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and Codes on Accounting and Auditing

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Main Abbreviations and Acronyms

A&A	Accounting & Auditing
ACAP	Association of Professional Accountants and Auditors
ACCA	Association of Chartered Certified Accountants
AESM	Academy of Economic Studies of Moldova
AFAM	Association of Auditors and Auditing Firms of Moldova
AOC	Audit Oversight Council
CAP	Certified Accounting Practitioner
CCG	Code of Corporate Governance
CFRR	Centre for Financial Reporting Reform
CIPA	Certified International Professional Accountant, ECCAA
CNVM	National Securities Commission
CPD	Continuing Professional Development
CPS	Country Partnership Strategy
CSE	Chisinau Stock Exchange
CVS	Control and Verification Service
DipIFR	Diploma in International Financial Reporting
EC	European Commission
ECA	Europe and Central Asia
ECCAA	Eurasian Council of Certified Accountants and Auditors
Ecofin Consult	Association of Auditors and Management Consultants
EU	European Union
FIDEF	Fédération Internationale des Experts-Comptables Francophones
FINREP	Financial Reporting System
GDP	Gross Domestic Product
IASB	International Accounting Standards Board
IAASB	International Auditing and Assurance Standards Board
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IPO	Initial Public Offering
ISA	International Standards on Auditing
ISQC	International Standard on Quality Control
IT	Information Technology
JSC	Joint-Stock Company
LLC	Limited Liability Company
MDL	Moldovan Lei
MOF	Ministry of Finance
MSE	Moldovan Stock Exchange
NAS	National Accounting Standards
NSA	National Standards on Auditing
NBM	National Bank of Moldova
NCFM	National Commission on Financial Markets
OECD	Organization for Economic Development and Cooperation
PIE	Public Interest Entity
PPA	Public Property Agency, subordinated to Ministry of Economy
ROSC	Report on the Observance of Standards and Codes
SCA	Savings and Credit Association

SEEPAD	South-Eastern European Partnership on Accountancy Development
SIIS	State Inspectorate of Insurance Supervision
SME	Small and Medium Sized Entities
SMO	Statement of Membership Obligations
SOE	State-Owned Enterprise
USAID	United States Agency for International Development
USD	United States dollar

CURRENCY: MOLDOVA LEI (MDL)
1 USD = 12,450 MDL as of June 10, 2013

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Executive Summary

- 1 **This assessment of accounting and auditing practices in Moldova is part of a joint initiative that is implemented by the World Bank and the International Monetary Fund to prepare Reports on the Observance of Standards and Codes (ROSC).** The assessment focuses on the strengths and weaknesses of the accounting and auditing environment that influence the quality of corporate financial reporting, and includes a review of both statutory requirements and actual practice.
- 2 **The strategic objective of this task is to support the Government of Moldova in its efforts to improve the business environment, an area that is also covered in the current and upcoming Country Partnership Strategy of the World Bank and Moldova.** Shortcomings in Moldova's investment climate are limiting the profitability of businesses, and with that, the prospects of attracting new foreign investment and promoting exports, both of which are important preconditions for achieving sustainable growth. Better reporting and governance standards by business entities would foster greater confidence among local and foreign investors and the timely provision of reliable financial information by business entities should make it easier to borrow or raise equity.
- 3 **This assessment was drawn up at the request of the Government of Moldova and builds on the previous Accounting and Auditing ROSC that was prepared in 2004.** The 2004 ROSC had the following objectives: (i) to spell out the ingredients of a good set of national accounting and auditing practices; (ii) to assess how Moldovan practices and its accounting profession perform relative to these practices, and (iii) to lay out the reforms needed to bring those practices and the profession into compliance with the generic model of good practices. In contrast, this report assesses the improvement in practices and professional performance since 2004 and develops steps for further reforms that take account of the human and financial resource constraints in Moldova, while maintaining the longer-term objectives of complying with international good practices and the EU *acquis communautaire*.

Country Context

Moldova is the second poorest country in Europe. After declaring its independence from the former Soviet Union in August 1991, Moldova became a republic with a constitution that provides for a multiparty democracy. Moldova has a small base of human resources on which to develop the country's economy in that it has a population of 3.6 million and a GDP of 7,000 million USD as of 2011. Furthermore, there is very limited private investment, partly due to a poor business climate and investment prospects, as well as perceived issues with the judicial system. As a result, the country has a relatively small economic base, which contributes modestly to exports and job creation. In addition, political tensions seem to create significant uncertainties that could discourage foreign direct investment and local long-term investment.

Moldova survived the 2008 crisis reasonably well and managed to post an average growth rate above 6 per cent in 2010-2011. The growth was mainly fuelled by a significant inflow of remittances from migrant workers which led to a rapid increase in consumption and private investments in the form of residential construction. It is forecasted that the Moldovan workforce will shrink by 11% in the coming decade due to aging, longer education periods and migration; this remittance-led growth, which keeps the economy vulnerable to external shocks, is not sustainable. It is therefore essential for Moldova to seek to maximize the development gains from migration and channel the corresponding funds to other engines of growth. This requires a favourable business climate.

The EU is the destination for approximately 47% of Moldovan exports, and is the source of around 20% of remittances to the country. Spill-over from the on-going Eurozone crisis is expected to cause a new slowdown in Moldova's GDP growth rate.

- 4 **In Moldova, all companies are required to prepare financial statements regardless of their size or legal form.** There are 45 public-interest entities (PIEs) and around 50,000 active entities. 569 entities are obliged to have their financial statements audited. This figure comprises 524 joint-stock companies and all PIEs.
- 5 **There has been significant progress since 2004 to improve the statutory framework for accounting and auditing¹.** The Government has implemented reforms consistent with good international practices and the *acquis communautaire*. Major reforms in accounting since 2004 include: the adoption of a new accounting law effective from 2008; the requirement that PIEs prepare financial statements in accordance with IFRS with effect from 2012; the establishment of a Financial Statements' Information Service (hereafter Public Registry) for the collection and public availability of financial statements; and the ongoing development of a new set of National Accounting Standards to align them more closely with EU accounting directives and IFRS. Major reforms in auditing since 2004 include: the adoption a new law on auditing activity effective from 2008; the implementation of International Standards on Auditing and Code of Ethics² for auditors with effect from 2012; the establishment in 2008 of an Audit Oversight Council; and the strengthening of requirements for the certification and professional development of auditors.
- 6 **Implementation and enforcement of these reforms has been hampered by major capacity and resource constraints.** Moldova's strategy for bringing the accounting and auditing statutory framework to international levels by aiming for convergence with EU requirements is welcome. Nevertheless, it is also important for Moldova to balance this long-term aim with the constraints facing the country. In particular, there is still poor awareness of the importance of accurate and transparent disclosure of financial information, the Ministry of Finance has limited capacity and resources in setting policy for the implementation of the standards, professional accountancy education needs upgrading and strengthening, and the

¹ The status of implementation of the 2004 ROSC A&A Recommendations is presented in Annex 1

² The official versions of IAASB, IFAC.

public oversight system still has limited capacity. This report should be read in light of these significant constraints facing the Government and business community.

- 7 **Transparency requirements have been greatly improved but compliance is still very weak. The Public Registry, responsible for collecting and publishing the financial statements of companies, is overburdened with many responsibilities and too little capacity and resources putting compliance with the Accounting Law at risk.** These responsibilities not only include publishing the financial statements of all enterprises registered under any legal form, but also collecting, processing and summarizing financial statements, supervising the observance of reporting requirements and organizing seminars on the preparation and presentation of financial statements. Despite the legal requirement to file and publish financial statements at the Public Registry, the Registry currently collects financial statements without actually publishing them. This reflects the significant lack of system and human resources at the Public Registry. Transparency is also hampered by lack of enforcement of the requirement for companies subject to statutory audit to publish financial statements on corporate websites. Only a limited number of financial statements are actually available on official company websites.
- 8 **The quality of financial statements is uneven.** The financial statements of banks are generally of a good quality, reflecting intensive supervision of the banking sector by the National Bank of Moldova. However, those of non-banks, as submitted to the Public Registry, are generally incomplete particularly as regards disclosures.
- 9 **The mandatory implementation of IFRS by non-bank PIEs from 2012 is a challenge.** Non-bank PIEs are generally not very well prepared to implement IFRS and the National Commission on Financial Markets lacks the technical resources to support them. There is also a need for proper guidance on the tax implications of using IFRS.
- 10 **Governance arrangements in joint-stock companies, particularly in PIEs, need enhancing for improved financial reporting.** In line with the EU's Statutory Audit Directive, Audit Committees are mandatory for PIEs. Currently, joint-stock companies are required to have so-called Censors' Committees; however, their roles and lines of accountability need to be clarified in line with the requirements of the EU Statutory Audit Directive.
- 11 **Major state-owned enterprises with public-interest character are not classified as PIEs and are exempt from the audit and transparency requirements expected from PIEs.** Significant SOEs should be regarded as being of public interest and accordingly be required to observe rigorous transparency principles. Significant SOEs should observe the same accounting and auditing standards and regulations as PIEs and the Government should require SOEs of public interest to have annual audits. A legislative amendment for requiring significant SOEs to have their financial statements audited is underway. There is a need to undertake a study of State-owned enterprises (SOEs) governance arrangements which will enable the Government to establish appropriate mechanisms for accountability and oversight of SOEs. This analysis should also include an assessment of the training and technical needs of public authorities for better monitoring and oversight of SOEs.
- 12 **The Ministry of Finance is in the process of preparing a new set of National Accounting Standards (NAS) for non-PIEs; these are likely to be a heavy burden for small**

enterprises. The draft standards are consistent with the provisions of the EU's Fourth Directive on the annual accounts of certain types of companies in many respects while the Seventh Directive's on consolidated financial reports requirement for consolidation is not incorporated.³ NAS are being prepared mainly on the basis of IFRS and so are likely to lead to a heavier reporting burden for small entities as the simplification applies to reporting requirements only and the accounting requirements such as recognition, valuation and measurement are still applicable. Simplified accounting and reporting requirements for smaller entities are not incorporated in the new NAS and no intention to develop a new accounting standard for smaller entities was expressed.

- 13 **Auditing is regulated by the Law on Auditing Activity which differs from the EU's Statutory Audit Directive in certain aspects.** In particular, the Law regulates activities other than statutory audits and as such regulate various consulting-type services provided by licensed statutory auditors; such services, when offered by consulting firms, are not regulated. In addition, the Law does not specify all the grounds on which an auditor may be dismissed or those on which the auditor may not be dismissed.
- 14 **The Law on Auditing Activities foresees the implementation of the International Standards on Auditing (ISA) from 2012 onwards; this has been and is likely to be a challenge for most auditors.** There is a need to further develop the capacity of the profession. Sole practitioners and small audit firms face a greater challenge as they often lack the resources to keep up with technical developments in auditing.
- 15 **Most elements of an audit oversight system as prescribed in the EU's Statutory Audit Directive are incorporated in the Law on Auditing Activity. However, implementation of the law is fragmented and challenging.** Alongside the Audit Oversight Council (AOC) established in 2008, other departments and entities also perform audit oversight activities such as certification, maintenance of the register of auditors and monitoring of the Continuous Professional Development requirements. In addition, the Control and Verification Service of the AOC lacks the necessary technical, financial and other resources to perform proper quality assurance reviews of auditors. This report acknowledges that Moldova is willing to develop the institutional capacity for this rather complex and relatively new mechanism and that this can only be expected to become functional at an acceptable level in the medium term and with a suitable institutional structure and adequate funding.
- 16 **Professional accountancy associations have only very recently started conducting quality assurance reviews of their members and the impact of their reviews on the quality of their members' work is limited.** The professional associations have expressed a wish for greater cooperation with the Government, regulators and stakeholders to help address common challenges with the accounting and auditing framework.

³ Two directives form the core of the EU *acquis communautaire* on corporate sector financial reporting: the Fourth EU Company Law Directive (1978) ("the Fourth Directive") which covers annual accounts⁴³ of companies, and the Seventh EU Company Law Directive (1983) on consolidated accounts ("the Seventh Directive"). For a recent consolidated version of the Fourth EU Company Law Directive, see <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:1978L0660:20090716:EN:PDF>. For a recent consolidated version of the Seventh EU Company Law Directive, see <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:1983L0349:20090716:EN:PDF>

- 17 **The audit certification program managed by the Ministry of Finance has significantly improved since 2004, though some concerns remain over the transparency and adequacy of the process.** Examinations are now in written form and there appears now to be greater conformity with IFAC’s International Education Standard (IES) 6 on the Assessment of Professional Capabilities and Competence. Furthermore, examination candidates holding a foreign qualification are accorded exemptions from certain exams depending on the qualification held. However, concerns remain about the adequacy of the certification process, in particular with respect to the quality of the pool of audit certification examination questions.
- 18 **There is a significant training gap in accounting education and qualification levels.** There are relatively few accountants with the adequate skills often obtained through international qualifications needed to satisfy the reporting obligations under NAS and IFRS, both of which are relatively complex. In addition to the three professional associations that provide training to certificate holders as well to students and other interested parties, there are nine universities in Moldova that award degrees in accounting. Most of the universities’ bachelor degrees curricula currently do not include IFRS and ISA and will need significant revision after the new NAS have been adopted.
- 19 **The following principles should underpin the efforts of the authorities and the profession to reform and strengthen Moldova’s corporate financial reporting, taking into account the substantial economic and human resource constraints facing the country:**
- a. *Strengthening existing mechanisms*, to the extent that they are conceptually sound and sustainable, rather than seeking a complete overhaul of existing mechanisms;
 - b. *Simplifying accounting and auditing obligations*, whenever possible, especially for SMEs, to reduce the cost of doing business in Moldova for modest-sized businesses;
 - c. *Adopting international standards*, whenever practicable, as opposed to developing custom-made solutions that are costly and difficult to maintain, and which do not convey the same level of confidence as international ones;
 - d. *Consolidating the institutional framework*, to eliminate duplication of efforts and foster synergy between regulatory agencies for best results.
 - e. *Supporting all measures with capacity building and awareness raising activities*, to ensure that stakeholders affected by accounting and auditing regulation, enforcement and practices, including the users of financial information, have a sound theoretical and practical understanding of the subject matter.
- 20 **The main recommendations of the report are as follows:**
- (1) The Government should review the accounting and auditing laws to (i) remove internal inconsistencies and (ii) achieve closer alignment with the EU Directives. The latter includes the establishment of appropriate thresholds for simplified accounting and financial reporting for smaller entities to reduce their reporting burdens. The Ministry of Finance should consider the alternative of adopting the “IFRS for SMEs”, which is a simplified version of IFRS developed by the IASB and designed for entities that have

no public accountability, for large and medium non-PIEs, with a longer-term view of further simplifying NAS for smaller entities.

