highest common denominator" of financial reporting. This is not convergence for convergence's sake. That's why the convergence must improve both existing financial reporting and consistency across borders (Tweedie, 2005). After all the major financial crises, bankruptcies and scandals the importance of high quality financial reporting standards started being more recognized. Those events revealed the fact that good financial reporting is essential to the effective functioning of capital markets and the productive allocation of economic resources. The failures of huge cooperation like Enron, WorldCom or Parmalat was not only a reporting failure to the shareholders of these companies, but to the whole economy. Those accounting scandals of the past few years have focused the world's attention on the importance of accounting in the functioning of the modern economy. Any loss of confidence in the quality of financial information could have significant effects on the economy (Tweedie, 2005).

3.2.3 Cost Reduction

One of the main expected benefits of the convergence process is reducing costs related with the requirement to prepare financial statements according to different accounting systems and practices. This is a major problem for a lot of international corporations nowadays, as they operate in various foreign markets. The reconciliation requirement of national regulatory creates extra expenses for many of listed companies in the world. The best example can be foreign listed companies in the US stock markets. Until very lately, in addition to financial statements in accordance with IFRS those companies had to provide financial reports either under US GAAP or reconciliation to US GAAP. It needed to be in accordance with guidance stipulated in SEC Form 20-F Item 17 or Item 18 that constitutes a part of the footnotes to the financial statements. The requirement to prepare two sets of financial statements is a very expensive operation and requires large number of human resources and financial supporting. Unfortunately this kind of barrier usually can demotivate foreign investors, which basically happened after the implementation of requirement of Sarbanes-Oxley Act of 2002. Many companies deregistered with SEC because of this burden, and other European companies that potentially were to enter the US market became unwilling to do so due to the reconciliation requirements (Erchinger & Melcher, 2007). Following the example of the US, the same kind of problems can be faced with certain reconciliation requirements of other markets

(Chinese, Japanese and etc.) and they prevent the integration process of capital markets. Therefore, converged unique set of financial reporting standards can resolve this issue by not letting any room for the reconciliation expenses and by that saving companies' fund for other investing opportunities.

3.2.3.1 Roadmap

Some steps towards convergence process have already been taken by SEC the Securities and Exchange Commission (SEC). In the fall of 2007, SEC eliminated the reconciliation requirement for foreign private issuers that use International Financial Reporting Standards (IFRS) as promulgated by the International Accounting Standards Board (IASB). In addition by 2014 SEC is planning to allow US listed companies to submit their financial results according with IFRS, and take away the requirement of reconciliation to US GAAP. In order to achieve this, the Commission has also set a "Roadmap" which includes several milestones like -improving accounting standards, the accountability and funding of the IASC foundation, education and trainings, improvement in the ability to use the interactive data for IFRS reporting and etc. (AICPA, 2009).

3.2.4 Benefits for tax authorities

Tax authorities are also expected to benefit from the convergence process. When assessing foreign income their work get very complicated as different measurement methods may exist in different countries (Nobes & Parker, 2008). A significant number of differences between IFRS and US GAAP can serve as a best example which could materially affect pre-tax accounting income. Such differences include the accounting for leases, revenue, asset impairments, classification and measurement of financial instruments, hedging activity and stock-based compensation and etc. In the US, tax methods of accounting do not necessarily follow the "book" method of accounting. This means that a conversion to IFRS will require an analysis of each new accounting policy for its related tax implications, including a determination as to whether it is permissible or advisable to conform the related tax method of accounting to the new book accounting method (PricewaterhouseCoopers LLP, 2008). The convergence process will make financial reporting standards to be more uniform, and by that will assist tax authorities to control the tax related operations of multinational enterprises.

3.3 Obstacles to the global convergence process

The convergence of accounting and auditing standards is not an easy and quick process. It is a long and challenging process with certain phases. And there are of course certain obstacles related with it that should not be underestimated. Differences in economical, legal systems and national practices, barriers related with nationalism, differences between the frameworks of the existing accounting standards, general resistance to change, costs related with convergence and etc. are some of main difficulties in this process (Nobes & Parker, 2008).

3.3.1 Culture

Cultural differences are one of the most important obstacles for the convergence process. Every country's culture contains the most basic values that an individual may hold. Therefore it affects the way that individuals would like to structure their society and how they interact with sub-structure (Nobes & Parker, 2008).

3.3.1.1 Business Culture

There are certain differences across countries with respect to the business and financial culture. Different countries conduct business and support financial markets in different ways. For example, because of incentives and disincentives in the income tax law and other laws, business transactions are often designed differently in different countries. In the USA, partly because of tax benefits, it is very common in certain industries to raise financing through long-term leases instead of equity or debt. Because of this reason airline companies in the US like American Airlines, Continental Airlines Delta Airlines and others never own their planes. The planes are owned by financial institutional that lease those assets to the airline companies. In majority of cases, the aircrafts leased by those airline companies do not appear on their balance sheet (Zeff, 2007)

There are also different business customs and corporate structures. For example, in Japan and Korea they have a special entrepreneurship called the *keiretsu* and *chaebol*, respectively (Nobes & Parker, 2008). They represent networks of companies with interlocking relationships and it is not clear who the parent company is, and if indeed there is any parent company. It is very debatable whether a standard on consolidated financial statements in its application in Japan and Korea would

produce anything that can be compared to countries that have a clear hierarchical relationship between parent and subsidiaries (Zeff, 2007).

3.3.1.2 Accounting Culture

Accounting culture is very different from country to country. It depends on many things like taxation, the relationship between tax accounting rules, accounting and auditing practices and etc. The asset impairment losses can be a good example of a difference in accounting culture of different countries. Those losses are tax deductible in Germany but not in the UK. This fact can possibly lead to the assumption that in the UK, companies would be less interested in recognizing an impairment loss, whereas in Germany because of tax deductions, companies would be more willing to show the assets impairment losses in their financial statements. Usually in the countries like Germany, companies were always focused on reducing taxable income and therefore took advantage of all the possible options to report a lower accounting income (Zeff, 2007).

3.3.1.3 Regulatory Culture

There are some differences between the regulatory traditions of different countries in terms of their role in dealing with financial statements. In some countries, both private and public regulatory bodies take a very proactive function, whereas in others it is less strong. In the US, the Securities Exchange Commission (SEC) has 3100 full-time staff and takes a very important role on accounting matters. It also presents a great deal of statutory authority to regulate the securities market. It is still debatable whether an oppressive regulatory body like SEC is preferred or not. But in general many countries would choose to have a less strict regulator. The regulatory body's role affects the degree of regulation one sees in different countries. Usually in countries where the regulator is very strong and more forceful, companies may be less willing to depart from a construction of IFRS, because the regulator will detect the difference and may insist upon changes in their financial reports. In contrast, in countries where the regulation is softer and less strict, companies may be more inclined to apply their own judgment on IFRS, believing that the regulator would not take any adverse action. There are several factors that can influence the strength of a regulator:

- the level authority the Parliament or national legislature give to the regulator
- the size of its budget
- the competence level of the recruited staff
- Political situation of the country

Ultimately, the degree of a regulator's proactivity in securing compliance with IFRS will be determined by the enforcement culture in the country (Zeff 2007).

3.3.2 Differences in legal and economical systems

3.3.2.1 Legal System

While some countries have a legal system that relies on limited amount of rules that is later interpreted by the courts, others have more detailed and large number of statute laws. Common law vs. codified Roman law syst. In a common law legal system individual cases are the primary sources of law and due to that reason usually accounting practices are more flexible. Common law system, allows accountants to establish the accounting practices by themselves, which later can be submitted as a recommendation of standards. It required more judgments and interpretations. In contrast, the code system (codified Roman law) is more rule-based and the legislation is seen as the primary source of law, therefore accounting rules are more centralized and controlled by the law (Nobes & Parker, 2008). As the legal systems influence the accounting practices in the countries, usually countries that have common law system are more willing to have principle based accounting standards, whereas, the ones with codified system prefer rule-based standard .

3.3.2.2 Economical systems

The differences economical systems can also create certain difficulties for the convergence process. Accounting practices of each country was developed in those systems and is very linked to these factors. The differences in economic systems can be observed between different countries in the world. For example, some countries have larger equity markets while others have small. Usually in countries where they have larger equity markets, shareholders are the main finance providers of the economy. In those countries the importance of a fair and true presentation of financial statements becomes more essential, because "outsider" shareholders do not have an access to the internal

information of the company. Therefore, financial statements are the key information source. But in countries like Germany the main finance providers of the economy are usually financial institutions and banks. Zysman argues that this perhaps changes the role of auditors and accounting regulation in the mentioned country (Nobes & Parker, 2008, p 31).

3.3.3 Implementation of standards

The main problem is that accepting international standards does not guarantee a proper implementation of them. The core of an implementation of IFRS and ISAs is a clear understanding of what these standards actually are, what they require, and what it means to adopt converge with them. When countries fail to do this, they become unable to set concrete implementation targets and to determine progress in reaching those targets. The findings of the ROSC team suggest that clarity of understanding is not universal. It helps to explain the reason for the significant gap that sometimes occur between prior self-assessments of compliance -such as those published by the International Accounting Standards Board (IASB) and International Federation of Accountants (IFAC) and the ROSC results. This is a main problem in transition economies. The concept of adopting international accounting standards has been interpreted in many various ways by developing countries, which holds back accurate and uniform application of IFRS and ISAs (Hegarty et al., 2004).

However, the ROSC results show that the adoption of International Standards on Auditing (ISA) has been less controversial comparing with those of accounting. Many transition economies have taken the ISAs as the main base for national standards and supplemented them with some additional requirements. It is believed to be suitable and appropriate to their domestic market. In many of them, including Azerbaijan the *IFAC's Code of Ethics* was also used as the base for the national code of ethics for auditors. However some developing countries have adopted only selected standards or adopted ISA in force as of a certain date in the past, with no account taken of changes since then. Because of these misunderstandings many countries and various shareholders groups within them get a wrong idea about the real standards gap and the true implementation challenges they face (Hegarty et al., 2004).

3.3.4 Translation problem

Translating international standards from English to the local languages of different countries is one of the major challenges in the convergence process. Translators usually find it very difficult to convey the real meaning of the English text in the translated standards. This is mainly related with the length of the sentences in English, inconsistent terminology, the use of same words describing different things and also the use of terminology that doesn't have an exact translation (Wong, 2004). The best example can be the translation of the term "true and fair view". Although it was translated to many languages, there is a big concern whether they all mean the same thing. It is a new concept in the accounting world, therefore it is very important that the translators understand the meaning behind these words and choose the best suitable translation. The other example can be the word "probable" or "probability". It doesn't explain in IFRS whether they mean 60%, 80 % or 90% like hood by using this word. Therefore, countries with conservative accounting culture like Germany would made strict estimation of probability while others may adopt a lower, or less strict, percentage as the equivalent of probability.