- (2) The Government and its regulatory and tax authorities should build capacity to support to PIEs on the implementation of IFRS and guidance on the resulting tax implications. The adoption of IFRS for accounting will affect the taxable income and the authorities should build up capacity in IFRS and have a proper process in place to allow taxpayers overcome the inevitable difficulties relating to IFRS implementation.
- (3) The Government should limit the requirements for disclosure to only entities subject to statutory audit during an initial period, expanding this requirement to cover more companies over time. With its current resource base the Public Registry is not able to enforce accounting standards or to fulfil the requirements relating to filing and publication of financial statements.
- (4) The Government should revisit the organization of the audit oversight system in light of Annex 4 of this report and considering the human and financial resource constraints. Currently the audit oversight system does not have adequate funding and human resources to operate in a manner consistent with the EU's Statutory Audit Directive. As a short-term measure, the Government could adopt a strategy of initially limiting the quality assurance activity to a limited number of auditors and audit firms, adopting a risk-based approach that would cover a balanced mix of auditors ranging from PIE auditors to small audit firms. It should look for ways to collaborate more closely with the professional associations and should consider requesting the support of development partners for a technical assistance program, which would include training and preparation of adequate secondary legislation.
- (5) The Government should conduct a specific analysis of State-owned enterprises (SOEs) governance arrangements; this will enable establishment of appropriate mechanisms for accountability and oversight of SOEs. This analysis should also include an assessment of the training and technical needs of public agencies for better monitoring and oversight of SOEs. Significant SOEs should be regarded as being of public interest and accordingly be required to observe rigorous transparency principles.
- (6) The Ministry of Finance and professional associations should collaborate in creating a national training program for accountants and increasing the reliability of the local auditing qualification. Areas of collaboration could include joint revision of the examination syllabus and the introduction of a quality assurance mechanism.
- (7) The professional associations should unify their efforts to promote the profession vis-à-vis the Government, regulators and the business community and engage in awareness raising activities.
- (8) In the longer-term the Government should consider making it mandatory for certified auditors to be members of professional associations adhering to certain standards. The Government should also consider delegating the role of CPD monitoring to qualifying professional associations for their members. Such delegation would contribute to a more efficient use of scarce resources and capacity in the country, and will be in line with international good practices.

- (9) The professional associations should be more proactive in the implementation of the accounting and auditing reforms through increased quality and improved perception of the profession by the business community by making twinning arrangements with institutes and associations in other countries, establishing peer-review mechanisms within the respective associations for better quality audits, committing to compliance with IFAC’s Statements of Membership Obligations or similar requirements, partnering with industry, trade and commerce chambers to engage in dialogue with the Government and regulators to facilitate the accounting and auditing reforms as well as organizing knowledge sharing and awareness raising activities.
- (10) Universities should update their accounting and auditing curricula at both bachelor and master degree levels to include IFRS, ISA, business ethics and governance and new NAS when adopted. Universities should also look for ways of collaborating with the professional associations and accredited institutions for CPD training.
- (11) The Ministry of Finance, in collaboration with the professional associations, should review the content of CPD programs with a view of upgrading in line with the needs of the new accounting framework. Furthermore, the CPD should also be used as a tool for re-training the professionals, especially in the context of new NAS adoption, IFRS and ISA adoption.
- (12) In the longer run, better corporate governance and accountability arrangements for all PIEs—including the most significant SOEs—will be critical to a sustainable, high-quality corporate financial reporting and auditing environment. This will involve, for instance, establishing audit committees as well as adopting a strong corporate governance code. Transitioning toward such a system will require a significant effort to raise awareness on the benefits of improved corporate governance, changes to the law, and technical support to PIEs so that they acquire the necessary capacity.

Next Steps

Implementation of the recommendations set out in this report will require that the Government: i) update the Country Strategy and Action Plan for corporate financial reporting by also differentiating between longer-term strategy and shorter-term actions in light of the findings and recommendations and policy options presented in this ROSC report, ii) revise the institutions and persons that will be responsible for the implementation and iii) evaluate the need for additional resources. The Government should work to secure resources to achieve the common goal of enhancing the quality of financial reporting. The World Bank is committed to supporting Moldova in this ongoing reform process.

Summary of Policy Recommendations

Action	Responsibility	Timing		
		Short-term (less than 1 year)	Medium- term (1 to 3 years)	Long-term (3 to 5 years)
<i>Statutory Framework</i>				
1. The Ministry of Finance should, after a thorough analysis of the businesses, establish appropriate thresholds for simplified accounting and financial reporting requirements, so reducing the burden on SMEs	MOF	X		
2. The Government should provide proper guidance on taxation issues for banks and other commercial entities producing financial statements in accordance with IFRS	MOF Tax Authority	X		
3. The Government should review the accounting and auditing requirements in all laws and regulations to remove inconsistencies and introduce clarifications	MOF, other competent authorities		X	
4. The Government should revisit the organisational structure of the audit oversight system so that it has adequate funding and human resources to operate effectively and in a manner consistent with the EU's Statutory Audit Directive	MOF			X
5. The Government should establish a sequenced strategy for a better oversight of the profession, through initially limiting quality assurance to a limited number of auditors adopting a risk-based approach covering a balanced mixed of auditors, identifying funding options, collaborating with professional associations and seeking donor support.	MOF AOC		X	

Action	Responsibility	Timing		
		Short-term (less than 1 year)	Medium- term (1 to 3 years)	Long-term (3 to 5 years)
6. The Law on Auditing Activity should be revised to make it more consistent with the EU Statutory Audit Directive	MOF			X
7. The Government, after analysing the weaknesses and needs of the SOE sector, should strengthen mechanisms for the accountability and oversight of SOEs, including enhanced financial reporting, transparency and audit requirements.	MOF, MOE and PPA			X
8. Engage a dialogue to raise awareness on the benefits of corporate governance and enhance existing practices especially as they relate to financial reporting and auditing within all PIEs, including significant SOEs	NCFM, MOF, PPA, stock exchange, and business association(s)	X		
<i>The Profession</i>				
9. The Government and professional associations should collaborate to increase the reliability of the local accountancy profession through revision of the syllabus, introduction of a quality assurance mechanism for the preparation and evaluation of examination questions, etc.	MOF Professional Associations		X	
10. There is a need to structure and standardize the additional examinations by the NBM and NCFM for the certification of auditors for the audit of financial institutions, insurance companies and the securities market. In the longer term, such industry-specific examinations could be abolished.	NBM and NCFM			X
11. The professional associations should promote the profession through	Professional			X

Action	Responsibility	Timing		
		Short-term (less than 1 year)	Medium- term (1 to 3 years)	Long-term (3 to 5 years)
awareness raising activities and commitment to higher professional standards.	Associations			
12. Professional associations should unify their efforts to organize technical training events.	Professional associations		X	
<i>Accounting and Auditing Standards</i>				
13. The national accounting standard-setting process should be made more participatory and sustainable	MOF	X		
14. The process for the acceptance and entering in force of the international accounting and auditing standards should be streamlined	MOF	X		
<i>Monitoring and Enforcement</i>				
15. The capacity of the Public Registry should be strengthened	National Bureau of Statistics			X
16. The Government should limit the disclosure requirement to audited companies only and expand the requirement to other companies over time.	MOF	X		
17. The Public Registry should increase coordination with tax offices and registration chambers for enforcement of the disclosure requirement.	National Bureau of Statistics	X		
18. The Government should seek donor support to provide the audit oversight and quality assurance system with the necessary resources and tools	Government, MOF, NCFM, NBM		X	

Action	Responsibility	Timing		
		Short-term (less than 1 year)	Medium- term (1 to 3 years)	Long-term (3 to 5 years)
19. Regulators should pursue and enhance active role in the enforcement of the accounting and auditing regulations	NBM and NCFM		X	
20. Regulators should increase support to non-bank PIEs to implement the 2012 requirement for IFRS	NCFM	X		
21. Regulators represented on the AOC should help more proactively resolve issues relating to audit oversight	NBM and NCFM		X	
<i>Education and Training</i>				
22. Universities should update their accounting and auditing curricula at both bachelor and master degree levels to include IFRS, ISA, business ethics and governance and new NAS when adopted.	Universities and Ministry of Education		X	X
23. Universities should collaborate with professional associations and accredited institutions for CPD training.	Universities and Professional Associations		X	
24. The Ministry of Finance, in collaboration with the professional associations, should review the content of CPD programs with a view of upgrading in line with the needs of the new accounting and auditing framework.	MOF and Professional Associations	X		
25. The staff of regulators, including those of the NBM, NCFM and MOF, should receive practical training to enforce accounting, financial reporting and auditing standards	MOF, NBM and NCFM	X		

I. Introduction

- 1 This assessment of accounting and auditing practices in Moldova is part of a joint initiative that is implemented by the World Bank and the International Monetary Fund to prepare Reports on the Observance of Standards and Codes (ROSC).⁴ The assessment focuses on the strengths and weaknesses of the accounting and auditing environment that influence the quality of corporate financial reporting, and includes a review of both statutory requirements and actual practice. It uses International Financial Reporting Standards (IFRS) and the International Standards on Auditing (ISA) as benchmarks and draws on international experience and good practices, as well as the European Union's *acquis communautaire*⁵ given Moldova's strategy of further integration with the European Union.⁶
- 2 In the medium term, improvement in Moldova's business environment⁷ is essential to put the country on a sustainable growth path. The strategic objective of this task is to support the Government in its efforts to improving the business environment in Moldova by contributing to an elevated level of competitiveness and productivity across the economy through business enterprises providing timely and reliable financial information, formulated according to internationally accepted standards, while also observing standards of governance that create confidence among local and foreign investors. These will enable companies to have greater access to finance, invest and increase their productivity.⁸
- 3 This assessment was drawn up at the request of the Government of Moldova and builds on the previous Accounting and Auditing ROSC that was prepared in 2004⁹. The 2004 ROSC had the following objectives: (i) to spell out the ingredients of a good set of national accounting and auditing practices; (ii) to assess how Moldovan practices and its accounting profession perform relative to those practices, and (iii) to lay out the reforms needed to bring those practices and the profession into compliance with the generic model of good practices. In contrast, this report assesses the improvement in practices and professional performance since 2004 and develops steps for further reforms that take account of the human and financial resource constraints in Moldova, while maintaining the longer-term objectives of complying with international good practices and the EU *acquis communautaire*.
- 4 This assessment also supports the World Bank's Country Partnership Strategy (CPS) for Moldova. Both the current CPS for 2009-2013 and the upcoming CPS for 2014-2017 contain

⁴ See www.worldbank.org/ifa/rosc_aa.html

⁵ Specifically the EU's First, Second, Fourth, Seventh and amended Eighth Company Law Directives, the European Commission's (EC) Recommendations on Statutory Auditors' Independence and Quality Assurance, as well as the Transparency Directive, the IAS Regulation and the Bank and Insurance Accounts Directives.

⁶ Negotiations with the EU on an Association Agreement, a Deep and Comprehensive Free Trade Agreement (DCFTA) and visa liberalization are progressing.

⁷ In *Doing Business 2013* Moldova ranks 83rd out of 185 economies, 2 places lower than in *Doing Business 2012* but 16 places higher than in *Doing Business 2011*. The average ranking across ECA countries in *Doing Business 2013* was 73rd.

⁸ More information is available in the 2011 Country Economic Memorandum at http://imagebank.worldbank.org/servlet/WDSContentServer/IW3P/IB/2011/12/14/000333037_20111214012758/Rendered/PDF/551950ESW0p1090sclosed0Dec013020110.pdf

⁹ http://www.worldbank.org/ifa/rosc_aa_mdv.pdf

pillars aiming to harness a competitive business environment, including components for improving the business environment and financial intermediation.¹⁰

Country Context

- 5 **Moldova is the second poorest country in Europe.** After declaring its independence from the former Soviet Union in August 1991, Moldova became a republic with a constitution that provides for a multiparty democracy. Moldova has a small base of human resources on which to develop the country's economy in that it has a population of 3.6 million¹¹ and a GDP of 7,000 million USD as of 2011¹². Furthermore, there is very limited private investment, partly due to a poor business environment and investment prospects, as well as perceived issues with the judicial system. As a result, the country has a relatively small economic base, which contributes modestly to exports and job creation. In addition, political tensions seem to create significant uncertainties that could discourage foreign direct investment and local long-term investment.
- 6 **Moldova survived the 2008 crisis reasonably well and managed to post an average growth rate above 6 per cent in 2010-2011.** The growth was mainly fuelled by a significant inflow of remittances from migrant workers, which led to a rapid increase in consumption and private investments in the form of residential construction. It is forecasted that the Moldovan workforce will shrink by 11% in the coming decade¹³ and this remittance-led growth, which keeps the economy vulnerable to external shocks, is not sustainable. It is therefore essential for Moldova to seek to maximize the development gains from migration and channel the corresponding funds to other engines of growth. This requires a favourable business environment.
- 7 **Access to finance by companies in Moldova is limited. Also, a major obstacle is that remittances are not being effectively captured by the banking sector and are not efficiently intermediated to fuel sustainable growth.** Access to finance is a major component of the business environment and plays a key role in the growth of firms. Business Environment and Enterprise Performance Surveys (BEEPS)¹⁴ indicated that: (i) access to finance is a constraint; (ii) only 18% and 30 % of medium and large enterprises have audited financial statements, which is far below the figures of 44% and 71 % reported for respective companies in the region; and (iii) the quality of the available audited financial statements is frequently perceived as being low. The financial sector needs to be further developed. The underdevelopment of the capital market and the lack of public information on the borrower

¹⁰ The relating CPS pillars are as follows: CPS 2009-2013: Improving Economic Competitiveness to Support Sustainable Economic Growth; draft CPS 2014-2017: Increasing Competitiveness.

¹¹ <http://www.statistica.md/category.php?l=ro&idc=103&>

¹² <http://www.statistica.md/newsview.php?l=ro&idc=168&id=3709>

¹³ Country Economic Memorandum: Moldova After the Global Crisis: Promoting Competitiveness and Shred Growth, The World Bank, 4 April 2011.

¹⁴ BEEP is a joint initiative of the European Bank for Reconstruction and Development and the World Bank. It covers a broad range of issues about the business environment.

credit risks available to the banks¹⁵ are major challenges. Furthermore, there is little private insurance activity; private sector pension funds are inactive; and the activity of the stock exchange is limited.