Chapter 4

Accounting reforms and convergence to IFRS in Azerbaijan

This chapter is about Accounting reforms and practices in Azerbaijan. It studies historical factors that have influenced accounting arrangement and regulations in Azerbaijan. It explains the disadvantages of Soviet accounting system and problems that faced Azerbaijan in 1991 when the transition process to a market economy began. The chapter analyzes Accounting Law in details.

4.1 History of Accounting in Azerbaijan

4.1.1 The role of Accounting in Soviet Union

Accounting system and practices in any country are very much affected by its economic and legal environment. Azerbaijan belonged to USSR and for 70 years the accounting practices in the country were as those as of any other former Soviet countries. Accounting was considered an important step to communistic society at that time. In the critical period immediately prior to the October [1917] Revolution Lenin gave some considerable thought to the place of accounting in the new society. Thus he wrote:

“Accounting and control – that is the main thing required for the ‘setting up’ and correct functioning of the first phase of Communist Society ... The accounting and control necessary for this have been simplified by capitalism to an extreme and reduced ... to the extraordinary simple operations – which any literate person can perform – of checking and recording, knowledge of the four rules of arithmetic and issuing receipts.” (Lenin, 1964, p. 71).

However, Lenin considered this to be but a necessary step towards further progress in social evolution.

“For when all have learned to administer and actually do administer social production ... the escape from this national accounting and control will inevitably become so incredibly difficult ... that very soon the necessity of observing the simple, fundamental rules of human intercourse will soon become a habit.” (Lenin, 1964, p. 72).

In a footnote he added that: *“When most of the functions of the state are reduced to this accounting and control by the workers themselves, it will cease to be a ‘political state’ and the public functions*

will lose their political character and be transformed into simple administrative functions.” (Lenin, 1964, p. 71).

And, Lenin concluded, *“the door will be wide open for the transition from the first phase of Communist Society to its higher phase and with it to the complete withering away of the state.”* (Lenin, 1964, p. 72).

According to the political thoughts of Lenin, accounting was seen to have a crucial role to play in the transition from the lower phase to the higher phase of Communist society, from the administration of persons to the administration of things.

4.1.2 Accounting practices

Historically accounting in the Soviet Union catered only to the needs of tax and statistical authorities. Obviously it did not provide any information required by finance providers, investors, securities markets or company managers in a market economy. That is because command economy didn't have any of these. Privatization was not allowed and all the enterprises were state owned, and didn't have any external shareholders. Approximately 55 percent of all industrial enterprises in the Soviet Union were run by all-Union ministries and departments; joint Union and Republic or Republic ministries have jurisdiction over 40 percent; the remainders are controlled by local administrative agencies (local soviets and executive committees) (Ash & Strittmatter, 1992, p. 21). And nor did it support an economically rational system of enterprise taxation, since many production costs were not deductible for tax purposes (e.g., certain payroll and interest expenses).

Azerbaijan has a very little history or tradition of using market-based accounting concepts such as accruals, going concern, fair presentation, consistency and substance over the form. In general, the Soviet accounting system only applied the historical cost method to measure the value of assets in the balance sheet, and revaluation of assets were never performed during its life time. Furthermore, neither provisions for the loan loss and doubtful debts, nor the obsolete inventories were calculated and recorded. Doubtful accounts were written off from the balance sheet only and only when they were evidently not collectable. The market environment was considered a very risk-free and therefore the Soviet accountants did not feel the need for revaluation of assets or determination of profit. That is explained by the communistic central-planning economy. Because in Azerbaijan and in USSR in general prices were controlled by the government, goods were not bought or sold in a

free market and therefore, there was no risk or estimation of a decline or increase in a value of assets. Enterprises did not need to report to investors, securities market, bankers or regulators for their performance (Athukorala & Reid, 2002). Accounting in Azerbaijan at those times consisted of approved charts of accounts (Uniform Accounting Systems: UASs). The charts of accounts were specially designed to meet the requirements of the central planning system and the primary purpose of this accounting was to record the factual data necessary to assess plan accomplishments, rather than to assess an enterprise's financial situation. The focus of Soviet accounting was more on bookkeeping than on the process of accounting. In fact, they were considered the same thing. But in modern concept, accounting, involves much more than just bookkeeping. Bookkeeping only involves the recording of economic events while the accounting process includes application of generally accepted accounting standards to identify, analyze, classify, measure and record those events and their effect on an entity (Athukorala & Reid, 2002).

4.1.3 Response to the transition period

In the decade since the beginning of the transition, Azerbaijan found itself in the same situation as other Former Soviet Union (FSU) countries concerning accounting arrangements and transition reforms. The country was able to make some progress in developing an accounting infrastructure suitable to the needs of a new open-market economy. Although not perfect but the Soviet accounting system had created some basis on which to build the new accounting system. Because accounting in USSR used some concepts of modern accounting including accrual measurement and double entry bookkeeping. However, financial management reforms were slow-tracked due to emphasis on the conflict and oil and gas sector developments (Athukorala & Reid, 2002).

4.1.4 Major problems with transition

The Asian Development Bank has conducted a diagnostic study on accounting reforms in Azerbaijan in 2002. According to the results of their research Azerbaijan had faced 6 major problems in reforming its accounting system at the beginning of 1990s. First of all, although there were thousands of bookkeepers, there were no any qualified Certified Practicing Accountants (CPAs) let alone a professional accounting body. Secondly, financial information on the performance and position of organizations was not publicly available. In any case, this information did not meet international standards nor did it cater to the needs of investors or lenders. Third, the users of financial information (investors and creditors) were unfamiliar with what they should

demand from organizations. Fourth, financial information was not independently verified (audited) to international standards and could not be relied upon. Fifth, the entire legal framework was geared to central planning and specified exactly what information should be produced, how it should be produced, and to whom it should be provided. Finally, the regulatory entities that generally exist in market economies to oversee financial disclosure practices, such as securities exchange commissions, did not exist (Athukorala & Reid, 2002).

For countries like Azerbaijan, having modernized the previous charts of accounts into the internationally accepted accounting principles is not enough. Because by simply changing accounting standards it is impossible to achieve market-based accounting system. IFRS and International accounting standards (IASs) and practices must be followed by professional judgment and high competence in understanding those concepts. Therefore it is essential to develop a strong accountancy profession whose members are qualified enough to exercise judgment in their application. The adoption of the Accounting Law 1995, 1996 and later of 2004 brought the Azerbaijan accounting system closer to International Accounting Standards (Accounting Law, 2004).

- (i) New market-based accounting concepts were introduced;
- (ii) enterprises were allowed some freedom over asset accounting;
- (iii) enterprises started to provide provisions for the doubtful debts; and
- (iv) financial statement formats were revised (Athukorala & Reid, 2002).

4.2 Cooperation with EU

4.2.1 European Neighbourhood Policy and Azerbaijan.

The significant reforms in economy and especially in accounting sphere in Azerbaijan were very much supported by the European Commission and their “European Neighbourhood Policy” (ENP). In 1999 the Partnership and Cooperation Agreement (PCA) entered into force which created the legal framework for EU-Azerbaijan relations. The PCA provides for wide ranging cooperation in the areas of trade, investment, and political dialogue, economic as well as accounting, legislative and cultural cooperation. Between 1992 and 2004, the total assistance provided by the EU Community to Azerbaijan amounted to some €400 million, a 1/3 coming from the TACIS project. (€116.5 million in technical assistance) (European Neighborhood Policy, 2005).

The history of ENP goes back to 2004. On the 1st of May of that year EU had enlargement by accepting ten new Member States. It has brought changes to the EU's political geography offering new opportunities to expand existing relations between the Union and its neighbours to the East and to the South. For mutual benefit, promoting security as well as stability and prosperity the EU was determined to further develop partnerships with its neighbors. The Union decided that its external borders would not become new dividing lines but the focus of enhanced co-operation (European Neighborhood Policy, 2005).

ENP has set very ambitious objectives for partnership with EU's neighboring countries based on strong commitments to shared values and political, institutional and economic reforms. The Union offers the prospect of a stake in its Internal Market and of further economic integration. The speed and intensity of this process will depend on the will and capability of each partner country to engage in this broad agenda. The policy builds upon the existing framework of co-operation (European Neighborhood Policy, 2005). Following a recommendation made by the Commission, the Council on 14 June 2004 decided to offer Azerbaijan, along with Georgia and Armenia, the opportunity to participate in the European Neighbourhood Policy, inter alia stating:

“This marks a significant step forward in the Union’s engagement with the region. Each country will be given the same opportunity to develop its links with the EU, including through action plans, and will be treated in its individual merits in line with the general policy of the ENP. The Council also invited the Commission, and the SG/HR for issues related to political cooperation and the CFSP, to report on progress made by each country with regard to political and economic reforms” (European Neighborhood Policy, 2005).

4.2.2 TACIS Project

The reform of financial reporting in Azerbaijan began in late 2002 with the drafting of the Five Year Plan by the Ministry of Finance (The “Programme of Development of National Accounting Standards for 2003-2007 aiming at introduction of IAS”). To assist the reform process, TACIS implemented an initial 18-month project, “*Introduction of IAS in Azerbaijan*” which started in January 2003. This project assisted the further development of the enabling law and a strategic plan for the introduction of accounting reforms (TACIS National Action Programme, 2004). The main objectives of the project were to assist the Ministry of Finance (MoF)

of the Republic of Azerbaijan to develop its capacity to draft, implement and publish National Accounting Standards based on International Accounting Standards (IAS) that will in turn enable commercial enterprises in the country to prepare financial statements that meet the needs of investors, shareholders and managers.

4.2.2.1 The objectives of the program

The following activities are part of this project (“Introduction of International Accounting Standards in Azerbaijan”, 2002):

Improve the institutional capacity of the MoF to transform the country's accounting system

- Establish a Coordination Group;
- Training of Ministry of Finance officials and the Co-ordination Group in IAS and National Accounting Standards based on IAS;
- Formulate a strategy and a plan for the development and implementation of National Accounting Standards and a financial reporting system based on IAS.

Assist in the drafting of a new accounting law and the subsequent National Accounting Standards

- Assist the beneficiary in the drafting of the new Law on Accounting;
- Assist the beneficiary in the drafting of National Accounting Standards;
- Assist the beneficiary in the drafting of a new chart of accounts;
- Assist the beneficiary in the drafting of application guidance for each new standard.