- 8 **The Government is committed to resolve these issues as part of its National Development Strategy Moldova 2020¹⁶ and understands that the private sector will need to be a driver of Moldova's future growth.** Accounting and auditing (A&A) go hand in hand with business environment reforms. One means available to policy makers and entrepreneurs for strengthening the private sector is to enhance the public and external perceptions of Moldovan business entities by enhancing their systems of governance and enhancing the availability and reliability of their financial information, allowing them to have greater access to borrowing from local investors, banks and financing from foreign investors.¹⁷
- 9 **The Government of Moldova has included accounting and auditing in its strategic priorities** and approved an "Action Plan for Accounting and Auditing Development in the Corporate Sector from 2009 to 2011" later extended to 2014. The plan is developed along four main axes: i) improving the financial reporting legal framework, ii) strengthening the main institutions responsible for financial reporting, iii) supporting the audit profession and iv) modernizing the system of education and professional development and public awareness.
- 10 **The progress in improving the accounting and auditing practices in the country and the perception of Moldovan business entities will be gradual, reflecting the human and financial resource constraints facing the Government and the business community.** Still, one objective of this updated Accounting and Auditing ROSC is to help the Government and professional bodies upgrade the accounting and auditing statutory framework and practices.

An Overview of the Private Sector in Moldova

- 11 **In Moldova although around 570 large firms dominate output and employment, micro enterprises and SMEs together employ a significant number of people and generate significant revenue.** Table 1 below shows the number of entities in the main sectors of the Moldovan economy, putting this section's description of the various sectors in context.

¹⁵ Country Economic Memorandum: Moldova After the Global Crisis: Promoting Competitiveness and Shred Growth, The World Bank, 4 April 2011, pp.21.

¹⁶ The National Development Strategy was enacted by the Parliament as a national law.

¹⁷ Several countries have made notable progress in reducing the cost of capital by improving perceptions in the international community, partly through accounting and auditing reforms.

Table 1: Number of business entities by main sector as at January 1, 2012¹⁸

Sector	Number of registered entities	Number of active entities	Total assets, MDL million	% of assets
Public Interest Entities	45	42	53,698	17
Banks (all JSCs) of which	14	14	49,489	15
<i>listed</i>	7	7	37,038	11
Insurance entities, of which	24	24	2,198	1
<i>JSC</i>	9	9	916	0
<i>LLC</i>	15	15	1,282	0
Pension funds	3	-	-	0
Listed entities (all JSC) which are not banks	4	4	2,011	1
State Owned Entities	390	326	32,200	10
<i>State-owned enterprises</i>	274	233	16,900	5
<i>State-owned JSCs</i>	116	93	15,300	5
Other entities	154,063	48,558	237,306	73
<i>Other JSCs</i>	4,532	1,693	12,923	4
<i>Other LLCs</i>	75,934	37,494	150,033	46
<i>Business cooperatives</i>	3,971	1,235	189	0
<i>SCAs and Microfinance organizations</i>	436	399	2,145	1
<i>Others</i>	69,190	7,737	72,016	22
Total	154,498	48,926	323,204	100

Note 1. The number of insurance companies as of January 1, 2013 declined to 17 as their licences were either withdrawn or expired.

Note 2. For the purpose of this table, active corporate entities are considered those that submitted their financial statements to the Public Registry.

Note 3. The significant difference between registered and active entities is due to a large extent to the sole trader companies that are not required to prepare general purpose financial statements. In addition, the procedures for liquidation of a company are burdensome and owners prefer to leave them in “stand-by”; these entities also often do not present financial statements. The systems of the public registry are not integrated with the other registries such as the tax authority and the registration chamber and accordingly the above numbers may differ

¹⁸ Prepared based on the information received from the Public Registry, State Registration Chamber as well as on information gathered by the ROSC team.

in that it is difficult to identify the entities required to submit reports without systematic reconciliation of various registries.

Note 4. 41 state-owned enterprises and 23 state-owned JSCs are inactive in that they do not submit financial statements. These 41 inactive state-owned enterprises consist of 7 entities registered in Ukraine, 5 registered in Moldova's autonomous region Gagauz Yeri, 16 that are under liquidation and 13 dormant companies. The 23 inactive state-owned JSCs consist of 18 entities under liquidation and 5 dormant companies.

- 12 **The banking sector is fairly well regulated by the National Bank of Moldova (NBM).** The NBM issues prudential regulations and monitors the banks' prudential and financial reporting. Although the sector is perceived to be adequately regulated and monitored, financial intermediation remains limited and various reports suggest that inefficient allocation of financial resources is a real constraint to economic growth in Moldova. In addition, it is estimated that only 10 per cent of remittances remain in the banking sector as deposits¹⁹ because of the constrained banking environment and poor investment climate. As a result, most remittances do not find their way into the formal financial system and from there to investments in businesses. Improving access to private finance for investment by stimulating bank credit, developing the capital market and improving financial intermediation - particularly for SMEs - are of crucial importance for Moldova's economic prospects.
- 13 **The Moldovan non-banking financial sector essentially comprises the insurance sector regulated by the National Commission on Financial Markets; it also includes the savings and credit associations (SCAs), leasing companies and micro-finance organizations.** The insurance sector is growing and becoming more concentrated. At the end of 2011, there were 24 insurance companies with annual premium income of around US\$82 million; in 2003 there were 50 insurance companies with annual premium income of around US\$25 million. The number of insurance companies operating in Moldova continues to decrease; at the time of this report this number was 17. There are approximately 370 SCAs, with total assets of approximately US\$ 24 million and 48 micro-finance organizations with total assets of approximately US\$ 149 million.
- 14 **Private pension funds are inactive.** There are three private pension funds registered in accordance with and regulated by the Law on non-state pension funds. However, none of them have any funds or other assets under administration.
- 15 **The securities market is extremely shallow.** Currently only 11 companies are listed on the MSE none of which entered the market through an Initial Public Offering (IPO). The volume of transactions traded on the MSE is low due to weak demand and accordingly no securities are traded at all on some days. In addition, five attempted IPOs failed due to a lack of demand. A second stock exchange, the Chisinau Stock Exchange (CSE), was recently established, however, it is currently inactive and no companies' securities are listed. The National Commission on Financial Markets (NCFM) has the mandate to regulate the listed companies on the stock exchange, as well as all the other JSCs and professional participants at securities market, including brokers, dealers and auditors allowed to audit professional participants; in addition the NCFM regulates the insurance sector, SCAs and micro-finance organizations.

¹⁹ Moldova Competitiveness Development Policy Operation Project Document, World Bank, pp.14

- 16 **The industrial sector is important to the Moldovan economy but its share in GDP is small.** In 2011 industrial production was approximately MDL 30.6 billion, accounting for 13.7% of GDP and grew in year-on-year terms for the first time since 2001. Processing industry accounted for 83% of the industrial sector, of which 45% was attributable to food and beverages processing and 38% to non-food processing. Despite a decline in industrial production over the past decade the volume of industrial exports has increased by a factor of four to US\$ 2.2 billion. The rate of growth of industrial exports in 2011 was 43.8% and reached a level only previously attained prior to the global financial crisis.
- 17 **SMEs play a significant role in the economy of Moldova.** SMEs comprise 97.5% of business entities, employ around 58% of employees and generate about 35% of the total sales revenue reported for the economy. Given the importance of SMEs, the Government has declared its willingness to base its policy on SMEs on the principle of "think small first" as included in the EU's Small Business Act which explicitly mentions the need to promote an entrepreneurial culture and create an enabling environment for SMEs.
- 18 **The State-Owned Entities (SOEs) play an important role in the economy of Moldova accounting for approximately 10% of the corporate sector's assets.** There are approximately 274 SOEs with the legal form of a state enterprise having 100% state ownership and 116 SOEs incorporated as joint-stock companies having greater than 50% state ownership. Many SOEs are included in the Government's privatisation program, and transparent and reliable financial reporting and auditing of SOEs as well as sound corporate governance arrangements are seen as important to the success of the program. The total value of public assets privatised during 2011 and 2012 was MDL 116.7 million²⁰ and MDL 140.0 million²¹ respectively.

²⁰ PPA's Annual Report for 2011.

²¹ <http://www.app.gov.md/en/newslist/0/1/3437/>

II. Institutional Framework

A. Statutory Framework

- 19 **There has been significant progress since 2004 in improving the statutory framework for accounting and auditing²².** The Government implemented reforms consistent with good international practices and the *acquis communautaire*. Major reforms in accounting since 2004 include: the adoption of a new accounting law effective from 2008; the requirement that PIEs prepare financial statements in accordance with IFRS with effect from 2012; the establishment of a Financial Statements' Information Service (Public Registry) for the collection and public availability of financial statements; and the ongoing development of a new set of National Accounting Standards (NAS) to align them more closely with IFRS and the EU accounting directives. Major reforms in auditing since 2004 include: the adoption a new auditing law effective from 2008; the implementation of International Standards on Auditing and Code of Ethics²³ for auditors with effect from 2012; the establishment in 2008 of an Audit Oversight Council; and the strengthening of the requirements for the certification and professional development of auditors.
- 20 **These accounting and auditing reforms were championed by the Ministry of Finance with assistance from the donor community and development partners.** The World Bank and the European Union are the main supporters of Moldova in the area. Since the completion of the ROSC A&A in 2004, the World Bank has continued to support reforms in corporate financial reporting in Moldova: (i) the Bank offered some policy advice related to the development of the new Accounting and Auditing Laws and Country Strategy and of the Accounting and Auditing Development Plan in the Corporate Sector for 2009-2011 for implementation of corporate financial reporting reforms based on the ROSC recommendations; (ii) the Financial Sector Reform and Strengthening (FIRST) Initiative funded Accounting Reform Project (2005-2006); (iii) the South-South Experience Exchange between Practitioners (SEETF) project for Moldova, supporting corporate financial reporting exchange program (August 2009 - May 2010); (iv) the on-going regional REPARIS program is supplying significant knowledge and experience of reforms to key stakeholders in corporate financial reporting. In addition to these, the EU funded the “Support for the Implementation of Agreements between the Republic of Moldova and the European Union” Project during 2008-2010. However, there is no systematic in-country approach to the reforms in the area of corporate financial reporting and the results do far have been limited. This issue will be partly addressed under the new Strengthening Auditing and Reporting in Countries of the Eastern Partnership program that will be launched by the World Bank in 2013 and will support some reform activities at the national level in Moldova.
- 21 **Resource and capacity constraints have hampered the implementation and enforcement of these reforms, requiring further reforms and system strengthening.** There is still poor awareness of the importance of accurate and transparent disclosure of financial information, the Ministry of Finance has limited capacity and resources in setting policy for the

²² The status of implementation of the 2004 ROSC A&A Recommendations is presented in Annex 1.

²³ The official versions of IAASB, IFAC.

implementation of the standards, professional accountancy education needs upgrading and strengthening, and the public oversight system still has limited capacity. These aspects will be diagnosed in detail in the remainder of the report.

- 22 **Moldova’s strategy for bringing the accounting and auditing statutory framework to international levels by aiming for convergence with EU requirements is welcome. Nevertheless, it is also crucial for Moldova to take account of the constraints mentioned above in implementing this strategy.** This assessment acknowledges that a sound accounting and auditing framework is not easy to build and some of the features of a modern framework have been recently developed and pose challenges even for countries more advanced in their accounting and auditing practices. Accordingly, in parts, this assessment suggests that Moldova should do less but do it well in the short-term while maintaining its longer-term goal of aligning its A&A framework with the EU *acquis*.

Legal forms and governance of companies

- 23 **Moldovan company law, The Law on Enterprises and Entrepreneurship, establishes the legal forms of enterprise including how they may be established, governed and wound up.** The main types of legal entity found in Moldova include: individual enterprises, joint-stock companies (JSCs) and limited liability companies (LLCs). There is separate legislation for each type of corporate entity, detailing applicable rules, procedures and governance arrangements as described further below. Table 2 below shows the number of entities by legal form, providing the context for this section’s description of the governance arrangements applicable to the various legal forms of entity.

Table 2: Number of entities by legal form

Legal Form	Number of registered entities, as at January 1, 2013	Number of registered entities, as at January 1, 2012	Number of active corporate entities, as at January 1, 2012
Joint stock company	4,695	4,675	1,813
Limited liability company	80,438	75,997	37,557
Individual enterprise	65,223	63,851	4,396
Non commercial entity	1,688	1,503	1,454
Cooperatives	3,991	3,971	1,235
State enterprise	274	274	233
Municipal enterprise	1,211	1,153	398
Other	3,133	3,074	1,840
Total	160,653	154,498	48,926

- 24 **The governance of JSCs is defined in the Law on Joint-Stock Companies** and requires that a general meeting of shareholders takes place at least once a year to: i) appoint, remove and remunerate the Board of Directors, ii) select the members of the so-called Censors' Committee, iii) appoint the statutory auditor, and iv) approve the annual financial statements and annual reports of the Censors' Committee and Board of Directors.
- 25 **A JSC Censors' Committee is charged with exercising control over the financial and economic activities of the company including checking and confirming the year-end financial statements.** Members of the Censors' Committee should be qualified in the fields of accounting, finance or economics but cannot be members of the executive body or employees in the accounting department. The role of a JSCs Censors' Committee is somewhat unclear in that they are not an internal audit function as they are appointed by and report to shareholders, they are not an external audit function as they report separately from external audit and appear to exercise a control function, and they are not an Audit Committee in that they do not appear to have a formal relationship with the external auditors. The requirement for a Censors' Committee should be removed. If shareholders wish for an internal audit function, they could at a general meeting require that one be established. If shareholders of JSCs that are not currently required to have a statutory audit wish for their JSC to have a voluntary audit, they could at a general meeting require that one be performed. In addition, for consistency with the requirements of the EU's Statutory Audit Directive, Audit Committees should be mandated for PIEs.
- 26 **Governance of LLCs is defined in the Law on Limited Liability Companies** which requires a general meeting of associates equivalent to that of shareholders in a JSC at least once a year to: i) appoint, remove and remunerate the Board of Directors and Censor, ii) decide on the distribution of the profits between associates, and iii) approve the Board's annual report, annual financial statements, Censor's annual report, and the statutory auditor's annual report. A Censor is required only when the number of owners exceeds 15.
- 27 **Governance of SOEs is uneven.** Some SOEs have the legal form of a JSC whereas other SOEs have the legal form of a state enterprise. The JSC SOEs are governed by the JSC Law whereas the state enterprises are governed by the Law on State Enterprises. Strategic management responsibilities for SOEs lie with the responsible line ministries while the Public Property Agency (PPA)²⁴ is responsible for ownership functions including analysis of financial statements and assessment of SOEs' performance. JSC SOEs where the state holds over 50% of shares and State enterprises are also monitored by the MOF's financial monitoring department (the PPA includes in their annual reports and financial analyses those JSCs where the state holds over 30% of shares). The governance of the state enterprises is exercised by a board of directors and an executive body (administrator). The board members are appointed by the founding institution; the executive body is appointed by founding institution based on the Board's proposal, meaning that the state ownership role is executed through the founder. Governing bodies of JSC SOEs are the general meeting of shareholders, board of directors, executive body and censors' committee as per JSC Law. The Law on JSCs does not include any provisions specific to SOEs. SOEs are not obliged to establish audit committees.

²⁴ The Public Property Agency is established under the Ministry of Economy.

- 28 **Major SOEs, which have a public interest character and important assets and revenues, are not classified as PIEs and do not have their accounts audited.** Table 3 below illustrates the accounting and auditing requirements and the transparency levels with respect to public availability of data in top ten SOEs in Moldova.

Table 3: A&A Requirements in Top 10 SOEs with Largest Asset Size²⁵

Entity	Sector	State share %	Thousands MDL		A&A requirements		Availability of the financial statements	Managing Authority
			Total assets	Total Revenue	Accounting	Audit		
1. JSC Banca de Economii (PIE)	Banking	56	5,841,010	666,003	IFRS	Mandatory	Yes	Ministry of Finance
2. JSC Moldtelecom	Telecommunication	100	5,445,160	2,238,624	NAS	Mandatory	No	Public Property Agency
3. SE Administratia de Stat a Drumurilor	Road infrastructure	100	3,821,397	59,677	NAS	Not required by Law. Done for 2011.	No	Ministry of Transport and Road Infrastructure
4. JSC Centrala electrica cu termoficare nr.2	Electricity generation	100	3,101,095	1,493,413	NAS	Not required by Law	No	Ministry of Economy
5. SE Calea Ferata din Moldova	Railways	100	2,609,169	1,281,826	NAS	Not required by Law	No	Ministry of Transport and Road Infrastructure

²⁵ As of January 01, 2012

Entity	Sector	State share %	Thousands MDL		A&A requirements		Availability of the financial statements	Managing Authority
			Total assets	Total Revenue	Accounting	Audit		
6. SE Moldelectrica	Electricity sector transmission	100	2,252,589	298,490	NAS	Not required by Law	No	Ministry of Economy
7. JSC Centrala electrica cu termoficare nr.1 din Chisinau	Electricity generation	100	1,089,647	216,724	NAS	Not required by Law	No	Ministry of Economy
8. JSC Retele de distributie NORD	Electricity distribution	100	878,103	877,725	NAS	Not required by Law	No website identified	Ministry of Economy
9. JSC CET-NORD	Electricity generation	100	654,477	247,816	NAS	Not required by Law	No	Ministry of Economy
10. SE Aeroportul International Chisinau	Airport	100	637,289	188,267	NAS	Not required by Law. Done for 2011.	No	Public Property Agency

Note 1. MOF intends to propose amendments in the legislation to require statutory audit in JSCs with more than 50 % state share and in State Enterprises. Two of the following criteria should be exceeded during two consecutive reporting periods to qualify State Enterprises for statutory audit: (i) capital–MDL 500,000; (ii) total revenue–MDL 10,000,000; and (iii) employees–100.

- 29 **Public Interest Entities (PIEs) are defined in the Law on Accounting. There are only 45 PIEs in Moldova** and these essentially comprise banks, insurance companies and listed companies²⁶. PIEs are required by the law to include a chapter on corporate governance in their management report, including disclosure of the extent to which the entity complies with the applied Code of Corporate Governance (CCG), including a reference to the source and place of CCG publication. The National Commission on Financial Markets (NCFM) issued and published a CCG, based on the principle “comply or explain” which is recommended to be implemented by all JSCs. The National Bank of Moldova (NBM) requires banks to implement the CCG in full. The NCFM is in the process of revising the CCG to bring it in line with good international corporate governance practices. PIEs generally fall under the jurisdiction of the NBM and the NCFM.
- 30 **Responsibility for financial reporting at entities level is in line with the EU 4th Company Law Directive whereby management has collective responsibility for signing financial statements.** Article 36 of the Accounting Law requires financial statements to be signed by the person representing the entity’s management, who may be members of the executive board, or the chairman of the executive board or supervisory body. Broadly, according to article 13 of the same law, the same people are responsible for maintaining the company’s accounting books and records.

Accounting and financial reporting requirements

- 31 **Accounting and financial reporting is primarily regulated by the Accounting Law** to which references are made in other legislation including, for example, the Joint Stock Company Law and the Law on Financial Institutions. The Accounting Law specifies how entities should maintain their accounting books and records and also specifies the financial reporting standards that should be used in the preparation of financial statements. The accounting and financial reporting requirements for the reporting entity depend on three sets of size thresholds: total income, total assets and number of employees. Currently, entities are subject to one of the following three sets of accounting and financial reporting requirements depending on whether they exceed two of the three sets of size thresholds for two consecutive years: single entry accounting and financial reporting in accordance with norms approved by the Ministry of Finance; simplified double-entry accounting²⁷ and financial reporting in accordance with National Accounting Standards (NAS) in force; and full double-entry accounting and an option to choose financial reporting in accordance with either NAS or IFRS in force since January 1, 2011.
- 32 **PIEs are compelled to maintain their accounts and produce financial statements in accordance with IFRS starting with their financial statements for the year ending December 31, 2012.** There remains some inconsistency between the listing rules of the

²⁶ The Accounting Law defines Public Interest Entities (PIE) as entities with significant importance to the public due to its area of activity and includes financial institutions, investment funds, insurance companies, non-state pension funds and commercial companies listed on a stock exchange.

²⁷ Simplified double entry accounting system permits the use of simplified charts of accounts, accounting books and records, as well as financial statements. Entities follow NAS 4 “Accounting for Small Business Entities”.

Moldova Stock Exchange and the Accounting Law in that the listing rules appears to allow some listed entities (included in tier 2 listing) to prepare their financial statements in accordance with NAS, whereas the Accounting Law considers all listed companies to be PIEs and therefore required to produce their financial statements in accordance with IFRS. This inconsistency needs to be resolved at the Moldova Stock Exchange.

- 33 **Parent entities are required to prepare and submit consolidated financial statements in accordance with the applicable accounting and financial reporting standards.** This is in addition to their individual entity financial statements. Thus entities that are obliged to produce individual financial statements in accordance with IFRS must refer to IFRS to determine whether or not they are obliged also to prepare consolidated financial statements. In case when NAS currently in force are applicable standards, a group is required to prepare consolidated financial statements, but an entity is exempted from this requirement only where it is itself a subsidiary. There are no exemptions from the requirement to prepare and submit consolidated financial statements for smaller groups as is the case in the EU's 7th Company Law Directive. In practice, very few groups prepare consolidated financial statements and there is no enforcement of this requirement except in the banking sector by the NBM.
- 34 **Banks and insurance companies are subject to the same accounting and financial reporting requirements but compliance and enforcement in these two major financial sectors appear to be uneven.** In addition, banks and insurance companies must publish and submit their financial statements to, respectively, the NBM and NCFM within four months of the financial reporting period²⁸. The Law on Financial Institutions requires banks to maintain accounts and records and prepare periodic financial statements to reflect their operations and financial condition in accordance with the chart of accounts and other regulations published by the NBM. The NBM facilitated banks' transition to IFRS by mandating the use of the financial reporting system, FINREP²⁹, which serves also to provide the NBM with prudential information as well as information on banks' performance.³⁰ In contrast to the banking sector, only a limited number of insurance companies seem ready to prepare their 2012 annual financial statements in accordance with IFRS and there is a real risk that this requirement will not be satisfied.
- 35 **The business community expects the Government to provide guidance on taxation issues for entities producing financial statements in accordance with IFRS. This is critical for creating an enabling business environment for good financial reporting.** There is a *prima facie* close relationship between taxation and financial reporting in that taxable income is derived from net income as reported in an entity's general purpose financial statements. However, there is considerable uncertainty in deriving taxable income due to a lack of clear guidance in the form of rules, regulations or precedence. Coupled with a general lack of familiarity with IFRS among tax inspectors, accountants and tax advisers, tax computations

²⁸ Law on Financial Institutions, Article 35.

²⁹ FINREP - FINancial REPorting designed for credit institutions that use IFRSs for their published financial statements and provide similar information in the periodic prudential reports they are required to submit to their supervisory authorities.

³⁰ In addition to FINREP, NBM issued a draft FINREP regulation for consolidated reporting. Banks indicated that they face some issues related to consolidation, as their subsidiaries use NAS in preparing their financial statements and it is costly to restate their information on an IFRS basis for consolidation purposes.

and thus tax charges can often be more subjective than objective. For example, the tax code was amended such that any income and expenses resulting from the transition from NAS to IFRS would not be recognized for tax purposes. The objective of the amendment was to smooth potential consequences of taxation during the transition period. However, there is no guidance on how to apply this amendment. This general lack of clarity has significant implications for both the public and the private sectors in terms of predictability of tax revenues and charges, tax collections and payments, as well as corruption. It also has the unintended consequence that tax issues could become an undue influence on the decision of non-PIEs as to whether they should apply IFRS on a voluntary basis. It is understood that the tax authority intends to revise its templates and provide taxpayers with additional guidance on deriving taxable income. This is very welcome. However, it is also recommended that training be provided to tax inspectors, accountants and tax advisers in order that they understand more fully the implications of applying principles-based financial reporting standards such as IFRS in deriving taxable income.

Auditing requirements

- 36 **Auditing is primarily regulated by the Law on Auditing Activity³¹, which is closely but not fully aligned with the EU's Statutory Audit Directive.** The Law specifies who should be audited, how an audit should be performed and how the auditing profession should be regulated. The Law stipulates that statutory auditors must use International Standards on Auditing (ISAs) as issued by the International Auditing and Assurance Standards Board (IAASB). The Law also prescribes the additional services that only audit firms or individual auditors may provide including: compilation services, accountancy services, tax advice and tax planning, and investment advice. The law thus regulates all activities of auditors, rather than only statutory audits and statutory auditors as is the case in the EU's Statutory Audit Directive. As such the Law could be construed as regulating various consulting services offered by licensed auditors; such services are not regulated if offered by other consulting firms. The Law should instead focus on statutory audits and statutory auditors. The Law should only refer to other activities of statutory auditors for the purpose of establishing when an auditor's independence may be compromised. In such circumstances, other services may be broadly defined without having a specific list of services that can be offered by auditors, as it is in the currently described in the law.³²
- 37 **Currently, 569 companies are obliged to have their annual financial statements audited including 524 JSCs and 45 PIEs. A legislative amendment for requiring significant SOEs to have their financial statements audited is underway.** The Law on Auditing Activity requires all PIEs to be audited, while the Law on JSCs requires the JSCs with more than 50 employees and share capital of more than 500,000 MDL (approximately USD 41,000) to be audited as well. The Ministry of Finance is in the process of drafting

³¹ Law No. 61 on Auditing Activity, effective from January 1, 2008.

³² In case the main reason for such a regulation is the concern that audit firms should not be involved in other types of businesses (manufacturing, trade, etc.) this can be addressed by having a provision in the law that auditors can offer other services that may be audit related or consulting services in general without having an exhaustive list.

amendments to legislation to require additionally all JSCs with state ownership greater than 50 per cent and all large state enterprises to be audited (a large state enterprise is to be defined as one that exceeds two of the following three thresholds in two consecutive years: (i) capital greater than MDL 500,000; (ii) total revenue greater than MDL 10m; and (iii) more than 100 employees).

- 38 **The provisions of the Law on Auditing Activity related to the dismissal of an auditor are not fully aligned with the EU Statutory Audit Directive**, including during an audit even though, for example and as described earlier in this report in relation to JSCs, there are clear provisions for the appointment of statutory auditors. In the banking sector, there are requirements that a bank should always have a contract with an external auditor acceptable to and approved by the NBM, even in circumstances where a bank sees fit to dismiss its appointed auditor. The Law on Auditing Activity needs to be revised to provide for the dismissal of auditors, including specifying those grounds for which the dismissal of an auditor would not be considered proper, e.g. consistent with EU's Statutory Audit Directive, disagreement on accounting treatments or audit procedures should not be proper grounds for dismissal.
- 39 **Statutory auditors are required to observe the Code of Ethics issued by IFAC with the latest translations yet to be adopted.** The Law on Auditing Activity was amended, so that the IFAC Code of Ethics is mandatory for all audits of financial statements for periods starting January 1, 2012. The latest IFAC Code of Ethics in force dates from 2010 and was published in the Official Monitor in August, 2012. It is also available on the website of the Ministry of Finance in both Romanian and Russian languages. The MOF needs to obtain the latest translations from IFAC so that the latest amendments to the Code can be adopted.
- 40 **Auditors' independence requirements are also specified in the Law on Auditing Activity.** These requirements include not only specifying that the auditor is free to choose how to work free of interference from the entity being audited but also specifying that the auditor's independence would be considered infringed if: (i) there is direct or indirect involvement of the audited entity by its founder, owner, person in charge and/or participation in its economic and financial affairs; (ii) the auditor exercised managerial or other functions in the audited entity during the audited period or in the three years prior to the audited period; (iii) the auditor has relatives or relationships with the owners or members of the management body of the audited entity; (iv) the auditor accepts goods and services or exceptional hospitality from the audited entity; (v) the auditor's remuneration is dependent upon the audit opinion; or (vi) the audited entity is audited by the same auditor for more than seven consecutive years.
- 41 **The matter of auditor's liability insurance needs further consideration in order to evaluate whether the current requirements adequately safeguard the interests of auditors and those who may place reliance on their audit reports and opinions.** Auditors are obliged in respect of their audits of financial statements either to have professional indemnity insurance or to establish a provision for claims in their own financial statements and in highly liquid assets in an amount of no less than 15% of annual audit revenues. There is no specified minimum professional indemnity insurance coverage and hence it is possible that auditors are significantly under-insured.

Filing requirements

- 42 **The Financial Statements Information Service (Public Registry) is overburdened with many responsibilities and too little capacity and resources putting compliance with the Accounting Law at risk.** These responsibilities not only include publishing the financial statements of all enterprises registered under any legal form, but also collecting, processing and summarizing financial statements, supervising the observance of reporting requirements and organizing seminars on the preparation and presentation of financial statements.
- 43 **The Public Registry is under-resourced and is currently unable to fulfil its functions, especially in making financial statements available to the public.** The Accounting Law requires all PIEs within 120 days and all other entities within 90 days to file their entity-level and any required consolidated financial statements, together with any required audit reports on them, with the Public Registry. In addition, entities that are statutorily obliged to have an audit of their financial statements are also required to make these audited financial statements available to the public on their own websites. Entities that do not comply with these filing requirements may be subject to fines. The Public Registry is established under the National Bureau of Statistics and is tasked with collecting, processing, summarizing and publishing the financial statements. However, the Public Registry is under-resourced and is currently unable to fulfil its functions. In particular, it is unable to make financial statements available to the public.
- 44 **Regulated entities are required to file their financial statements with the appropriate regulator.** Banks are required to: (i) file their full financial statements with the NBM by April 30 following each year-end; (ii) make available copies of their annual report to the public free of charge and (iii) publish their balance sheet and audit opinion in both national newspapers as well as in local newspapers wherever the bank has a branch also by April 30 following each year-end. It is worth noting that such partial publication is inadequate in scope as it may be misleading for users in that an audit report should be read as a whole.
- 45 **The following table summarizes the corporate reporting requirements in Moldova:**

Table 4. Corporate Financial Reporting Requirements in Moldova

Entities	Accounting Standards	Audit Requirement	Public Disclosure
PIEs	IFRS	Required.	Required. ³³
Limited liability companies	NAS or IFRS on voluntary basis	Not required.	Required. ³⁴

³³ Accounting Law Article 40 requires that the financial statements of the entities subject to statutory audit will be posted on the official website of the entity and made available to the general public.