Harmonize existing laws relating to accounting to facilitate the introduction of NAS

- Identify possible amendments to the Civil Code;
- Develop an approach to the reconciliation of accounting and taxable profits;
- Assist in the development of a Code of Ethics.

Develop a strategy for mass dissemination of the new standards

- Establish a project web site for the dissemination of information and to facilitate wider consultation;
- Establish a working group of companies as the pilot sites for testing new standards;

- Test the individual NASs using a virtual company (a "test company");
- Pilot the new standards developed in one of the participating companies;
- Develop a plan for the mass dissemination of the new standards (“Introduction of International Accounting Standards in Azerbaijan”, 2002).

4.2.2.2 The Strategic Plan

The strategic plan of the projects has set 4 phases for effective introduction of international accounting standards in the country. This enabled a phased approach to the dissemination of new accounting standards and allowed a systematic building of the capacity to draft National Accounting Standards. The phases are as below:

1. Phase 1: Adopting IAS compatible structure for entity based financial statements. To become effective for periods starting 1st January 2005;
2. Phase 2: Adopting IAS compliant accounting practices based on the historic cost convention. To become effective for periods starting 1st January 2006;
3. Phase 3: Introducing consolidated group financial statements based on historic cost convention. To become effective for periods starting 1st January 2007;
4. Phase 4: Introducing fair value accounting into the financial statements as the economy develops. To become effective for periods starting 1st January 2008; (“Introduction of International Accounting Standards in Azerbaijan”, 2002).

As of writing this thesis the project is conducting its last stage, Phase 4. So far it has been successful in achieving set goals, and assisting standard setting authorities in Azerbaijan in creating National Accounting Standards that is based in IAS. The main technical outcome from this project is the new Accounting Law 2004, that replaced the old one of 1996. As discussed more detailed below, under the heading “Accounting Law 2004”, the new Law made IFRS mandatory for all the Public interest entities in Azerbaijan, moreover, for small entrepreneurship it gave the choice either to submit financial statements in accordance with the simplified NAS or IFRS. The outputs of the last phase that is still on going are summarized in the chart below. (“Introduction of International Accounting Standards in Azerbaijan”, 2002

№	Title	IAS Equivalent	Comments on Content
1.	Fair Value	No Equivalent	Fair Value is an important aspect of IAS - cropping up in many standards. It is probable that more guidance and perhaps stricter rules than those contained in IAS 22 will be needed in Azerbaijan. It may be advisable to introduce a standard like UKFRS 7 - Fair values in acquisition accounting. It may also be used as a vehicle to introduce amendments to standards such as NAS 6 to bring them more in line with their IAS equivalents.
2.	Impairment of Assets	IAS 36	Impairment brings in a far higher degree of judgment into the values ascribed to individual assets in recognized in the balance sheet. Establishing a coherent cost based system is an important first step and then "fair value" and "impairment" can be introduced together as the accounting system is brought closer to the IAS model of financial reporting.
3.	Financial Instruments: Recognition and Measurement	IAS 39	Clarifies the provision for accounting for financial assets and liabilities within the context of fair value accounting.
4.	Investment Property	IAS 40	This is linked to the above standard to create consistency of accounting for investment in physical assets and financial investments.
5.	Employee Benefits	IAS 19	Based on IAS 19 with consideration of the provisions of the Civil Code - it will incorporate the incorporation of long term liabilities to employees at a fair value.
6.	Agriculture	IAS 41	IAS 41 states that an enterprise should recognize a biological asset or agricultural produce when, and only when: (a) the enterprise controls the asset as a result of past events; (b) it is probable that future economic benefits associated with the asset will flow to the enterprise; and (c) the fair value or cost of the asset can be measured reliably.
7.	Deferred Taxation	IAS 12	Introduce deferred taxation provisions as a separate standard, as in UK, incorporating those parts of IAS 12 that are appropriate to Azerbaijan.

4.3 Accounting Law of 2004

Considered to be one of the major steps towards westernized accounting practices in the country, Accounting Law 2004 introduced a new concept and approach to financial reporting in Azerbaijan. It changed the previously existing system that was governed by the Civil Code (1999), the Tax Code (2001) and Law on Accounting (1995) (ROSC, 2006). As stated in the Article 4 of the Accounting Law; “the main purpose of the state regulation of accounting in the Azerbaijan Republic is to provide for the transparency of the financial statements and development of the accounting in the country on the basis of international standards by developing and implementing the International Financial Reporting Standards and the National Accounting Standards based on them for commercial organizations and the National Accounting Standards based on International Public Sector Accounting Standards for noncommercial organizations.” (Accounting Law, 2004). The transition period was specified of 1 year for small private enterprises, 2 years for public interest entities, and 3 years for non-commercial and non-governmental entities. During the transition period all effective normative acts relating to accounting remained in force (PricewaterhouseCoopers, 2005).

4.3.1 Classification of entities

The new Law identifies 4 categories on reporting entities (Accounting Law, 2004).

1. **Public Interest Entities (PIEs)***. The Law provides a broad definition of PIEs that includes credit organizations, investments funds, insurance companies, non-state social funds, publicly-traded companies and commercial organizations exceeding certain pre-set thresholds. All PIEs in Azerbaijan are required to apply IFRS in their financial statements. The Law also requires any PIEs that have one or more subsidiary to submit consolidated financial statements in accordance IFRS. The only possible exemption from consolidation is if all of the 4 conditions below are met:

* Entities which are of significant public interest because of their business, their size, their number of employees or their corporate status is such that they have a wide range of stakeholders. Examples of such entities might include credit institutions, insurance companies, investment firms, UCITS(1), pension firms and listed companies. (EC Recommendation, 2002)

- parent itself is a subsidiary and all owners (participants, shareholders) including those not otherwise entitled to vote, unanimously agree that entity need not present consolidated financial statements;
- its securities are not publicly traded;
- it is not in the process of issuing securities in public securities markets; and
- the immediate or ultimate parent publishes consolidated financial statements that comply with International Financial Reporting Standards.

2. *Commercial Organizations other than PIEs that are subjects of Small Entrepreneurship.*

Those organizations must prepare their financial statements in compliance with the “Simplified Accounting Rules for Subjects of Small Entrepreneurship” or at their election, may prepare their financial statements in compliance with the “National Accounting Standards for Commercial Organizations”.

3. *Commercial organizations other than public interest entities and subjects of small*

entrepreneurship. Those organization need to submit their financial statements in accordance with “National Accounting Standards for Commercial Organizations’ (NASCO) or at their choice they may prepare their financials in conformity with International Financial Reporting Standards.

4. *Non-commercial organizations.* Those organizations are required to apply National Accounting Standards for Budget Organizations (NASBOs)

4.3.2 Advisory Council

Accounting Law 2004 also established Advisory Council for Accounting that is responsible in advising the relevant executive authority, especially Ministry of Finance in exercising the state regulation of accounting on matters related to accounting and financial reporting. The relevant executive authority exercising the state regulation of accounting is required to consult with the Advisory Council for Accounting in advance about the following issues: introduction of International Financial Reporting Standards and International Public Sector Accounting Standards, development of National Accounting Standards and any major issues related to the development of the accounting in the Azerbaijan Republic. All the members of the Advisory Council for Accounting are appointed from among highly qualified specialists who have essential knowledge

on International Financial Reporting Standards and International Public Sector Accounting Standards. By this Azerbaijani government tries to assist ministries and other executive bodies in transition to new accounting system (Accounting Law, 2004).

4.3.3. The role of Ministry of Finance

The new Law has completely changed the accounting standard setting practices in Azerbaijan. It made the Ministry of Finance in the country the main state regulator of accounting. Now the ministry also is responsible to translate IFRS into Azerbaijani language, to set National Accounting Standards based on IFRS, to develop the explanations and recommendations for their applications and also set simplified accounting rules for the entities that are subject to small entrepreneurship. But the problem here is that the Ministry doesn't have enough permanent staff or sufficient budget to support the developments of National Accounting Standards and their guidelines. A special group of international and local consultants that are financed by a donor funding is assisting the Ministry in carrying out these duties. Due to the limited budget and no permanent staff, the progress in developing NAS and its guidelines has been slow.

In 2006 ROSC team did an evaluation of the work of Ministry of Finance, and the conclusion was that as of the evaluation date 12 draft NAS based on IFRS had been prepared and 3 draft NAS based on IFRS had been approved. In addition to the funding and resources problem, the Ministry faces the problem with translation to Azerbaijani language. Reaching a common understanding of accounting concepts using Azerbaijani terminology had created certain challenges for the working group (ROSC, 2006). According to Zeff terminology is one of the main problems in convergence process. As an example of different national interpretations placed on common terminology, an interesting question surrounds the term "probability". The words 'probability' and 'probable' appear quite many times in IFRS, but it is impossible to agree whether they mean 60%, 80%, or 90% likelihood? As Zeff discusses, one country may make a conservative estimate of probability, while others may adopt a lower, or less strict, percentage as the equivalent of probability. These terms can be defined or interpreted differently from country to country and therefore can impair international convergence and comparability (Zeff, 2007, p. 297).

4.4 Accounting Standards in Azerbaijan as in practice

Although the new Law on Accounting made a significant difference in existing accounting system in Azerbaijan, the Azerbaijani accountants started facing problems with understanding this new approach. With introducing IFRS in the country and making it mandatory for all the PIEs, the Azerbaijani accounting profession had to start to apply professional judgment in their work more frequently, which they rarely did before. The previous Law on accounting (1995) outlined the overall framework and principles of accounting (e.g., the double-entry method); it provided only strict definitions and composition of financial statement categories and prescribes the use of depreciation ratios approved by the state executive authorities. Usually in all cases, the main purpose of the financial reports prepared by Azerbaijani companies was to support tax calculations. As a result, financial accounting was and continues to be closely linked with taxation and follows the principles and rules of the Tax Code. That is why majority of publication issued by the tax authorities usually consist of only guidance on the calculation of the tax base and taxes due.

4.4.1 Major differences between IFRS and accounting practices in Azerbaijan

Many concepts and requirements in IFRS including fair value, going concerns and others are still very new and almost unknown to accounting practitioners in Azerbaijan. These main differences and their implications in Azerbaijan are summarized as below.