³⁴ Accounting Law Article 38 requires submission to the public registry on an annual basis.

Entities	Accounting Standards	Audit Requirement	Public Disclosure
Joint stock companies (excluding PIEs)	NAS or IFRS on voluntary basis	Required for JSC meeting the criteria set in Article 2 of the Law on JSCs.	Required. ^{33 34}
State Owned Enterprises	NAS or IFRS	Not required for state enterprises; for JSCs, the same rule as above.	Required. ^{33 34}
Savings and Credit Associations (SCAs)	NAS 63 Presentation of financial statements by the SCA and by other similar entities	Required for SCAs with license C and SCAs with license B exceeding a certain asset value.	Required. ^{33 34}
Non-commercial entities	NAS and Norms approved by the Ministry of Finance ³⁵	Not required.	Required. ³⁴
Micro entities	NAS 62 Accounting based on simply accounting system. No requirements to prepare financial statements.	Not applicable.	Not applicable.

B. The Profession

The accounting profession

- 46 **The number of accountants³⁶ is not easy to quantify, however, observers estimate their number as 35,000.** Although some accountants hold a university degree in accounting or finance, only some have a professional qualification or belong to a professional accountancy association. Currently there are only 53 professionals holding foreign accountancy qualifications including 32 ACCA and 21 CIPA members. In addition, there are professionals that either hold a specialized certificate or are candidates for a foreign accountancy

³⁵ Order no. 158 dated 16.12.2010 on approving the Recommendations on Peculiarities of Accounting in Non-Commercial Entities.

³⁶ The term is to be understood as the persons maintaining the accounts of companies, usually chief accountants of entities of medium or large size. These normally would be persons with university degree in accounting or finance.

qualification: ACCA has 166 candidates and 5 affiliates; 55 accountants hold the ACCA's Diploma in International Financial Reporting (ACCA DipIFR); 280 accountants hold the ECCAA's Certified Accounting Practitioner (CAP), which the first step to obtain CIPA qualification.

- 47 **There are three professional accounting associations in Moldova which share similar objectives but cooperate very little:** the Association of Professional Accountants and Auditors (ACAP), the Association of Auditors and Auditing Firms of Moldova (AFAM) and the Association of Auditors and Management Consultants (EcoFin-Consult). All three professional associations are self-financed from fees charged to their members as well as fees charged to attendees on their training courses. The associations neither rely on government funding nor on external funding from development agencies.
- 48 **Such fragmentation tends to weaken the profession's image and its ability to articulate clear positions to the public and policy makers.** The profession is unable to initiate dialogue with the Ministry of Finance and regulatory agencies in unity. The profession could benefit from unifying the efforts and ensuring a greater level of cooperation in addressing the common challenges facing the profession, including those facing auditors, to the Government, regulators and other stakeholders. Merging the professional associations into a single strong body could be considered as a medium to long-term goal.
- 49 **ACAP is the only IFAC member in Moldova and is the professional organization hosting the largest number of certified auditors.** It has 373 full members, 456 associate members, 35 student members and 36 corporate members. Full membership requires a relevant degree and three years of relevant work experience, or an appropriate accountancy qualification (CAP is a minimum requirement. Associate membership is open to accountants in practice, trainees in audit or work in a related field of business; and student membership is open to full-time students in accounting, auditing and related fields.³⁷ ACAP is member in several regional bodies: (i) SEEPAD (South-Eastern European Partnership on Accountancy Development); (ii) ECCAA (Eurasian Council of Certified Accountants and Auditors), and (iii) associate member of the *Fédération Internationale des Experts-Comptables Francophones* (FIDEF). ACAP offers a certification programme based on the ECCAA's program for CAP (Certified Accountant Practitioner) and CIPA (Certified International Professional Accountant), a Russian language accountancy qualification. ACAP is organized with a board of directors and six subordinate committees: ethics and discipline; education and certification; quality control; membership; professional development; and finance and publications. ACAP is currently implementing a compliance action plan to implement and comply with IFAC's SMOs and has recently conducted ten pilot quality assurance reviews in line with a detailed methodology and written procedures.
- 50 **AFAM has 456 members including 55 certified auditors, 33 corporate members and 12 non-practitioner certified auditors.** Legal and physical persons can become members of AFAM by applying to the Council with copies of requested documents. AFAM divulges only limited information about itself including its charter and internal regulations but indicates that it has the following committees: quality control; training and professional development;

³⁷ http://www.acap.md/eng/member_rights/

ethics and discipline; development and external relations; and accounting and auditing methodology. It also indicates that it performs a quality assurance function. AFAM has established a Center for Vocational Training of Auditors that was accredited by the state for the provision of CPD training. AFAM intends to apply to IFAC for membership.

- 51 **Ecofin-Consult has 1,117 members including 22 auditors and 1,058 accountants as well as IT specialists, consultants and lawyers.** Membership is open to anyone who supports the objectives of the association. The association operates five departments: auditing policy; membership; quality and management policy; protection of members' rights and interests; and a training centre. It has cooperation agreements with the Academy of Economic Studies and the Free International University of Moldova. It initiated quality assurance reviews in 2012 with reviews of four audit firms and six auditors.
- 52 **The professional associations are expected to take on a more proactive role in the implementation of the accounting and auditing reforms. This could be achieved by showing further commitment to raise their quality standards and mobilizing efforts to improve the perception of the business community vis-à-vis their work.** Quality standards can significantly be raised through by making twinning arrangements with institutes and associations in other countries and also by establishing peer-review mechanism within the respective associations for better quality audits. The perceptions of the business community could be significantly improved by partnering with industry, trade and commerce chambers to engage in dialogue with the Government and regulators to facilitate the accounting and auditing reforms.
- 53 **There is a significant training gap in accounting education and qualification levels** because of the relatively complex corporate financial reporting obligations under NAS and IFRS as well as the relatively low number of accountants with the skills required to satisfy those reporting obligations.³⁸ There are a large number of accountants who need to upgrade their accountancy skills. A possible approach to address this issue is discussed later in this report.

The audit profession

- 54 **Auditors are not required to hold membership in any professional association and none of the professional associations perform any formal role in the qualification, licensing, regulation or public oversight of auditors.** As of December 31, 2012 there were 241 certified auditors of whom only 183 were active in the audit market, and 124 audit firms. The number of audit firms appears to be high with respect to the size of the market in Moldova but in fact most of these firms operate as sole proprietorships.
- 55 **The discussions conducted with various stakeholders revealed that the local professional qualification for accountancy is not credible either on the local market or**

³⁸ The conclusion is also drawn up based on discussions the ROSC team had during the main mission with various local stakeholders and on the results of analysis of the financial statements compliance with requirements of the applicable accounting standards.

internationally. The certificate awarded by the MOF's Certification Commission to auditors is also not perceived on the market as a sound professional qualification. Audit firms who are members of international audit networks tend to encourage their employees to take ACCA's professional qualification program which is available only in English. The ECCAA's CIPA program has little recognition and it is available in Russian language only.

- 56 **The Ministry of Finance is responsible for the certification of auditors, the process of which has significantly improved from 2004. Requirements for practical experience still diverge from those in the EU's Statutory Audit Directive and there is also still room for improving the examination syllabus and the quality of the question pool.** A Certification Commission under the MOF organizes professional competence examinations for auditors. These have improved since the time of the 2004 ROSC: examinations are now in written form (previously, candidates had the choice of being examined either in written or oral forms), so that there appears now to be greater conformity with IFAC's International Education Standard 6 on Assessment of Professional Capabilities and Competence. Foreign qualifications are fully or partially recognised; examination candidates holding a foreign qualification are accorded exemptions from certain exams depending on the qualification held³⁹. The Commission is chaired by a representative of the MOF, the Head of the Department for Accounting and Auditing Regulation in the Corporate Sector, whose department acts as its secretariat. The majority of members of the Commission are drawn from academia and includes two representatives of the MOF. The examination can only be taken by graduates of economic sciences, finance or law with at least three years of practical experience, of which in some cases only six months must have been completed with a licensed auditor. The recently introduced reduced requirement for certain categories of applicants⁴⁰ of only six months practical experience with a licensed auditor is at variance with the EU's Statutory Audit Directive which requires at least two-thirds of any practical training to be with a licensed auditor, and such practical experience to be for no less than three years. The minimum practical experience for a trainee auditor with a licensed auditor should be increased to two years. In addition, the MOF would do well to address concerns regarding the competences examined.
- 57 **A Licensing Chamber subordinate to the Ministry of Economy is a centralised government body responsible for issuing licences, including licences to firms or individuals who satisfy the licensing requirements established by the Law on Auditing Activity.** More specifically, the law permits an audit firm to be established as a limited liability company or a joint stock company, the majority of which is owned by the auditors and/or resident or non-resident audit firms. In addition, there is a requirement that the executive body of an audit firm be managed by a certified auditor. The MOF maintains a public register of certified and licensed auditors and firms that is also accessible via the MOF

³⁹ For example, holders of ACCA qualification will need to pass tax and law exams, while CIPA will be fully recognized as its tax and law exams are local.

⁴⁰ The Law on Auditing Activity, Article 20, 3b requires reduced term of practical experience of 6 months for the persons who have worked at least 2 years as employees of public and private institutions in subdivisions of accounting, audit, legal, financial control and/or tax inspections as well as within the subdivisions, having functions of development and/or implementation of the legislation and/or regulations in accounting, auditing, financial control and/or tax inspection.

website⁴¹. Audit licenses are valid for five years after which an audit firm can apply to the Licensing Chamber to renew its license for another five years. Where the AOC determines that an auditor has failed to comply with any particular aspect of the Law on Auditing Activity, the AOC will submit a decision to the MOF to withdraw the auditor's qualification certificate and the MOF in turn will amend the register of auditors and inform the Licensing Chamber. Where an auditor whose certificate is withdrawn is registered with an audit firm and is that firm's only licensed auditor, the Licensing Chamber will withdraw the audit firm's licence because of its failure to have at least one certified auditor.

- 58 **Auditors of financial sector entities must be certified and licensed as for general auditors but must additionally be certified by the NBM and NCFM. There is a need to structure and standardize these additional examinations and they could be discarded in the longer term.** Prospective bank auditors are assessed in an oral examination by a commission of NBM specialists. Similarly, auditors of insurance companies, professional participants at securities market and savings and credit associations must be additionally certified by the NCFM on the basis of written examinations. Successful candidates are awarded a certificate by either the NBM or NCFM that may be withdrawn if the MOF withdraws its general audit certificate. These examination processes should be strengthened in short-term so that (i) the process is rigorous and transparent with written exams; and (ii) the content covers subjects relevant to audits of regulated entities. In the longer term, the practice of additional examination could be abolished, as auditors would be expected to gain industry-specific knowledge through experience and CPD.

C. Professional Education and Training

- 59 **Currently, there are nine universities in Moldova that award degrees in accounting. They have limited international recognition and need substantial upgrades to their curricula.** The Academy of Economic Studies of Moldova (AESM) is widely regarded as the leading university for accountancy and awarded approximately 500 bachelor degrees in 2012. The Ministry of Education accredits universities to award degrees and thereby ensures a certain level of harmonisation of curricula and standards. However, universities usually only provide in-depth teaching of IFRS and ISAs in their masters programs and thus significant numbers of those with bachelor degrees have little or no formal education on these topics. Recent changes to the regulatory framework for corporate financial reporting such as the adoption of IFRS by PIEs⁴², the implementation of ISAs by auditors and the intention of the MOF to introduce a new set of NASs for non-PIEs starting January 2014 create a major challenge for universities in terms of their ability to provide relevant course curricula. In recognition of this, the AESM has initiated a process to obtain ACCA accreditation for the

⁴¹ The Law on Auditing Activity is not consistent with Article 15,3 of the EU's Statutory Audit Directive in that the public register should also contain the name and address of the competent authorities responsible for approval of auditors, for quality assurance, for investigations of and levying penalties on statutory auditors and audit firms, and for public oversight.

⁴² Currently there are 45 PIEs, mostly including commercial banks; even though the Accounting Law allows non-PIEs to apply IFRS on voluntary basis, a very little number of entities are applying them (and only when it was required by investors and/or foreign shareholders).

bachelor degree awarded by its accounting faculty. Accordingly, revised and improved curricula together with examination papers will be sent to ACCA in 2013 in the expectation of obtaining that accreditation. It is recommended that such an approach is extended to other universities.

- 60 **The financial sector companies as well as the regulators need more staff knowledgeable in modern financial reporting standards, especially IFRS and ISA.** Some accountancy training in the banking sector, focussing on the initial adoption by banks of IFRS, has been provided through USAID-sponsored programs. However, there is no system in place to provide continuous professional training for updates in IFRS and ISA to staff of NBM or to offer professional qualifications for both the banking and non-banking financial sectors. There is no training available in IFRS-based financial reporting for non-banking financial institutions. There is a need to develop regular programs of accountancy training for both banking and non-banking financial institutions and to introduce CPD requirements or programs.
- 61 **Universities, regulators and the profession should collaborate better on the design and delivery of accounting and auditing education in order that it better serves the needs of the market.** Currently, there is a disconnect between universities and regulators in the sense that regulators do not accord holders of university accounting and auditing degrees any credits towards either the training or examination requirements for professional certification of auditors. Consistent with the provisions of the EU's Statutory Audit Directive, it should be possible for universities to design degree programs such that a person who holds an accountancy degree may be exempted from certain aspects of the certification requirements.
- 62 **As discussed earlier, there is a significant training gap in accounting education and qualification levels** because of the relatively complex corporate financial reporting obligations under NAS and IFRS and the relatively low number of accountants with the skills required to satisfy those reporting obligations. There are a large number of accountants who need to upgrade their accountancy skills. Training programs need to be designed and delivered to upgrade the skills of practising accountants and to enable them to implement the significant body of new accounting and financial reporting requirements, particularly NAS and IFRS.
- 63 **The Law on Auditing Activity requires certified auditors to maintain their competence through participation in programs of Continuing Professional Development (CPD),** the structure, content, and organization of which is described in the Regulation on Certification of Auditors. The annual minimum CPD requirement for auditors is 40 hours and may include attending training programs, seminars, conferences, publishing research. A minimum of 20 hours should be accumulated as result of participating to the courses organised by the continuous education institutions of the Republic of Moldova or by the specialized international entities, aiming at improving the qualification level in the professional fields. Each certified auditor is required annually to provide evidence of formal training in the form of attendance certificates together with a self-declaration in respect of other CPD to the secretary of the Certification Commission. Furthermore, the CPD should also be used as a tool for re-training the professionals, especially in the context of new NAS adoption, IFRS and ISA adoption.