- IAS 27, Consolidated Financial Statements and Separate Financial Statements have no equivalent under the local practices. That's why; consolidated financial statements usually were not presented. In Azerbaijan companies may have some very complex relationships; this represents a significant obstacle for third parties to gain a full understanding of the economic relationships that exist between entities and the resulting consequences for a group of companies.
- IAS 16, Property, Plant and Equipment require that the depreciable amount of an asset be depreciated over its useful life. But according to the existing practice in Azerbaijan depreciation rates are applied for a tax calculation purposes and do not necessarily reflect the useful life of the asset.

- Cash Flow Statements are not required and usually not prepared. Due to the absence of sufficient disclosures users lack from understanding fully the basis of preparation of the financial statements. This of course makes those statements less beneficial for the economic decision making.
- IAS 24, Related Party Disclosures has not been defined therefore; adequate information about its disclosures is not provided to the preparers of the financial statements. It is important to note that especially in Azerbaijan the related party activities could be very substantial given the environment in the country companies (ROSC, 2006).

4.4.2 ROSC Team

In 2006, the World Bank's ROSC team made an assessment of compliance gap in accounting practices in Azerbaijan. ROSC stands for Reports on the Observance of Standards and Codes. The program was established by the initiative of World Bank and IMF. It aims to assist World Bank's member countries in implementing international accounting and auditing standards for strengthening their financial reporting regime. The main objectives of this program are the two below:

- Analyze and study the comparability of national accounting and auditing standards with international standards, determine the level of compliance of accounting and auditing standards, and evaluate strengths and weaknesses of the institutional framework in supporting high-quality financial reporting.
- Assist and support the country in developing and implementing a country action plan for improving institutional capacity with a view to strengthening the country's corporate financial reporting regime (World Bank, http://www.worldbank.org/ifa/rosc_aa.html).

Upon the request and invitation of the country the World Bank conducts reviews of accounting and auditing within the ROSC initiative. The World Bank uses a diagnostic tool that it developed to gather applicable information for preparing the Accounting and Auditing ROSC. Those tools have four components: Part I: Review of the Accounting and Auditing Environment, Part II: Review of

National Accounting Standards with Reference to the IFRS, Part III: Review of Actual Compliance with IFRS and Part IV: Review of Auditing Standards as Designed and as Practiced.

The ROSC team works closely with investors and shareholders and makes recommendations that can lead to a country action plan. The World Bank publishes the ROSC report on its official Website (www.worldbank.org) only with permission of the country authorities. (World Bank, http://www.worldbank.org/ifa/rosc_aa.html)

4.4.2.1 ROSC team's observance in Azerbaijan

In order to analyze the current situation of accounting in a practice in Azerbaijan ROSC team gathered 6 sets of financial statements that were supposed to be prepared in accordance with IFRS and 7 sets of financial statements that were prepared by the local accounting standards. Among total 13 sets of statements, 7 were audited by the local companies, and 6 by the international audit firms. Four of six had unqualified opinion, while the rest, had disclaimer of opinion. The team used non-statistical random sampling method to chose these companies, therefore, the results can not be applied to all the listed companies in Azerbaijan. But still, the sampling gave some idea about the situation of accounting in practices in the country.

With respect to IFRS financial statements, the ROSC team noted the following non-compliance issues:

“• The IFRS consolidated financial statements of two enterprise sector companies do not comply with IFRS. Both companies disclose major areas of non-compliance with IFRS and the auditors of both companies express the opinion that the financial statements do not comply with IFRS. The areas of non-compliance disclosed by the companies and referred to by the auditors are:

• *the failure to determine recoverable amount of property, plant and equipment when there were indications of impairment:* In both instances, management believes that a number of facts indicate that the recoverable amount of property, plant and equipment may have declined below the carrying values of the respective assets. The financial statements explain that no suitable cash flow forecasts have been prepared in order to estimate the recoverable amount of property, plant and equipment. This conflicts with IAS 36, *Impairment of Assets*. In both cases, the issue is made yet more complex due to the failure to restate the financial statements for changes in the measuring unit during periods of hyper-inflation.

- ***the measurement of obsolete, slow-moving, or damaged inventories:*** In one instance, the financial statements state that the company did not properly account for obsolete, slow-moving or damaged inventories. They also state that a number of facts indicate that the net realizable value of inventory might have declined below cost. However, the company has been unable to determine the extent of any impairment; accordingly no adjustment has been made. This does not comply with IAS 2, *Inventories*.

- ***the measurement of trade receivables:*** In both instances, the accounting policy for trade receivables correctly states that the amount of the provision for impairment is the difference between the carrying amount and the present value of expected cash flows discounted at the market rate of interest for similar borrowers. However, the basis for preparation states that the company does not consider the timing of the future expected cash flows when considering the recoverable amount of accounts receivable, which does not comply with the accounting policy or IAS 39, *Financial Instruments—Recognition and Measurement*. The financial statements state that the law requires that accounts receivables from dissolved enterprises, enterprises in the process of agricultural reform, and enterprises in occupied regions should be written off. However, the receivables have not been written off or impaired because management “believes” the accounts receivable will be offset against payables to the State budget. Furthermore no impairment provision is recognized for trade receivables from households. While the impairment provision for these receivables may be correct, the limitation on the provision does not comply with IAS 39 and may conflict with the accounting policy. The financial statements acknowledge that insufficient impairment losses have been recognized.”

However with regards to the consolidated financial statements prepared by the banks, the team concluded that banks in Azerbaijan generally complied with IFRS. The financial statements are generally of a high standard with adequate disclosures (ROSC, 2006).

Chapter 5

Reforms in Auditing practices and regulations in Azerbaijan

This chapter of the work is concentrated on auditing regulations and audit practices in Azerbaijan. It studies the structure and the work of The Chambers of Auditors of Azerbaijan (CoAA) which is the national professional accountancy body in the country. It also analyzes auditing regulations and the code of ethics of CoAA.

5.1 Auditing in Azerbaijan

5.1.1 Background information

During the command economy Audit profession in Azerbaijan was essentially a verification exercise, with the final accounts being traced to bookkeeping records of the enterprise. Along with transition to the free market economy, the role of audit profession has changed and became more important. After the independence, large amount of foreign capital started flowing to the country. Especially because of the oil industry many large oil firms like BP, Statoil, Chevron, Exxon and others began their operations in Azerbaijan. These factors created a need for new high quality, transparent audit services for the best interest of investors. But the problem was that, Azerbaijan didn't have an internationally recognized audit certification that would indicate a high level of competence. Although all 15 nations of the Former Soviet Union (FSU) had a number of accounting and audit certifications none of them had much credibility in the international investment community. There is the perception that financial statements certified by someone who has only a national or local accounting or audit certification are not trustworthy and reliable enough. Unfortunately there was some truth in this perception, for several reasons. One reason was that there were a lot of corruption under the communistic regime and some of this corruption filtered through to the accounting professions in the various countries of the Former Soviet Union. Another reason was that the level of difficulty of the local exam in accounting was not considered to be high enough to ensure adequate competence in the audit field (McGee, 2005).

The short-term solution to this problem is that enterprises would use services of one of the Big-4 accounting firms to audit their financial statements. Those four firms – Ernst & Young, Deloitte & Touche, KPMG and PricewaterhouseCoopers – are viewed as incorruptible and high quality. And if an enterprise receives unqualified audit opinion from any of these audit firms it is deemed to have transparent financial statements that comply with one of the internationally recognized sets of accounting principles, either International Financial Reporting Standards (IFRS) or U.S. GAAP.

But there is also a problem with this short-term solution. In emerging countries like former Soviet Union, from the perspective of the local accounting and audit firms, these Big-4 international firms are stealing their clients. And that very much true for Azerbaijan. Practically all of the largest enterprises in the country are audited by one of these Big-4 firms or one of the second-tier firms such as Baker Tilly, Moore Stephens which are also perceived as being incorruptible. If local accounting and audit firms are ever going to be able to compete with the Big-4, their staff will definitely need to have accounting and audit certifications that are equivalent with those held by the employees and partners of the Big-4. Anything less will not create the necessary confidence in the international capital market. Another solution, which must be considered long-term, is to develop a national or regional certification that will have the same credibility in the international financial markets as the English-language exams (McGee, 2005).

5.1.2 Audit profession in Azerbaijan

As of now, audit profession in Azerbaijan can be categorized in 3 groups.

1) The local branches of the big international audit firm networks, which mainly audit either IFRS based or US GAAP based financial statements in accordance with ISA (Sarbanes-Oxley in case of American companies). The clients of these firms are usually very large companies, mainly in oil and gas sector, but also main banks in the country. Because many of those clients are subsidiaries of a certain global firm, they conduct voluntary (contractual) audit and normally at least twice a year, some even quarterly. Those international firms also perform statutory audit that are required by tax authorities for their clients.

2) Few local audit firms, which have enough qualified staff to do audit engagements for IFRS based financial statements, in accordance with ISA. Those firms face a big competition by the

Big 4 firms and other international accounting firms in the country. Unfortunately, a lot of times they are unable to compete with them, and have to be satisfied with small local clients.

3) Enormous number of small local audit firms and independent auditors that only conduct statutory audit and usually with low quality and merely for the formality only. The clients of these firms also, are small local enterprises, with no outside shareholder or investors. That is why those statutory audits are performed only because it is required by the Chamber of Auditors of Azerbaijan (ROSC, 2006).

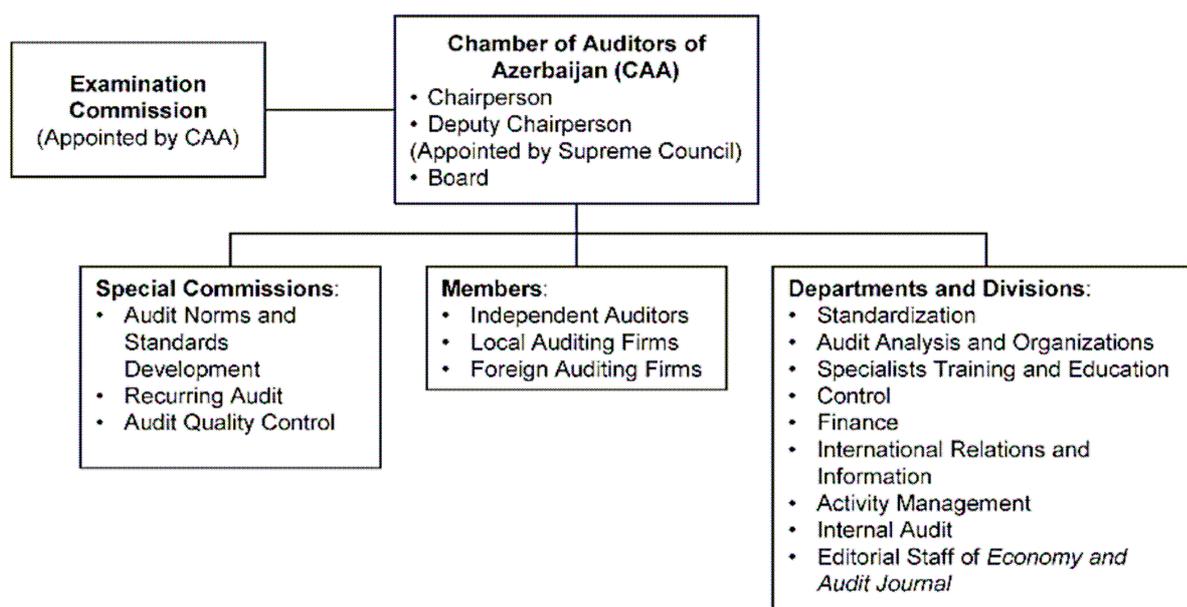
5.2 Chamber of Auditors of Azerbaijan Republic

5.2.1 The structure of CoAA

The Chamber of Auditors of Azerbaijan (CoAA) was created in 1996, in accordance with the provision of the Law on Audit Services (1994). The Law states that the CoAA is an independent body that aims to regulate and improve audit services, protect investors' rights, control the compliance of state laws by all audit firms and independent auditors in the country. The main activities of the CoAA are as following (CoAA, www.audit.gov.az).

- Licensing individual auditors and audit firms in Azerbaijan
- Organizing special exams for getting the mentioned licenses
- Preparing guidelines and instructions for the audit activities
- Overseeing auditing activities in Azerbaijan;
- Protecting rights of individual auditors and audit firms;
- Consulting the profession on relevant legislative issues;
- Reviewing the compliance of independent auditors and audit firms with the provisions of the Law on Audit Services; and
- Representing the profession internationally (CoAA, www.audit.gov.az).

Figure 1: Structure of the Chamber of Auditors (COAA)



Source: (Athukorala & Reid, 2002)

5.2.2 Becoming an auditor in Azerbaijan

In Azerbaijan it is possible for individuals to become independent auditors. In order to do so, first of all they should be eligible for holding a position in business by a court decision and haven't had legal judgments against them. In addition they need to complete the CoAA's certification program and renew their audit licenses periodically for continuing independent audit practice. All international and local audit firms also are required to employ at least one licensed auditor and to pay an "audit firm license fee". The license fees are roughly around USD 15,000 for the local firms of international audit firm networks, and USD 7,000 for the local firms, USD 1,500 for independent auditors (ROSC, 2006).

5.2.3 ROSC team's analysis on CoAA

ROSC team concluded that CoAA is not very successful in being an effective regulator of the audit profession in Azerbaijan. The main problems that causes it is lack of capacity in terms of qualified

staff, insufficient statutory framework, less market demand and the absence of the needed enforce mechanism. In fact the lack of capacity in auditing is the common problem for all Former Soviet Union countries in the region. As Mr. Russell stated in the *“Financial Times”*, - “Countries want to attract foreign capital and have proper corporate governance. But do they have enough trained people to do it? It is not a question of will. It's a question of capacity.” (Bruce, 2007). The staff of the CoAA has been working carefully to adopt international practices, but without the proper training, knowledge and experience, the implementation remains inadequate. Implementation of external quality control is still in its early stages.

According to the ROSC team, CoAA is having a problem in fully understanding its role as a regulator and has an inadequate structure and due process. It still does not have a body providing it with adequate oversight. The National Assembly of Azerbaijan does not have enough resources and technical expertise to monitor a body charged with adopting auditing standards and regulating auditors. In order to establish an appropriate oversight, the board should have an interest in high quality financial reporting in Azerbaijan. Unfortunately some activities of the CoAA are subject to insufficient due process and transparency which very negatively affects its legitimacy. The Law on Audit Services (1994) in its turn also does not provide sufficient details on the operation of the CoAA, disciplinary provisions, the process for accreditation of its members and sanctions. If these elements were added in the legislation it could provide greater legitimacy and authority to the CoAA (ROSC, 2006).

5.3 Auditing Financial Sector

The situation of auditing in the financial sector is little confused as well. While the Law on Banks requires each bank to be audited by an external auditor, it does not specify the auditing standards to be applied. The National Bank of Azerbaijan (NBA) recommends that banks have their audit done in accordance with ISA. Any independent auditor or audit firm certified to practice in Azerbaijan can be engaged to perform an audit of a bank. It is not mandatory for the banks to inform the NBA upon termination of the audit engagement. The NBA has a right to require a bank to replace its auditors and conduct an additional re-audit if the original audit does not meet its requirements. AS of 2006 no such request has been officially documented by the NBA. According to the data received from the USAID Bank Supervision Project, 24 out of the 42 existing banks have chosen one of the “Big 4” as their auditors in 2004. This can be explained with the fact that many of those larger banks in Azerbaijan have some outside shareholders, or foreign investors and the audit

conducted by the Big 4 is generally accepted more reliable than those conducted by the local audit firms. Banks are required to submit audited consolidated financial statements to the NBA, not later than five months following the end of the fiscal year. Banks are also required to publish audited consolidated financial statements in the mass media and on their websites and also prepare and submit annual reporting packages to the tax authorities and the State Statistics Committee (ROSC, 2006).

5.4 Reforms in Auditing

5.4.1 International organizations and CoAA

Despite these difficulties, some reforms in the audit sphere are noticeable in the country. CoAA has become the full member of some important organizations like The European Federation of Accountants and Auditors (EFAA), The European Organization of Supreme Audit Institutions (EUROSAI) and International Federation of Accountants (IFAC) (IFAC, 2005). As a member of IFAC CoAA has provided self-assessment information about the regulatory and standard-setting framework in Azerbaijan (Part 1) and the organizations' activities in addressing IFAC's membership requirements (Part 2) as described in the Statements of Membership Obligations. Based on an analysis of this information, the Chamber of Auditors of Azerbaijan is now developing action plans (Part 3) for continuous development and improvement (Member Body Compliance Program, IFAC, <http://www.ifac.org/ComplianceAssessment/published.php>).

5.4.1.1 CoAA Self-Assessment

Below are the some of the conclusions that were attained while analyzing the responses provided by CoAA in Part 2 of Self-Assessment in 2008 (IFAC, 2008).

- “There is a mandatory quality assurance review program in place for members of CoAA performing audits of financial statements of listed companies. Quality Assurance Review Program in Azerbaijan is a subject to review and update as part of the IDF grant. Planned implementation of the updated program is 2008. Accordingly, Statute on quality assurance review was prepared and approved on February 4, 2008. Supplements and amendments to the Law on

Audit Service related with issues on quality assurance review are considered. Proposal on establishment of quality assurance review body was put forward to the Cabinet of Ministers of the Republic of Azerbaijan. The role of the Chamber on Quality Assurance is to prepare normative and legal documents on Quality Assurance and to present them to the Cabinet of Ministers, to select and prepare specialists on Quality Assurance, perform quality assurance, as well as provide methodical guidelines and instructions.

- The Chamber has concluded that local Quality Control System is not fully in compliance with the requirements of ISQC 1, because it is based on the requirements of the Law on Audit Service. However in 2005 the Chamber decided to make transition to the implementation of International Standards of Auditing prepared by IFAC (without preparation of national standards). CoAA believes that after the complete transition to ISAs this problem will be eliminated. Because Quality Control System will be regulated in compliance with ISQC established by IFAC. As of 2008 the Chamber uses “cycle approach” to select subjects for quality assurance review and the maximum number of years in the review cycle is 1 year.

- The National Strategy on "Increase of transparency and fight against corruption" approved by the Order of 28 June, 2007 of the president of the Republic of Azerbaijan, defines that the Chamber of Auditors must realize the direct transition to the implementation of ISAs *without preparation of National Auditing Standards*. This is expected to increase transparency in auditing practices in the country. The Chamber applied for permission to IFAC on translation and publication of IAASB pronouncements. The preparation of Memorandum of Understanding between two organization is in progress. After obtaining permission from IFAC IAASB pronouncements will be translated and published. The translation process is considered to be finalized in 2008-2009. In order to communicate the standards, IFAC Update and News to the public, the Chamber publishes appropriate articles in its monthly magazine "Audit and Azerbaijan".” (IFAC, 2008).

In order to promote and assist in the implementation of IAASB pronouncements and other IAASB activities CoAA undertakes the following activities:

- translating and adopting those pronouncements
- publishing those pronouncements for the public consideration
- maintaining the application of this practice
- presenting these pronouncements to the appropriate governmental authorities

(IFAC, 2008).

5.4.2 Laws and Regulations on Audit

In accordance with regulations under the Auditing Services Law 1995 the CoAA had issued auditing instructions. These instructions are directly based on International Standards on Auditing (ISAs). Audit standard setting is an ongoing process. The Board makes a final decision on the acceptability of the suggested standard, its compliance with the existing laws and regulations, and recommends amendments if necessary. Once agreed the draft is submitted to the Ministry of Justice, which only registers those standards that it considers compatible with the Constitution and other laws. The process of issuing these audit standards has the following stages:

- The Chamber of Auditors selects certain ISAs for consideration.
- Three external specialists are assigned to work with these ISAs. One of the specialists translates the standard into Azerbaijani; the other two reviews the translation and analyze suitability and compatibility with the specific needs of Azerbaijan
- The standard is presented to the Board of the Chamber of Auditors of Azerbaijan for consideration. The Board identifies conflicts with Azerbaijani laws and conditions, if any. Where these are considered beneficial, the Board identifies consequential amendments to Azerbaijani laws. Otherwise, the conflicting provisions are removed from the standard.

In 2002 the Chamber of Auditors of Azerbaijan had reviewed amended and issued 24 of the 36 ISAs (Athukorala & Reid, 2002). According to the ROSC team analyze, 4 years later, as of 2006, the Chamber of Auditors of Azerbaijan had issued 35 auditing standards. In addition, ten guidelines have been issued (for example, specialized guidance on the audit of insurance companies). Most of the standards issued were derived from ISA (ROSC, 2006).

In December 2001, CoAA approved its Code of Ethics which is very much based on the IFAC's Code of Ethics. It includes the similar values, ethics and attitudes as included in the IFAC Code of Ethics (IFAC, 2008). However unlike the IFAC Code of Ethics, it does not differentiate assurance assignments from other audit services and does not contain sections on professional appointments, second opinions, gifts and hospitality, application of the framework to specific situations, preparation of reporting information, and inducements (ROSC, 2006).