D. Setting Accounting and Auditing Standards

- 64 **IFRS is the set of standards applied by PIEs. PIEs use the officially endorsed translations of IFRS for accounting and financial reporting though the latest amendments in IFRS are not officially endorsed yet⁴³.** IFRS become officially recognized when the translations are published in the Official Monitor. IFRSs were first published in a special edition of the Official Monitor on December 30, 2008. However, official translations received from the IFRS Foundation since then have been published only on the website of MOF. As a result, the most recent amendments to IFRS have neither been endorsed by MOF decree nor published in the Official Monitor. The mechanism for adoption of IFRS should be reviewed to ensure that all the amendments and updates are officially endorsed and published on a timely basis.
- 65 **Non-PIEs use the National Accounting Standards (NAS) for accounting and financial reporting. The MOF is responsible for developing new NAS for non-PIEs in accordance with the Accounting Law, which requires NAS to be prepared on the basis of EU accounting directives and IFRS. .** The new NAS are being drafted by working groups established by the MOF and financed from the state budget; there is room to improve both the process of standards setting and the content of the standards. The majority of working group members is from academia although the group also includes some practitioners. The MOF should lead the process of NAS development with due regard to transparency, participation and sustainability. The standard-setting process should also be clear. For example, exposure drafts should be published⁴⁴, sufficient time should be allowed for inputs from stakeholders and their inputs should be discussed in a transparent manner⁴⁵. In addition, there should be clear delineation between the technical working groups that are developing the new NAS and those who review, consider, deliberate and approve the new NAS. The working groups could benefit from representatives of users of financial statements, such as representatives of the investment' community and banking community. . Finally, the standard-setting process should have clear procedures for revisions based on implementation experience and feedback from preparers, auditors and users of financial statements.
- 66 **An alternative approach to developing NAS would be the straightforward adoption of IFRS for SMEs⁴⁶ for medium and large firms, while micro and small entities would**

⁴³ MOF published in the Official Monitor all IFRS received recently in April, 2013. Also MOF prepared an amendment to the Accounting Law aiming to address the described issue.

⁴⁴ Draft NASs were published on the official web-site of the MOF for public consultations on April 12, 2013. The deadline for submission of comments is June 30, 2013. This gives the stakeholders approximately 2.5 months for providing feedback as opposed to the minimum requirement of 15 days for public consultation of draft legislation.

⁴⁵ The MOF will publish on the website an analysis of the comments received on the draft NAS from the competent authorities and the public before enactment.

⁴⁶ IFRS for SMEs is a simplified set of standards developed by the IASB and designed for entities that have no public accountability. It is based on full IFRS, but simplified in two aspects: (i) valuation and measurement – the standard uses simplified approaches and those that are less costly; and (ii) reduced disclosure requirements. The standard is also supported by illustrative financial statements and disclosure checklist. In addition, the IFRS Foundation dedicates significant resources for disseminating and implementing the standard; for example a detailed set of training material is developed and publicly accessible on IASB website in many languages. The standard also aims to be static with revisions only once every three years.

apply cash-based accounting and simple reporting as developed by MOF for physical persons who undertake entrepreneurial activity. IFRS for SMEs, the translation of which is available in Moldova, is designed to be consistent with IFRS and is intended specifically to reduce the burden on national accounting standard setters; it follows a rigorous standard-setting process, which includes various stages of drafting, exposing drafts for comments, deliberations and making balanced decisions, which normally take into account the views of national standards setters and other stakeholders. Applying the standard will bring a range of benefits. In particular, the fact that it is an internationally recognized standard will make financial statements more credible and understandable. In addition, the IFRS Foundation is developing guidance, training and support materials, which will facilitate its implementation by countries like Moldova. Both approaches, developing NAS or adopting IFRS for SMEs, require significant resources for developing the standards and for training the preparers, auditors and regulators.

- 67 **The Law on Auditing Activity stipulates that all auditors, including statutory use International Standards on Auditing (ISA) and comply with the Code of Ethics as issued by the IFAC's International Auditing and Assurance Standards Board (IAASB) and published in the Official Monitor.**

E. Enforcing Accounting and Auditing Standards

Enforcing accounting standards

- 68 **The Public Registry suffers from inadequate secondary regulation, a lack of appropriate IT infrastructure and an inadequately organized, trained and remunerated cadre of technical staff. There is a need to move from a full-fledged implementation approach to a phased one for better enforcement of regulatory requirements on accounting while preparing an action plan for expanded enforcement.** The Accounting Law assigns the Public Registry the task of collecting, processing, summarizing and publishing entities' financial statements as well enforcing entities' compliance with the accounting framework, the latter requiring further technical capacity. The Registry is currently unable to perform its assigned tasks satisfactorily. The Accounting Law provides the basis for fines to be levied on entities that do not comply with the accounting framework and filing obligations; however, given the lack of capacity and adequate secondary legislation at the Registry, fines are not currently levied. The more serious consequence is that financial statements are often incomplete, particularly in terms of disclosure of accounting policies and explanatory notes, audit reports are not collected and financial statements are not made publicly available. This undermines the ultimate objective of fostering a sound corporate sector accounting and auditing framework. The Registry needs an urgent and significant investment to develop appropriate secondary regulation, IT infrastructure and a well-organized, trained and remunerated cadre of technical staff.

Enforcing auditing standards

- 69 **As noted above, professional associations are at an early stage of overseeing the activities and performing quality assurance of their members. Accordingly, the Audit**

Oversight Council (AOC) places little or no reliance on the oversight and quality assurance functions of the professional associations. Rather, auditors are subject to direct oversight by the AOC. The AOC is an administrative entity established under the Ministry of Finance to supervise auditing activity as defined in the Law on Auditing Activity. The AOC is currently chaired by the Deputy Minister of Finance and comprises seven members from, respectively, the Ministry of Finance, National Bank of Moldova, National Commission on Financial Market and academia. The AOC is thus independent of the audit profession in that none of its members are auditors in practice or have an interest in an audit firm.

- 70 **The AOC is responsible for ensuring compliance by auditors and audit firms with the relevant auditing standards, code of ethics and quality assurance requirements; the AOC also monitors the certification, licensing and CPD processes performed by the MOF and Licensing Chamber; and acts as an advisory body for regulations in the area of auditing.** Auditors and audit firms must send annual financial reports, details of their quality control procedures and, where they audit PIEs, transparency reports to the AOC by April 30 of each year (in the EU's Statutory Audit Directive, such reports have to be submitted within three months of the end of the year).
- 71 **The AOC is limited in the amount and depth of direct inspection or quality assurance it may perform because of its limited resources, particularly as regards to funding and human resources.** Quality assurance is the responsibility of the AOC's Control and Verification Service (CVS) which comprises three civil servants with limited relevant professional background who perform compliance reviews of auditors and audit firms with respect to auditing standards, the code of ethics and other normative acts regulating auditing and quality assurance mechanisms. The CVS started carrying out quality assurance reviews in the last quarter of 2012. There is a need to strengthen the AOC in order that it may foster a credible audit profession.
- 72 **The AOC may impose the following sanctions and discipline on registered audit firms and auditors: warnings; decisions to the Ministry of Finance to withdraw or suspend an auditor's qualification certificate; and proposals to the Licensing Chamber to withdraw or suspend an auditor's license.** The AOC maintains a page on the website of the Ministry of Finance detailing all of its disciplinary actions and decisions. In 2012 the AOC issued and published nine decisions which resulted in a total of 25 sanctions including: (i) three instances of warning to auditors who had less than the statutorily required minimum of 40 hours CPD; (ii) seven instances of proposals to the Licensing Chamber for the withdrawal of an audit firm's license because of its failure to provide a report on its year's activities to the AOC; (iii) five instances of decisions to the MOF for the withdrawal of an auditor's certificate of qualification because of its failure to meet its CPD requirements; and (iv) ten instances of warning to auditors and audit firms for various infringements of the Law on Auditing Activity.
- 73 **Most elements of an audit oversight system as prescribed in the EU's Statutory Audit Directive are incorporated in the Law on Auditing Activity. However, the audit oversight system is fragmented with different aspects of the oversight system being performed by different departments and entities. Fragmentation combined with lack of funding makes the system ineffective.** The certification of auditors is performed by the Certification Commission under the MOF; licencing of audit firms is performed by the

Licensing Chamber; the registry of auditors is maintained by the MOF; professional auditing standards are adopted by the MOF; CPD is monitored by the AOC and information is gathered by the secretary of Certification Commission; quality assurance is performed by the AOC's CVS; warning sanctions are issued by the AOC; the AOC decides that an audit certificate is revoked and MOF will withdraw the certificate based on their decision; and the AOC may propose that an audit licence is revoked and Licensing Chamber will withdraw the licence based on that decision. This fragmentation makes it difficult for anyone and, particularly, for the AOC to be responsible for or be held fully accountable for the oversight of statutory audits and auditors in a manner consistent with the EU's Statutory Audit Directive. This lack of clear accountability is likely to lead to confusion and inconsistent enforcement of auditing standards. The lines of responsibility and accountability for oversight of the audit profession and enforcing auditing standards should be streamlined and the AOC given an unambiguous lead role with resources sufficient to enable it to strengthen its organizational structure, develop its staff, formulate appropriate working practices and procedures, and devise robust risk-based tools and methodologies. Options for organizing the oversight function are presented in the Annex 4. Implementing these recommendations clearly requires time and resources. Accordingly, the Government would need to identify and implement some transitional steps to win support and respect to the oversight system as a whole.

Roles of the National Bank and National Commission on Financial Markets

- 74 **The National Bank of Moldova enforces implementation of standards and codes in the banking sector including of appropriate accounting and financial reporting standards.** This is achieved through field visits by NBM inspectors, reviewing banks' periodic financial and prudential reports, reviewing auditors' reports and monitoring mandatory disclosures made by banks on their websites. The NBM is in regular contact with the auditors of banks and periodically convenes meetings with auditors to emphasise the role of the auditor, to discuss and clarify certain aspects of the NBM's regulations, and to convey the NBM's expectations in respect of banks' audits. As discussed earlier, auditors of banks must be certified by the NBM in addition to being certified and licensed for general audits. Audit firms have an obligation to inform the NBM of any illegal bank activity as well as of any irregularity in the management or operation of a bank that could lead to material losses. The relationship between the NBM and banks' auditors may be further formalised and strengthened consistent with the Core Principles for Effective Banking Supervision of the Basel Committee on Banking Supervision.
- 75 **The National Commission on Financial Markets** lacks experienced staff and could greatly benefit from improving its monitoring and enforcement systems. NCFM regulates a significant portion of PIEs and is responsible for enforcing standards and codes in the insurance sector, securities market and, for savings and credit associations and leasing entities.

III. Accounting Standards as Designed and as Practiced

The Standard Gap

- 76 IFRS is the set of standards applied by PIEs. Accordingly **for PIEs, there is no standards gap in the area of financial reporting standards.**
- 77 **The MOF is responsible for drafting new National Accounting Standards (NAS) for all companies that are not PIEs in accordance with the Accounting Law which requires NAS to be prepared on the basis of EU accounting directives and IFRS.** . The ROSC team reviewed both the process and content of the ongoing NAS development project. The review, presented in Annex 2, was based on a benchmarking of NAS against the EU's Fourth and Seventh Company Law Directives as well as IFRS for SMEs. Both benchmarks are relevant for Moldova: (i) the EU's Fourth and Seventh Company Law Directives are requiring the EU member states to transpose into national legislation financial reporting requirements; Moldova has EU aspirations and approximation to the EU requirements are key; (ii) IFRS for SMEs is a simplified set of standards that is developed on the basis of full IFRS, to satisfy the less demanding needs for information for entities with no public accountability; IFRS for SMEs have only few areas of incompatibility with the EU's Fourth and Seventh Company Law Directives and therefore these are very much relevant and could be chosen as a policy option for Moldova instead of developing NAS.
- 78 **The draft new NAS are consistent with the provisions of the Fourth EU Directive on the annual accounts of certain types of companies in many respects, though the Seventh Directive's on consolidated financial reports requirements are not incorporated.** There are certain areas of differences between the draft NAS and the Fourth Directive including: accounting for investments in associates, contingent liabilities, research and development costs, disclosure requirements and the layouts of the financial statements. The requirements for consolidated financial statements are currently prescribed by Article 37 of the Accounting Law which requires that consolidation should take place if required by the accounting standards being followed by the entity. Consolidated financial statements are required by IFRS. If the final NAS do not incorporate the requirement for consolidation in line with the EU's Seventh Directive, the alternative option would be that the Accounting Law is amended to require that large groups prepare consolidated financial statements in accordance with full IFRS. This will satisfy the requirements of EU's Seventh Directive which contains exemptions from consolidation for smaller groups.⁴⁷
- 79 **The draft new NAS are derived from full IFRS. In many respects this is a good thing because it helps ensure that NAS are consistent with best international practice. However, the preparers of the new NAS need to appreciate that NAS should be considerably simpler than full IFRS.** NAS should be designed as a simplified set of standards applicable to non-PIEs. In addition, the draft new NAS contain references to full

⁴⁷ The team was informed that the MOF decided to develop a new NAS which will cover the consolidation requirements for non-PIEs.

IFRS which results in a very complex set of standards. While recognizing the importance of ensuring consistency of NAS with the IFRS, NAS should nevertheless be developed as a standalone standard as is the case for IFRS for SMEs. One option to help simplify the development of NAS would be to use IFRS for SMEs as the main benchmark rather than full IFRS. Additional comments on the differences between and similarities of the draft NAS and IFRS for SMEs are included in Annex 2.