5.4.3 Association of Certified Accountants of Azerbaijan

One of the major steps towards the reform in the audit field in Azerbaijan was creating the Association of Certified Accountants of Azerbaijan (ACAAz). It was established in 2000 and it is a non-government, not-for-profit organization. ACAAz's declared purpose is to unify the professional accountants of Azerbaijan and to provide assistance with the accounting reform aimed at introducing IFRS in Azerbaijan. The Association conducts training courses on IFRS, U.S. Generally Accepted Accounting Practices, and bookkeeping for accounting practitioners, auditors, and enterprises; it has signed a memorandum of understanding with the Ministry of Finance to provide assistance with the development of National Accounting Standards (<http://www.cipa.az/news-1.htm>). As of 2006 the association had around 400 members. But only 18 of those members were full time staff. Those full-time employees of ACAAz include accounting practitioners, all of whom have completed training in international accounting and financial reporting standards and practices. The Association's development is being funded by the Eurasia Foundation as a grant to introduce IASs and to develop qualified Azerbaijani financial experts. The amount of the support equals to \$125,000 . The project includes the following:

- (i) training specialists and producing printed training materials;
- (ii) introducing a system of accounting certification;
- (iii) organizing ongoing courses for accounting certification; and
- (iv) expanding the ACAAz's activities into the four regions of Azerbaijan (ROSC, 2006).

The International Regional Federation of Accountants and Auditors Eurasia is not an Azerbaijan-based professional accountancy body, but influences accountancy developments within the former Soviet Union countries including Azerbaijan. This Federation was established in 1999—its members include 20 professional accountancy organizations from 10 former soviet countries. The Federation's mission is to develop and strengthen the accounting and audit profession, promote the implementation of international professional standards and professional standards on ethics as developed by IFAC and IASB through its member bodies. The Federation provides support and assistance to national organizations of accountants and auditors in the following areas:

- (i) developing national organizations in preparation for IFAC recognition;
- (ii) ensuring high quality accounting and audit services;

- (iii) developing the practice and theory of accounting and audit based on international standards;
- (iv) preserving the professional independence of accountants and auditors; and
- (v) developing and strengthening professional contacts at the regional and international levels. Azerbaijan is represented on each of the Federation's five standing committees: accounting standards, auditing standards, legal reform, membership and ethics, and professional education and certification (Athukorala & Reid, 2002).

Chapter 6

Accounting education and certification in Azerbaijan. The role of Big Accounting firms in promoting international standards.

This chapter is a case study of accounting education and the problems with competence within Azerbaijan. It starts by talking about accounting education and training in Azerbaijan and the role of Big 4 accounting firms in business and in promoting IFRS and ISAs. It also compares the accounting certification in Azerbaijan with that of in neighbor Post-Soviet country, Georgia

6.1 Accounting Education

6.1.1 Education in Public and Private Institutions

Accounting education and competence issues in Azerbaijan were especially examined in details, because of it tremendous importance in the convergence process. If accountants in a country do not have sufficient educational background to help them understand IFRS and ISAs, it creates challenges for the whole profession to adopt those international standards. Accounting education and training in Azerbaijan is in the transition and developing period. Among 42 academic institutes and universities in Azerbaijan, 16 teach accounting; of which three are state institutions (State Economic University, State Oil Academy, and University of Cooperation). The largest of the 16 institutions is the Azerbaijan State Economic University (ASEU). This institution sets the basis of the accounting curriculum for other universities and colleges in Azerbaijan. The main weaknesses of the public universities are their limited resources, outdated teaching methods, and a curriculum that is still mostly based on old soviet reporting requirements. The professors teaching in public universities in Azerbaijan need to be trained and get more acquainted with the international accounting standards. Starting from 2005 a new course has been introduced on IFRS for students studying accounting and auditing (ROSC, 2006).

In some public universities there is a special study program called "Special Talents Groups". Students that study in this program are selected very carefully among many, according to their level of knowledge in economic subjects and English language. The program provides students with high-level and updated economic studies. Usually teachers that give classes in this program are

employees of one of Big 4 or other big accounting firms. But the number of places this program offers every year is very limited, therefore not everyone gets the opportunity to get better and modernized education on accounting in ASEU. Another option is private universities in Azerbaijan, as they have better resources and more updated accounting programs to offer than public universities. Usually private universities have a lot evening classes for young professionals who work in different companies. Many of them take those classes, because if successfully passed, they get exemption from some parts of ACCA certification exams. Gafgaz University, a private university, is quite famous for its good accounting education that is mainly based on international and Turkish standards (Interviewee B, 2008). In practice, these programs are also not fully based on IFRS/ISA, but rather address those standards as separate areas of study. Although private universities are better funded than the State ones, there are still some problems with the absence of competent professionals and educators capable of delivering IFRS based programs (ROSC, 2006).

6.1.2 The role of the Big 4 in promoting international accounting & auditing standards

Independent corporate audit is a new concept in Post Soviet world, and the Big 4 accounting firms have successfully sought to obtain the audits of the largest companies in this region. The demand for local accountant trained in Anglo-Saxon accounting skills was partly met by making the UK based ACCA qualification available and even mandatory in some cases (Nobes & Parkers, 2008, p. 248). But the Big 4 also plays an important role in promoting international accounting and auditing standards in Azerbaijan. The main reason is because; implementation of IFRS requires sufficient competence and knowledge on these standards, and the professionals working in the Big 4 are the ones who are capable in understanding and interpreting them in a most proper way.

PricewaterhouseCoopers had a very close cooperation with the Ministry of Finance of Azerbaijan Republic in translating IFRS into Azerbaijani language (Interviewee B, 2008). The experience has shown that the words of IFRS can be read very differently, depending on national GAAP practices and other cultural issues that brought into reading of the IFRSs (Tokar, 2005, p.55). As the employees of the Big 4 attain better knowledge on “free market accounting” and international standards, they are the ones that can provide more accurate and correct interpretation of IFRS. PricewaterhouseCoopers also gives IFRS trainings to a lot big companies in Azerbaijan, including International Bank of Azerbaijan, State Oil Company and etc. This is common for Deloitte and Ernst & Young as well. Because of their internal rules, the Big 4 makes great efforts to be independent from their clients; therefore they do not audit companies that they help to prepare

financial statements. But only giving IFRS training, is not considered a threat to independence. The World Bank has given a huge amount of money to Azerbaijani government to improve the implementation of IFRS in Azerbaijan. All three active Big 4 firms in Azerbaijan are now trying to get involved in this project (Interviewee B, 2008).

According to the professionals working for the Big 4, after few years working there almost all of them get a job offer from some of their audit clients. It is easy to guess why it is like that. Clients understand that their auditors are well acquainted with IFRS, and instead of paying for the normal IFRS training which does not help them that much, it is better to recruit the qualified professionals from the Big 4 firms. Those professional have practical experience as well as theoretical background (Interviewee A, 2008) (Interviewee C, 2008).

6.2 Accounting Certification

6.2.1 Accounting certification in the Former Soviet Union

All 15 countries of the former Soviet Union have their own accounting and auditing certification systems. But the common characteristics between all of these systems are that they are only recognized locally, not internationally. This can be explained by the fact that, accounting profession in all of these countries was very much corrupted during the soviet regime and the international community does not feel confident to accept it yet. Their quality is also suspect, since many of them do not meet the standards of certifications in the more advanced market economies.

According to Robert McGee there are several reasons why one country may not fully recognize a certification from another country. The first reason is the tax issue. Because the accounting and tax rules vary from one country to another, so the material being tested by one certification body may be considerably different from that tested by certification bodies in other countries. Another reason is the lack of familiarity with the certification rules, content and requirements. This factor of course diminishes trust and confidence, even though the quality of the foreign certificate may be high and adequate. A third reason for the hesitancy to recognize a foreign certification is that some certifications really lack of credibility and do not ensure the competence level of people giving those exams. Especially in developing and transition countries, some national certifications can not be trusted. According to some sources, in Russia, for example, some of the local accounting associations go to the countryside selling their own certifications (McGee & Preobragenskaya,

2004). So far there was no any clear evidence of this kind of issues in Azerbaijan. The fourth reason is protectionism. The old accounting regulation bodies feel threatened by the possible introduction of new certifications. Because, it may require those accountants to take and pass the new certification exams. Even TACIS counterpart projects by EU and USAID accounting reform programs in several countries have faced resistance from local accounting associations when new certifications models were first introduced (McGee, 2004).

In order to attract foreign investment to these countries financial statements should be trusted. But preparing statements in accordance with the international standards is not sufficient enough, because investors also want to be sure that the accountants who prepare the financial statements and the auditors who audit them are fully acquainted with the standards that they use. This created a need for the increase of the accounting certification in Former Soviet Union. Several globally recognized certification bodies tried hard to fill this space in the market of those countries but the problem is that their exams are only in the English language. The most popular international accounting certifications exams in Azerbaijan now are ACCA (the Association of Chartered Certified Accountants), CPA and CIMA (Chartered Institute of Management Accountants). Until very recently there was not a single alternative for the non English speaking professionals in those countries, including Azerbaijan.

6.2.2 ACCA exams

ACCA exams consist of 3 parts, and a total of 14 exams should be passed to receive a full certification. There is also a specific experience requirement. Although these exams are offered only in the English language, the ACCA certification has had a significant influence on accounting education and accounting certification in several republics of the former Soviet countries. In Azerbaijan ACCA exam materials are seen as a source of learning accounting and IFRS by many young professionals. Some private universities have adopted all or some of the ACCA syllabus as part of their accounting degree programs. During the early phases of the various USAID Accounting Reform Programs the ACCA syllabus was promoted in Azerbaijan, Georgia and Armenia, to a lesser extent in some of the other FSU republics. Some of ACCA exam preparation materials are also translated in Azerbaijani language and are used in various preparation courses and also by some higher education institutes (McGee, 2005).

ACCA exams are only offered in English, which has both up and down sides. From the positive side, offering the exam only in English means that the same identical exam can be offered all over the world, so there is no perception that the quality or content of the exam may vary in different countries. And this makes it truly international. Not having exams in other language is also beneficial for ACCA certification body in terms of administrative cost reduction. But however, there are some downsides of not offering the exams in different languages. The main reason of course is lack of English language knowledge in many countries, including Azerbaijan as well. A lot of potential candidates for ACCA exams are not able to read or understand in English. If those exams were offered in various languages then the principles and knowledge on international standards that are tested in ACCA exams could have spread faster and more professionals would benefit from it. Until now some countries have asked the ACCA to offer its exams in other languages but those requests have been denied, with the minor exception of the Diploma in International Financial Reporting, which is now available in Russian. It will be interesting to see how popular this diploma program becomes, as word of its existence reaches the 15 former Soviet republics (McGee, 2004). As of 2009 only the materials of one ACCA paper- F3 (Financial Accounting FA) was translated to Azerbaijani language. The project was sponsored by the private accounting education company- GRBS* (Interviewee B, 2008).