- 80 **Simplified accounting standards for small entities are not foreseen in the draft NAS.** The draft of NAS 1, Presentation of the Financial Statements, permits small entities to submit a reduced number of statements: a balance sheet, income statement and explanatory notes. However, this does not appear to exempt small entities from applying full NAS in all other respects. Consistent with the EU's Fourth Company Law Directive⁴⁸, NAS should offer a simplified standard for smaller entities that will incorporate simplified accounting and reporting requirements.
- 81 **The provisions in the Accounting Law relating to double-entry and simplified systems of accounting should be revised**⁴⁹. More specifically, article 15 should not include references to the acceptability or otherwise of double-entry and simplified systems of accounting. Rather, the Law should require all entities to maintain robust systems of accounting and internal controls that *inter alia* enable them to produce reliable and timely financial statements in accordance with prescribed financial reporting standards. One consequence of such an approach is that it would almost certainly require all entities other than the very small to maintain double-entry systems of accounting because otherwise it would be very difficult for them to assert that their systems are indeed robust and enable preparation of credible financial statements.

The Compliance Gap

- 82 **The ROSC team reviewed a selection of financial statements to assess the compliance gaps with NAS in force and with IFRS.** The selected sample of financial statements included 21 entities that prepared financial statements on the basis of NAS, and seven entities that voluntarily prepared IFRS financial statements⁵⁰. As mentioned earlier in the report, IFRS are mandatory for PIEs and the first set of financial statements are required for the period ending December 31, 2012⁵¹ and will be available after the reporting deadline of April 30, 2013. Before IFRS entered in force for PIEs, they were required to apply NAS. However, some entities, including PIEs used to prepare two sets Financial Statements, applying both NASs and IFRS.
- 83 **Financial statements purportedly prepared in accordance with NAS appear to be similar in quality to those reviewed for the 2004 ROSC which concluded that banks'**

⁴⁸ Art. 1a

⁴⁹ MOF developed and published on May 07, 2013 for public consultations an amendment to Accounting Law. The article 15 is proposed to be amended and to remove the double-entry simplified accounting system.

⁵⁰ PIEs are first required by law to produce IFRS financial statements as at and for the period ending December 31, 2012.

⁵¹ This requires that all the comparative information has to be collected by entities starting from January 1, 2011, so that previous year comparative information is included in financial statements as of December 2012.

financial statements were of a good quality but those of non-banks did not comply with NAS because the disclosures and explanatory notes were either missing or very poor.

The entities reviewed included five banks, two listed non-bank companies, three JSC state-owned entities, four insurance companies, five other entities and two small entities that apply simplified reporting. Most of the financial statements were obtained from the Public Registry and were incomplete, having no disclosure notes and no audit reports. Very few entities published their full audited financial statements on their websites despite the legal requirement to do so. The results of the review can be summarized as follows.

- Most banks' NAS financial statements were audited by audit firms that are part of international networks. They were all prepared to a good standard and complied with the requirements of NAS for presentation and disclosures;
- All other entities' financial statements were presented in accordance with NAS-prescribed formats for the balance sheet, profit and loss statement and cash flow statement. However, with the exception of two cases, the entity financial statements did not properly disclose accounting policies nor provided other explanatory notes in compliance with NAS 5, Presentation of Financial Statements. The absence of such disclosures and explanatory notes makes it practically impossible to understand the financial results and the position of the entity.

84 **The quality of non-bank entities' NAS financial statements is very low.** In the absence of complete information and details sufficient for a proper analysis and understanding of a company's financial position, performance and cash-flows, financial statements do not provide useful information for shareholders, investors and lenders to make informed corporate, investment, or credit decisions.

85 **Financial statements voluntarily prepared in accordance with IFRS did not appear to depart materially from the standards.** The team reviewed the IFRS financial statements of five banks and two other entities, all of whom were audited by audit firms that are part of international networks. Some of the financial statements were made available to the team by the banks themselves, and some of them were also available on their websites, while financial statements of the two other entities were made available to the team on confidential basis. The results of the review are below:

- Most banks' IFRS financial statements were prepared to a high standard, though the notes and disclosures were not always easy to follow and could result in confusion;
- Non-banks' IFRS financial statements were also prepared to a high standard;
- Both of the non-banks' sets of reviewed IFRS financial statements contained qualified audit opinions with a number of important qualifications such as valuation of property, plant and equipment, revenue recognition and related party transactions. Overall the IFRS reporting was carried out to a satisfactory standard subject to the limitations explained in qualified audit reports

86 **Most PIEs, except the commercial banks, face serious challenges in producing financial statements in accordance with IFRS.** PIEs started mandatory implementation of IFRS for the year ending December 31, 2012 with a reporting deadline of April 30, 2013. Non-bank PIEs in particular face technical challenges and capacity issues in implementing IFRS and may not be able to submit technically acceptable financial reports by the April 30, 2013 deadline. Also, and as discussed earlier in this report, the tax authority and its inspectors are not fully prepared for IFRS implementation and there is a need to establish a tax bridge and reconciliation from profits reported under IFRS to taxable profit.

IV. Auditing Standards as Designed and as Practiced

The Standard Gap

- 87 **There is no standards gap in the area of auditing standards.** The Law on Auditing Activity stipulates that all auditors use International Standards on Auditing (ISA) as issued by the International Auditing and Assurance Standards Board (IAASB). ISA are applicable for audits of financial statements as of 31 December, 2012 onwards. Before ISA were introduced by the law and official translations formally adopted, National Standards on Audit were applicable, which were based on ISA as of 1999-2000, and therefore did not contain risk-based auditing introduced by ISA later.

The Compliance Gap

- 88 **The reviewed audit reports prepared in accordance with ISA appeared to be of a good quality, though the limited sample means no general conclusions can be drawn.** At the time of this assessment, only a very small number of audit reports, essentially for banks, had been prepared in accordance with ISA, as ISA only became mandatory for audits of financial statements produced as at and for the year ending December 31, 2012. The review of ISA based audit reports prepared by audit firms that are part of international networks (usually big-four) complied with ISA requirements, and as the review of financial statements confirmed, the team may reasonably conclude that the those audit firms aspire to comply with ISA.
- 89 **However, the implementation of ISA is a challenge especially for local small and medium-sized practices because:** it difficult to justify the higher cost of an ISA audit to management and governance bodies of entities who do not regard an audit as valuable; auditors face difficulties in applying internal quality control standards (ISQC1); only very few auditors have audit methodologies consistent with ISA; and liaising with an entity's previous auditor is often problematic.
- 90 **As discussed in the "Filing requirements" section, except for banks, it is difficult to obtain full sets of audited financial statements that contain audit reports.** Despite the legal requirements⁵², entities do not publish their full audited financial statements and the Public Registry currently does not collect audit reports as part of financial statements.
- 91 **The review of limited number of NAS financial statements audited in accordance with National Standards on Auditing (NSA) - replaced in 2012 with ISAs as per the Law on Auditing Activity- revealed significant deficiencies in audit quality, except for the audit of banks.** Out of 21 sets of financial statements reviewed, nine included audit reports. The reports were obtained from five banks (available on their official websites), two insurance

⁵² According to the article 40 of the Accounting Law, the financial statements of entities subject to statutory audit will be posted in the official website of the entity and the body to which financial statements are submitted and made available to the general public.

companies and two trading entities (one entity published the audit report on the official website, but did not attach audited financial statements). Although no definitive conclusions can be made in this respect due to the limited size of the sample, the results of the review can be summarized as follows:

- Most banks' NAS financial statements were audited by audit firms that are part of international networks. In some cases NSA were applied (3 banks) and in other cases audit was performed based on ISAs (2 banks). They were all prepared to a good standard and complied with the requirements of auditing standards used;
- For other entities audits, most audit reports used standard wording contained in NSA 700 *The Auditor's Report on Financial Statements*. The audit reports for insurance companies contained emphasis of matter paragraphs that the report is prepared for and can only be used by the NCFM in one case and in by entity's shareholders the other case. This is not acceptable, as auditors should express their opinion that is of value for all the other active or potential users of financial information and should not limit their responsibility to any type of user. The financial statements of the two trading entities did not contain disclosures on the accounting policies and/or other disclosure notes, except the templates as prescribed by NAS 5 Presentation of the financial statements; despite this lack, both reports had unqualified (clean) audit opinions. The absence of disclosures of the accounting policies and of explanatory notes on the NAS-based statutory financial statements should have given rise to adverse opinions in the corresponding audit reports, on the basis that those financial statements were incomplete and possibly misleading.

92 **The current institutional framework and current corporate sector practices do not create an environment where the audit function can be effective and auditors can bring economic value to the market and its stability by complying with audit standards.** Several factors may explain the difficulties or disincentives in complying with established auditing standards, including:

- *Limited understanding of the audit process and its value by those in charge of governance in corporate entities* - representatives of audit firms interviewed mentioned to the ROSC team that both management and owners often see an audit as something imposed on them with no value. Also, audit committees are infrequent in Moldova, as corporate entities are not required to establish them, and their role in ensuring that external auditors fulfil their responsibilities to deliver an audit that meets the needs of the stakeholders is not met;
- *Limited practical experience and technical expertise for applying auditing standards* - as described in the "Professional Education and Training" section, education curricula and the as the content of continuous professional development need to be upgraded. Both also need to be oriented toward practical application of auditing standards;
- *The audit oversight system needs strengthening in order to be able to effectively monitor auditors and impose appropriate sanctions for non-compliance* - as previously noted, the existing oversight system has limited capacity to monitor compliance with auditing standards and to ensure that practicing auditors observe internal quality assurance procedures (including ISA 220 on quality control of audit work). Also, the law contains a limited set of sanctions for non-compliance. Combined with the fact that financial statements of most companies are not published this reduces the possibility that infringement by auditors of their responsibilities are uncovered, thereby weakening auditors' incentive for quality.

V. Perception of the Quality of Financial Reporting

- 93 **The demand for transparent financial statements is still relatively low, due to the collateral based lending, lack of availability of financial information, the early stage of development of the securities market and the modest level of foreign investment. Banks and creditors tend to seek other information resources as they do not rely on the quality of the financial reporting. Similarly,** private and foreign investors place limited reliance on statutory financial statements when conducting due diligence as part of their investment projects in Moldova. Instead, they request special-purpose financial statements under IFRS. Observers acknowledge the achievements in the 1990s in developing a reporting framework based on international standards, and the improvements this has brought, especially in the banking sector which is generally viewed as producing better quality financial information than the corporate sector. Enterprises' reluctance to disclose information and the focus on the tax consequences of accounting are widely seen as obstacles to increasing transparency and to improving the quality of financial reporting. Many interested persons interviewed pointed to the state-owned sector as an area where information was generally not transparent and was rarely available.
- 94 **Anecdotal evidence regarding the perceived quality of audits and the value that an audit brings to financial statements suggests that audits performed by the international networks and particularly those of the so-called Big Four are much more highly regarded than those of local, usually smaller, audit firms.** A review of audit firms conducted by a World Bank team in July 2011 also confirmed that audit firms that are members of international networks outperform their peers in using a formal audit methodology based on or consistent with International Standards on Auditing and ensuring quality assurance processes are in place in addition to that performed by the audit teams.
- 95 **The limited availability of credible financial information in Moldova makes it more difficult for companies in Moldova to access finance.** The quality of the available audited financial statements is often being perceived as low by potential lenders. In addition, the Business Environment and Enterprise Performance Surveys (BEEPS) for example show that only 18% of medium and 30 % of large enterprises have audited financial statements, which is far below the figures of 44% and 71 % reported for medium and large companies, respectively, in the region. These factors, combined with limited understanding of financial information by those in charge with entities' governance, have a negative effect on access to finance and ultimately lead to a high cost of capital.

VI. Policy Recommendations

- 96 **The recommendations of this ROSC are interrelated and mutually supportive and are designed to collectively improve the financial reporting environment in Moldova under the leadership from highest levels of Government in Moldova.** These recommendations are presented below along the major pillars of the corporate financial reporting framework i.e. (i) Statutory Framework; (ii) the Profession; (iii) Accounting and Auditing standards; (iv) Monitoring and Enforcement; and (v) Education and Training. These five pillars are mutually reinforcing and ideally many of these reforms should be addressed in parallel in order that the weakest aspects of the corporate financial reporting framework do not undermine the framework as a whole.
- 97 The following principles should underpin the efforts of the authorities and the profession to reform and strengthen Moldova’s corporate financial reporting, taking into account the substantial economic and human resource constraints facing the country:
- a. *Strengthening existing mechanisms* to the extent that they are conceptually sound and sustainable, rather than seeking a complete overhaul of existing mechanisms;
 - b. *Simplifying accounting and auditing obligations* whenever possible, especially for SMEs, to reduce the cost of doing business in Moldova for modest-sized businesses;
 - c. *Adopting international standards* whenever practicable, as opposed to developing custom-made solutions that are costly and difficult to maintain, and which do not convey the same level of confidence as international ones;
 - d. *Consolidating the institutional framework* to eliminate duplication of efforts and foster synergy between regulatory agencies for best results.
 - e. *Supporting all measures with capacity building and awareness raising activities* to ensure that stakeholders affected by accounting and auditing regulation, enforcement and practices, including the users of financial information, have a sound theoretical and practical understanding of the subject matter.

Statutory Framework

- 98 **The statutory framework should establish appropriate thresholds for simplified accounting and financial reporting requirements and thereby reduce the burden on SMEs.** This should be done after a thorough analysis of the businesses in Moldova. The MOF should simplify the accounting and financial reporting requirements for smaller entities in a manner similar to the option provided for in the EU's Fourth Company Law Directive.
- 99 **While the World Bank advocates the adoption of the “IFRS for SMEs” for larger SMEs and adoption of simplified standards for small enterprises, the Government of Moldova decided to develop a new set of standards for all non-PIEs. The Ministry of Finance should address the following issues before enacting the new NAS to make the standards set easier to understand and implement:**

- a. The MOF should prepare a conceptual framework underpinning the National Accounting Standards.⁵³
- b. The requirement of the Accounting Law to prepare consolidated financial statements should be revised to make it consistent with the EU's Seventh Company Law Directive and should only be applicable to large groups. One possibility would be to require large groups to apply IFRS and by implication their consolidation requirements and thus obviate the need to include any consolidation requirements in NAS.⁵⁴
- c. The MOF should ensure that the new draft NAS⁵⁵ is consistent with the EU's Fourth and Seventh Company Law Directives.
- d. The MOF should set up a sustainable system to maintain the standard setting and updating process.

100 **The Ministry of Finance jointly with the Tax Administration should provide proper guidance on taxation issues for banks and other commercial enterprises producing financial statements in accordance with IFRS.** The guidance should include explanation of the major differences between IFRS and tax legislation and should provide a reconciliation of the net income reported in a company's financial statements with its taxable profit.

101 **The Government should review and where necessary amend accounting and auditing requirements in all laws and regulations to remove inconsistencies and introduce clarifications.** This would include:

- a. Reviewing and amending as necessary the stock exchange regulations for consistency with the Law on Accounting so that, for example, there is no difference in the accounting and auditing requirements applicable to the various types of listed entities, or by thoroughly revising the definition of listing.
- b. Reviewing and amending as necessary the Law on Financial Institutions so that, for example, references to accounting standards issued by NBM are removed.