6.2.3 Russian language accounting certifications

6.2.3.1 Introduction of CIPA program

Azerbaijan's financial sector suffers from an acute shortage of qualified accountants. According to USAID a survey conducted in 2006 found a single certified accountant in the Azerbaijani banking industry. The shortage is felt more as banks are required to adopt International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS.) USAID's SME Support through Financial Sector Development Program recently helped launch a Certified International Professional Accountant (CIPA) program to train financial sector accountants (USAID, 2007).

CIPA is a Russian language professional accountancy certification, originally developed by USAID to train and certify accountants from FSU countries. The objectives of the CIPA are to substantially raise the quality of the accounting profession in several countries of the former Soviet Union

* GRBS- is the first ACCA Approved Learning Partner (Gold Status) in Azerbaijan that provide various range for preparation courses and training. www.gr-bs.com

through promoting IAS and ISA, and professional ethics. The CIPA certification was established in 2001 in with the formation of the Eurasian Council of Certified Accountants and Auditors (ECCAA) - a federation of regional professional accountancy associations whose working language is Russian and whose goal is to attain the highest possible level of professionalism in its membership. The 10 founding associations from Russia, Central Asia and Ukraine agreed to adopt and mutually recognize the CIPA education qualification requirements, the exams, and the certification (www.globalcipa.com).

CIPA program includes the following modules:

- Financial Accounting (I and II)
- Managerial Accounting (I and II)
- Finance
- Audit
- Taxation & Business Law (country-tailored)
- Informational Technology

6.2.3.2 Potential benefits of CIPA program

CIPA program is considered to be very much beneficial for the economies of former Soviet countries. It ensures that it can speed up the development of the accounting profession and assure transparent, profitable enterprises, as well as the overall economic growth and stability. Local professionals can also benefit from it to obtain the opportunity for a high quality, internationally recognized Russian language certification at an affordable price. CIPA is also believed to contribute to the accounting harmonization with Eurasian economies and improve international trade and exchange. CIPA training centres translate international textbooks and materials and develop supplemental material with input from local professionals and trainers. CIPA requirements include CPE as a necessary part of the accounting profession. The founders of CIPA believe that society's perception of accountants as skilled professionals in the former Soviet Union should be developed and maintained by the profession (www.globalcipa.com).

The project fielded an experienced accounting instructor from the U.S. to launch Azerbaijan's CIPA program and to train financial sector accountants. This initial phase, leading to Certified Accounting Practitioner Certificate, was completed in 2006. The Ukraine-based CIPA Examination

Network conducted an examination. As a result of this initiative, six accountants from Azerbaijan's financial sector have qualified to earn Certified Accounting Practitioner (CAP) Certificate. Several accountants passed individual courses. 16 participants passed Financial Accounting, 14 passed Management Accounting and 12 passed Tax and Law Courses. More professional in the financial sector are expected to have CAP certification (USAID, 2007).

6.2.3.3 Separation between accountants and auditors

However there is still an ongoing discussion within the former Soviet countries regarding the need for professional certification of accountants - these countries have nationally-prescribed certification of statutory auditors. Historically, there always had been a greater separation between accountants and auditors in those countries than in Europe; and in many countries they are treated as separate professions. That is why those FSU countries have some problems understanding the importance of the accounting qualification. The CIPA program's purpose was to create an independent, professionally and market (as opposed to a government) recognized accounting certification. (www.globalcipa.com).

6.2.3.4 Some problems with CIPA program

Although CIPA program can give opportunity to a lot of non-English speaking professionals in Azerbaijan to get certification, it still has some downsides. The problem is that CIPA is offered in Russian. Comparing with other Former Soviet countries like Ukraine, Kazakhstan, or Uzbekistan, Azerbaijan is very much sensitive in the language issue. Even during soviet times not like other countries, majority of people in Azerbaijan spoke Azerbaijani instead of Russian in their daily life and work. After the independence in 1991 this issue got even more serious, and nowadays although they can speak Russian, 80-90% of the young professionals in accountancy have Azerbaijani as their first language. This shows a need for the international recognized certification exams to be translated to local language of the country.

Another Russian language certification is DipIFR (Diploma on IFRS) (ДипИФР – DipIFR http://gaapsoft.ru/index_dipifr.html). According to the manager of one of the Big 4 accounting firms' branch in Azerbaijan, for Russian speaking professionals DipIFR is more famous than CIPA. But still, the Big 4 firms do not accept certifications of neither CIPA nor DipIFR as a satisfactory

indicator. PricewaterhouseCoopers & Deloitte mainly requires ACCA, whereas Ernst & Young does CPA exams for its employees both in Assurance and also in Tax department (Interviewee B, 2008). However medium-size audit firms in Azerbaijan do accept certifications like CIPA and DipIFR. In general, the situation with the accounting qualification is not that strict in medium-size firms as in the Big 4. For example, in order to become a Senior Associate in the Assurance department, the first level of ACCA papers should be passed by employees in PricewaterhouseCoopers. Small and medium-size international accounting firms do not have this requirement (Guliyeva, 2008).

6.2.4 Certification of accountants in Georgia

Georgia, is another former soviet country, and boarded with Azerbaijan in the northwest. Although it does not have an emerging oil industry or many natural resources like Azerbaijan, it is still progressing and has been quite successful in transition process. The reason for comparing the situation with accounting certification in Azerbaijan with Georgia is to examine the similar challenges they face, and the solutions each of them had taken. Accepting International Financial Standards also have been one of the main goals of Georgia in the past few years. The country also did some steps in creating national accounting certification that meets the needs of the investors in the market economy. Several different kinds of accounting certification are available in Georgia. As in Azerbaijan the Association of Chartered Certified Accountants (ACCA) is also popular in Georgia and they give their certification exams twice a year. The main problem from the Georgian perspective is that they are given only in the English language, which prevents the majority of Georgian accountants from participating in the ACCA program. As discussed above, this problem is very much identical to Azerbaijani problem with English exams. However, in recent years the Georgian Federation of Professional Accountants and Auditors (GFPAA) has started offering parallel exams in the Georgian language. The program started independently in 1999. Later in 2001 USAID started providing financial support to it. Although the Georgian exams are quite similar to those offered by the ACCA in English, they are not identical. Table 1 compares the content of the two sets of exams (McGee, 2008).

ACCA Exam Topics**Georgian Exam Topics**

<p><i>PART 1</i></p> <p>1.1 Preparing Financial Statements 1.2 Financial Information for Management 1.3 Managing People</p> <p><i>PART 2</i></p> <p>2.1 Information Systems 2.2 Corporate and Business Law 2.3 Business Taxation 2.4 Financial Management Control 2.5 Financial Reporting 2.6 Audit and Internal Review</p> <p><i>PART 3</i></p> <p>ANY TWO</p> <p>3.1 Audit and Assurance Services 3.2 Advanced Taxation 3.3 Performance Management 3.4 Business Information Management</p> <p>ALL THREE</p> <p>3.5 Strategic Business Planning and Development 3.6 Advanced Corporate Reporting 3.7 Strategic Financial Management</p>	<p><i>PART 1</i></p> <p>Preparing Financial Statements Financial Information for Management Not tested</p> <p><i>PART 2</i></p> <p>Information Systems Georgian Corporate and Business Law Georgian Taxation Financial Management and Control Financial Reporting Audit and Internal Review</p> <p><i>PART 3</i></p> <p>ANY TWO</p> <p>Not tested Not tested Performance Management Business Information Management</p> <p>ALL THREE</p> <p>Strategic Business Planning and Development Advanced Corporate Reporting Strategic Financial Management</p>
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Source: (McGee, 2008)

6.2.4.1 Differences between Georgian and ACCA exams

Analyzing the above table shows that there are more similarities than differences in terms of content between ACCA and Georgian exams. In the Part 1 the only paper that is not tested by GFPAA is Managing People. But this paper clearly doesn't have much content on accounting. The papers in the Part 2 are also very much similar to the ones in ACCA. The only difference is that the exams on Corporate and Business Law and Business Taxation of ACCA that are based on British Laws and tax rules were replaced with those of Georgian. This is the very good point, because after all Georgia needs accountants who are acquainted with their national laws and regulations and there is a very little need to know British Laws. Part 3 of the ACCA exam scheme allows candidates to choose any two out of four papers that are offered. The Georgian exam scheme requires the papers on Performance Management and Business Information Management and does test neither Audit and Assurance Services nor Advanced Taxation. The second half of Part 3 in Georgia exam is exactly identical with ACCA (McGee, 2008).

It is very interesting fact that Georgia did not join the CIPA program that was developed especially for the former soviet countries and for Russian speaking professionals. The Board in charge of accounting certification in Georgia was of course aware of the CAP and CIPA exams but however, they concluded that having 14 parallel exams in Georgian language that are very much similar to ACCA would be more beneficial than 18 exams of CIPA. The Board believes that those exams offered in Georgian will soon receive a significant recognition (McGee, 2008).

6.2.4.2 Problems with translation and competence

There of course were some main challenges at the early stages of forming national accounting certification in Georgia. The Board needed qualified people to be able to translate materials from English to Georgian language. Another problem is terminology, which is always an issue for interpretation. For example, in some cases there was no equivalent Georgian word for some of the English language terms. As a solution, some of the translators were chosen among the best ACCA students. This is because those people were in a better position to perform the translations since they understand the content of the exams more. Another problem was finding qualified professionals to teach those courses since not many people in Georgia were acquainted with the course content in the beginning. As in Azerbaijan, the only exception was probably a few Big-4 accounting firms' employees and the people who managed to pass either the English language

ACCA exams or something equivalent (CPA, CIMA). In order to teach the exam preparation courses the board in charge of the accounting certification in Georgia had set some special requirements. Potential lecturers first had to pass the relevant exams. Besides that lecturers must also have had experience in teaching before. As of 2008 some professors have passed at least some of the exams, which partially solve the problem of finding qualified instructors. Since some professors are now qualified to teach the exam preparation courses, it is now also possible to teach the exam subjects in Georgian universities (McGee, 2008).

Chapter 7

Conclusion

The main aim of this chapter is to bring forward all the findings of this thesis work. It analyzes the answers of the problems questions set in the beginning of this work and discusses the final comments. The chapter also gives recommendations on the further possible researches.

7.1 Findings

This master thesis discussed and analyzed the current situation of adoption and implementation of IFRS & ISAs in Azerbaijan. It studied the past of the accounting and auditing systems in Azerbaijan to better understand the difficulties and challenges they face now. In order to formulate this case study the questions below were set in the beginning of this thesis work:

1. Why is the global convergence of accounting and auditing standards becoming important?
2. What was the situation in accounting sphere of Azerbaijan during Soviet times?
3. What are the main challenges Azerbaijan faces in the process of transition to IFRS & ISAs?
4. How is the situation with implementation of international standards on accounting and auditing in practice?
5. What concrete steps have been made towards the reforms in accounting and auditing?
6. Does the accounting education in Azerbaijan support this transition?

The thesis work was successful in addressing all these questions. As the world gets more and more globalized, debates and discussions over the convergence of national and international standards increases significantly. The markets are integrating without regard to borders in search of new investors to reduce their cost of capital; companies are listing on major international exchanges outside their home jurisdiction (Wong, 2004). All these factors increase the importance of the harmonization of accounting and auditing standards. This thesis work examined and analyzed the problems and difficulties Azerbaijan faces in this process of harmonization. Although a case study of one country cannot be applied to many others, it at least gave some enlightenment to the current

situation in a Post-Soviet world. It showed that a lot of problems and challenges faced by different countries trying to converge with IFRS and ISAs are also very common in Azerbaijan.

7.1.1 The Challenges that Azerbaijan face in the process of convergence to IFRS & ISAs

As this thesis work exemplifies, Azerbaijan continues to face several challenges in the process of adopting IFRS in practice. For a former soviet country it is definitely not that easy to move from the traditional accounting rules, chart of accounts and accounting practices that were formed for many years.

7.1.1.1 Education

Education and the lack of competence are the main problems in Azerbaijan. Accounting education is very necessary for understanding and properly implementing international accounting and auditing standards. Adopting IFRS & ISAs by Azerbaijani government does not assure that preparers and users of financial statements in the country really understand those standards and are able to do right interpretations. The main higher education institutes in the country are still not in a position to provide satisfactory accounting education that meets the needs of current market economy. Professors and teachers teaching accounting classes are not trained enough to be able to teach IFRS and today's accounting. However, some solutions were made to solve this issue. These include private courses on IFRS, programs within universities that provide better education on accounting and etc. Although these mentioned solutions are good, but the number of people that can benefit from them are limited, therefore it is very important to influence accounting education in the universities level. The problem with the quality of education also influences the local market of audit firms. It makes it hard for the small and medium sized local firms to compete with the big international firms, since they lack qualified and competent staff.

7.1.1.2 Bureaucracy

Bureaucracy is another main problem of Azerbaijan. Having an emerging economy and huge amount of natural resources, the country still lacks sufficient development due to bureaucratic system. Accounting and auditing regulation bodies are also very much bureaucratic as it was observed while conducting the research on accounting reforms in Azerbaijan. There is also a very

close link between accounting and taxation in the country, which makes it hard to apply IFRS. Historically accounting was only performed for statistical and tax purposes in Azerbaijan and in all other countries of the Soviet Union. That is why, companies still prepare two sets of financial statements; one for tax authorities, the other for the shareholders & investors. But preparing two statements require more work and administrative costs, which is not in the best interest of companies operating in Azerbaijan. Although *The Accounting Law 2004* made the transition to the international standards, tax rules in the country haven't changed much.

7.1.1.3 Lack of qualified professionals

Lack of qualified professionals in the country slows down the convergence process. Usually professionals working in the Big 4 or in other big accounting firms are well acquainted with IFRS & ISAA. That is because of regular accounting & auditing training provided by these companies to their employees. Another reason is that in all these big accounting firms in Azerbaijan, ACCA, CIMA, CPA or other equivalent accounting certification is mandatory. The Big 4, for example also organizes free private preparation courses for its employees for successfully passing those certification exams. But the situation in other companies and banks in Azerbaijan are not satisfactory. Although they claim to prepare their financial statements in accordance with IFRS, in reality the compliance is far from being perfect. According to the interviews with young professionals working in the Big 4 after one or two years working as an auditor, almost all of them get a job offer from the clients of the audit firm they work for. Although sometimes they accept those job offers because of a higher salary, but usually young professionals still prefer to work for the Big 4, as there are more perspectives and future career growth (Interviewee A, 2008) (Interviewee C, 2008).

7.1.2 ROSC team's diagnostic report

ROSC team's report on accounting and auditing of Azerbaijan was one of the key sources for this thesis work. With the initiative of the World Bank, ROSC team conducts diagnostic review on accounting and auditing in many transition countries. This review assesses the comparability of national accounting and auditing standards with IFRS and ISAs, respectively, and the actual level of compliance with the standards applicable to the Statutory Financial Statements of business entities (http://www.worldbank.org/ifa/rosc_aa.html). It also focuses on the education and competence issues in those countries. The ROSC's review analyzes the current situation of accounting and auditing practices in the country, reveals the areas of improvement and also

includes valuable policy recommendations. The report is also available in Azerbaijani language in the website of World Bank ROSC team, which is a good thing because it makes it available for almost all professionals in Azerbaijan to read it. However, after reviewing main accounting journals, news-papers and websites in Azerbaijan, it can be concluded that this report was not discussed in many of them. It certainly could have been more beneficial, if local accounting journals wrote about it and promoted it. Because the main aim of ROSC team's doing these reports in developing countries, is to assist and support them with transition process.

7.1.3 Convergence of audit standards vs. accounting standards

It is interesting to see that, adopting international audit standards seems more successful than accounting standards in Azerbaijan. According to Wong, in general, implementation and adoption of IFRS faces more challenges than ISAs. It is because the international accounting standards have direct effect on more people than audit standards; preparers of financial statements, users, investors, regulators, tax authorities, employees of the firms and etc. For instance, the complexity of ISAa can be reflected in the audit fee an entity pays, but the entity itself does not have to learn, interpret, and implement the standards (Wong, 2004). However, another issue is that it is hard to really evaluate the success of adopting ISAs. Although it may seem that converging with audit standards are more accomplished, this is not always justified. The situation in the Big 4 firms and the medium-size firms of FOF is quite different. They have practical manuals instructing on implementation of audit standards and quality assurance. These all ensure the quality of audit services they provide, but in many other national local firms they don't have implementation guide of ISAs. Even despite all the measures taken on quality assurance and expectations that comes from the use of their global brands, the ROSC team's results and audit failures over past years suggest that the international audit firm networks do not always deliver consistent, high-quality audit services. There is sometime a slip under the network quality. But the Big 4 firms are struggling hard to ensure that all their members really live up to their standards (Hegarty et al., 2004).

Azerbaijan has made quite important reforms in converging with international standards. Adopting IFRS and ISAs and making it mandatory for certain groups of companies, including PIEs was an important step that Azerbaijan accounting regulation bodies made. This was mainly the result of the natural needs of the market economy. Except few big companies, all others are privatized in the country; therefore, it is obvious that they are trying to attract foreign investors and capital. In order to make financial statement more credible, investors and outside shareholders have to trust the

information provided there. All these reasons supported the transition to the international standards in the country. *The Accounting Law 2004* is the main law supporting this change in accounting system in Azerbaijan. Becoming a member and developing cooperation with important international organizations also influenced the speed of convergence to international standards in Azerbaijan. The EU and World Bank have granted huge amount of money and resources to Azerbaijan, in order to help the country with the transition period. One of the priorities set in the strategic plan of their programs is improving financial reporting and implementation of IFRS & ISAs. TACIS and ENP are some of very important programs introduced in Azerbaijan. It is important to note that all these programs have milestones and deadlines for the countries they apply to. Therefore, Azerbaijan gets some pressure by the EU & World Bank in meeting requirements of these projects and complying with international standards in certain time limit. In a bigger picture, the convergence of IFRS & ISAs in Azerbaijan also contributes to the convergence process in the whole Europe.

7.2 Further Research area

Accounting and auditing reforms in transition economies is not a very well explored area. There is always a need for the further research that would go deeper in finding out the degree of compliance and implementation of IFRS and ISAs in developing countries. By doing more researches on this topic, the international community will get better understanding of the difficulties those countries face in the convergence process. Knowing these problem, will help to address them and by that speed up the process of global harmonization of accounting standards. It is very interesting to do a case study on one particular country, in order to see the current situation there. But for the bigger picture, further researches are also required in comparing the compliance level among many countries that are in transition period.

Research on Eastern European countries comes to the mind as a potential case study for the further investigation. Eastern European countries have gone through very rapid change after the fall of the Berlin wall. The accounting systems in those countries are leaning towards IFRS. But at the same time the influence of the “communistic past” of these countries creates some challenges in this convergence process. Another study could be presented to update this work on Azerbaijan after few years. It will be very interesting to see the development in accounting system and education in Azerbaijan in some years. It would give some clear idea whether international programs like

TACIS and ENP were successful or not in helping Azerbaijan to adopt and implement IFRS & ISAs.

Appendix A

Main questions asked when interviewing two professionals working in the Big 4 firms

1. What is level of IFRS knowledge of your clients?

2. Comparing with previous years, is there any improvement in client's understanding of IFRS?

3. Does your company provide any IFRS trainings to its clients?
 - 3.1 *If yes*: Does it create any threat to audit independence?
 - 3.2 *If yes*: How do you solve this issue?

4. Does your company require any accounting qualification.
 - 4.1 *If yes*: Which accounting qualification?
 - 4.2 *If yes*: Do you provide any exam preparation courses for you employees?

5. Have ACCA exam materials been translated into Azerbaijani?

6. What can you say about the accounting education in higher institutions in Azerbaijan?

7. Comparing with its neighbor Post-Soviet countries, is Azerbaijan more converging to international standards or less?

8. Is there anything else you would like to share about your company or/and the accounting in Azerbaijan in general?

Appendix B

Main questions asked when interviewing a professional working in a medium-sized accounting firm.

1. What size of companies does your accounting firm audit?
2. What is level of IFRS knowledge of your clients?
3. Comparing with previous years, is there any improvement in client's understanding of IFRS?
4. Does your company provide any IFRS trainings to its clients?
 - 3.3 *If yes*: Does it create any threat to audit independence?
 - 3.4 *If yes*: How do you solve this issue?
5. Does your company require any accounting qualification.
 - 4.1 *If yes*: Which accounting qualification?
 - 4.2 *If yes*: Do you provide any exam preparation courses for you employees?
6. Is there anything else you would like to share about your company or/and the accounting in Azerbaijan in general?

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