102 **The Government should revisit the organisational structure of the audit oversight system and ensure it has adequate funding and human resources to operate effectively and in a manner consistent with the EU's Statutory Audit Directive.**⁵⁶ More specifically, there is a need to:

- a. Revisit the legal status and institutional structure of the audit oversight system to secure adequate funding while maintaining its independence from the audit profession.
- b. Ensure that the audit oversight system is able financially and otherwise to recruit professionals with appropriate qualifications and experience into the quality assurance inspection unit (currently Control and Verification Service).

⁵³ The team was informed that the MOF decided to develop a conceptual framework.

⁵⁴ The team was informed that the MOF decided to develop a new NAS which will address the consolidation requirements for non-PIEs.

⁵⁵ Observations of the ROSC team on the draft National Accounting Standards shared by the Ministry of Finance in January 2013 are presented in Annex 2.

⁵⁶ Policy options for the Government's consideration are presented in Annex 4.

- c. Prepare secondary legislation adequate to support the methodology, manuals and working procedures of the audit oversight and quality assurance system.

103 Reflecting the financial and human resource constraints of the Government, the implementation of the above recommendation will take time and accordingly the Government should establish a sequenced strategy for improving the oversight of the profession in the shorter term. Such a strategy could include the following:

- a. Limiting the quality assurance activity over the work of auditors to a balanced mixed of auditors and audit firms ranging from PIE auditors to small audit firms adopting a risk-based approach;
- b. Identifying options to provide additional funds to the quality assurance system (one option that is used in many countries is for auditors to provide contributions to the system);
- c. Collaborate with the professional associations to develop the capacity of the quality assurance unit (currently CVS) in conducting quality reviews;
- d. Observe the quality reviews conducted by professional associations for their members and assess the extent to which these reviews could be relied on by the AOC;
- e. Request training for technical staff and technical assistance for the development of methodologies from international donors and development partners;

104 The Law on Auditing Activity needs to converge more closely with the EU Statutory Audit Directive in the long-term. Full convergence will require the following revisions:

- a. The Law regulates ‘auditing activity’ but does not distinguish between audit and non-auditing services, thereby essentially regulating various non-audit consulting activities by certified auditors. The Law should instead focus on statutory and voluntary audits and address the issue of other consultancy services only to the extent it may affect an auditor’s independence. For this, the law does not need to specify the exhaustive list of services that auditors can provide, but make a more general definition, as services may evolve in time depending on market development and business needs.
- b. The Law should define the grounds on which companies may dismiss their auditors consistent with the provisions of the EU’s Statutory Audit Directive.
- c. The Law should contain clear guidelines to ensure that there are no conflicts of interest between the quality assurance staff and statutory auditors.
- d. The Law should be amended such that the current four-month deadline for auditors of PIEs to publish their annual transparency reports is reduced to three months. Additionally, transparency reports should be required to include a description of the international network, if any, to which the audit firm belongs, as well as financial information showing the basis for the remuneration of the audit firm’s partners.
- e. The Law should include those requirements of the EU’s Statutory Audit Directive that provide for better independence of PIEs’ statutory auditors, including the requirement for a confirmation to audit committees of independence, disclosure to audit committees of additional services provided, and requiring auditors to discuss issues of independence with audit committees. The Law should also require regular quality assurance reviews of auditors of PIEs.
- f. The minimum experience requirements for a candidate to take the Certification Commission’s qualification examinations for auditors should be amended to two years from the current requirement of six months available for some categories of applicants.

- g. The Law should be amended to ensure that the information included in the public registry of auditors and audit firms is in line with that required by the EU's Statutory Audit Directive. More specifically, the public register should also contain the name and address of the competent authorities responsible for approval or auditors, for quality assurance, for investigations of and levying penalties on statutory auditors and audit firms, and for public oversight.
- h. The current definition of auditing standards in the law should be aligned with the classification of auditing standards by IAASB⁵⁷ namely: (i) ISA (ISAs 100–999 International Standards on Auditing); (ii) ISQCs 1–99 International Standards on Quality Control; and (iii) IESBA Code of Ethics for Professional Accountants.

105 **It would be necessary to perform a specific analysis of the sector, so that the Government could establish adequate mechanisms for enhanced transparency and disclosure for SOEs.** The analysis should also include an assessment of the training and technical needs of public agencies for better monitoring and oversight of SOEs as well as a review of corporate governance arrangements and fiscal risk. Major SOEs which have a public interest character are currently not audited and do not have adequate transparency requirements. SOEs' financial statements should be audited and appropriately scrutinized by SOEs' audit committees or their equivalents. As a first step, state enterprises may be corporatized to have unity in the regulatory framework for SOEs. Furthermore, the three government structures with oversight responsibilities for SOEs (the Ministry of Finance, the line ministries responsible for their SOEs and the Public Property Agency), should be required actively to monitor SOEs' financial and non-financial information. This will also contribute to the MOF's effort to assess fiscal risk of SOEs. The Government could seek support from development partners in undertaking such work.

The Profession

106 **Both the professional associations and the Government should collaborate towards increasing the reliability of the local accountancy professional qualification initially on the local market initially and, in the longer term, internationally.** Discussions with the stakeholders and the business community revealed that the local qualification is often perceived as a bureaucratic qualification that is required for auditors to be able to operate in the market rather than one that recognizes the holder as fit for the purposes of providing assurance and business advisory services. The professional examination system for auditors should be enhanced in order to improve professional skills and to increase recognition for the qualification. This would require:

- a. Revision of the syllabus to better align it with provisions of the IFRS, and corporate governance, as well as of the national accounting standards when adopted;
- b. Introduction of a quality assurance mechanism for the preparation of examination questions;

⁵⁷ http://www.ifac.org/sites/default/files/publications/files/2012%20IAASB%20Handbook%20Part%20I_Web.pdf

- c. An expanded pool of examination questions, which may be achieved with the involvement of the professional associations;
- d. Improved transparency, by making past exam questions publicly available;
- e. Improved reliability by revisiting the way the Certification Commission operates;
- f. Additional financial resources to ensure that all the above-proposed measures may be properly implemented.

107 **There is a need to structure and standardize the additional examinations by the NBM and NCFM for the certification of auditors for the audit of financial institutions, insurance companies and the securities market.** Although it is understandable that regulators wish to ensure that only auditors with appropriate industry-specific knowledge, capacity and experience perform audits in their sectors, the existing system does not seem adequate to assess this. Furthermore, in the longer term, it would be advisable to move away from such sector-specific requirements as they are essentially incorporated into ISAs and should be capable of being monitored through enhanced quality assurance and audit oversight.

108 **The professional associations should be more proactive in the implementation of the accounting and auditing reforms through increased quality and improved perception of the profession by the business community. This could include:**

- a. Making twinning arrangements with institutes and associations in other countries
- b. Establishing peer-review mechanisms within the respective associations for better quality audits.
- c. Committing to compliance with IFAC's Statements of Membership Obligations or similar requirements.
- d. Partnering with industry, trade and commerce chambers to engage in dialogue with the Government and regulators to facilitate the accounting and auditing reforms.
- e. Partnering with other stakeholders and perhaps development partners in knowledge sharing activities for accountants on accounting standards, for auditors on auditing standards and for businesses and investors on the importance of this agenda.

Accounting and Auditing Standards

109 **The national accounting standard-setting process should be made more participatory and sustainable.** The standard-setting approach should be expanded to provide for broader consultation with preparers, users and auditors of financial statements as well as tax experts. Furthermore, sufficient time should be allowed for public consultations, with all such discussions and feedback being transparent. Consideration should be given to the sustainability of the standard-setting process together with clarification of the way future revisions will be made to keep the standards up-to-date. As adopting the IFRS for SMEs would allow national standard setters to benefit from the rigorous and participatory process followed by the IASB, national standards setters may find it more effective to refocus their attention into participating in this process and expressing their needs to IASB, rather than developing their own customised solutions.

110 **The process for adopting accounting and auditing standards should be streamlined.** The Law on Accounting and Law on Auditing Activity between them require the use of IFRSs,

ISAs and IFAC's Code of Ethics. However, the legislation requires translations of these standards or any updates to them to be published in the Official Monitor and there is currently a backlog of standards and their updates for publication. The Ministry of Finance should make sure that all updates enter into force on a timely basis.

Monitoring and Enforcement

- 111 **The capacity of the Public Registry needs strengthening.** The Public Registry is responsible for ensuring that companies comply with the financial reporting and transparency provisions of the Law on Accounting. However, the Public Registry has neither the capacity nor the resources to fulfil these responsibilities, which would initially require that:
- a. The Public Registry is provided with the necessary IT infrastructure to collect, process and publish the financial statements required by the Law;
 - b. The Public Registry develops or acquires software that integrates with the State Registry of entities as well as registers of taxpayers so that it can compile a full list of entities that are required to submit their financial reports;
 - c. The Public Registry is staffed and funded;
 - d. The Public Registry staffs are trained on financial reporting and auditing standards.
- 112 **Reflecting the financial and human resource constraints of the Government and other stakeholders, the implementation of the above recommendation may take time. The Government should therefore establish a sequenced strategy for securing improved compliance and transparency in the shorter term.** Such a strategy could include the following:
- a. Initially limiting the disclosure requirement to audited financial statements and gradually expanding the requirement to a wider range of companies;
 - b. Supporting enforcement of these limited disclosure requirements by increasing coordination with registration chambers and tax authorities.
 - c. Requesting financial reporting training for technical staff and technical assistance for the development of review methodologies from professional organizations, international donors and development partners.
- 113 **The audit oversight and quality assurance system should be provided with the necessary resources and tools for performing its duties in the medium to long term and as stipulated in the Law on Auditing Activity.** The quality assurance unit (currently CVS) should be adequately funded and staffed consistent with the EU's Statutory Audit Directive. The Government should seek technical assistance from development partners to devise methodologies, manuals and operational guidelines as well as deliver training to its technical staff. Recognizing that addressing these weaknesses will take time and given substantial resource limitations, the quality assurance unit (currently CVS) should in the short-term focus its efforts on the quality assurance of the work of a limited number of auditors and audit firms, adopting a risk-based approach that would cover a balanced mix of auditors ranging from PIE auditors to small audit firms.

- 114 **Regulators should take an active role in the enforcement of accounting and auditing regulations.** While the banking sector is relatively well monitored by the NBM, there is room to improve monitoring by the NCFM of listed companies, insurance companies and other regulated entities. NCFM should be adequately staffed and the staff should be trained on accounting and auditing standards, with a specific emphasis on particular topics such as insurance sector accounting, corporate governance and financial reporting. Furthermore, the regulators should develop methodologies to deal with audit reports containing modified, adverse or disclaimers of opinions. A structured technical assistance program may help the NCFM resolve these capacity issues. The banking regulator should continue its efforts to enforce financial reporting requirements and to comply with the Basel Core Principles for financial reporting by banks, including the relationship between banks' regulators and auditors.
- 115 **Regulators should support PIEs to implement the 2012 requirement for IFRS.** Preparers of financial statements as well as their consultants and advisers face significant challenges and would benefit from detailed guidance. Regulators should take a more proactive role to facilitate implementation of IFRS and increase compliance by PIEs.
- 116 **As a short term action, regulators represented on the AOC should help more proactively to resolve issues relating to audit oversight.** For example, regulators could provide technical support to the CVS and would benefit from an exchange of information about the performance of auditors in their sectors.

Education and Training

- 117 **Universities should update their accounting and auditing curricula to include principles, concepts and key features of IFRS, ISA, business ethics and governance and new NAS when adopted.** The AESM is currently going through such a process and the other Universities could learn from its experience. Universities should also aim to obtain exemptions for their graduates from parts or whole of examinations for national and international accounting and auditing qualifications. Such initiatives would create incentives for students to join the accounting and auditing profession. This would need i) training of trainers in IFRS, ISA, ethics and corporate governance, ii) development of the teaching materials as well as the translation of relevant international materials.
- 118 **Universities should expose their students to IFRS and ISA in the bachelor degrees in relevant departments awarding accounting and business degrees.** Currently, students are not exposed to IFRS and ISA until they pursue masters' degrees. This could also be achieved by collaborating with the professional organizations and accredited education institutions providing CPD training for certified auditors. Furthermore, aspiring auditors should be encouraged to practice auditing through internships recognizing the importance of practical training in addition to the theory for a good understanding of ISA.
- 119 **There is a need to review the content of CPD programs with a view of upgrading in line with the needs of the new accounting and auditing framework.** Furthermore, the CPD should also be used as a tool for re-training the certified professionals, especially in the context of new NAS adoption, IFRS and ISA adoption.

- 120 **The staff of regulators, including those of the NBM, NCFM and MOF, should receive practical training to enforce accounting and financial reporting standards with a good basic understanding of the auditing standards and their application.** Training programs should focus on practical, legal and compliance issues in the banking and insurance sectors as well as the securities markets.
- 121 **In the longer run, better corporate governance arrangements for PIEs will play a critical role in ensuring that Moldova high-quality financial reporting and audit practices.** An improved framework will help improve the effectiveness of transparency and disclosure requirements pertaining to PIEs. This would include establishing audit committees with well-defined responsibilities and adequate resources, as required in the EU in the Statutory Audit Directive.⁵⁸ The new draft Code on Corporate Governance, which is currently being prepared by NCFM, would be an ideal entry point for introducing such reform.
- 122 **Later on, a requirement for all PIEs to establish an audit committee or equivalent should be introduced in the law on Audit Activity,** as part of the long-term objective of full alignment with the EU *acquis communautaire*.

⁵⁸ Eighth Directive, Article 41.

Annex 1: Status of implementation of the 2004 ROSC policy recommendations

2004 ROSC recommendation	Status of implementation
1. The Accounting Law should be thoroughly revised	<i>Regulatory framework improved; substantial implementation challenges.</i> A new Accounting Law was published in 2007 and entered into force on January 1, 2008.
2. Adopt available Romanian and Russian translations of all IFRS standards that have not yet been reflected into NAS and revise existing NAS for better alignment with IFRS	<i>Addressed.</i> Romanian and Russian translations of IFRS were adopted in 2008. However, subsequent amendments to IFRS have not been adopted. The mechanism for the adoption of amendments to IFRS should be reviewed to ensure that all the amendments are adopted on a timely basis. The Government is developing a new set of NAS for non-PIEs rather than revising existing NAS – see Annex 2.
3. Amend NAS 4, Accounting for Small Business Entities, to provide SMEs with a comprehensive reporting framework	<i>In progress.</i> As described above, the government is developing a new set of NAS which is expected to address this recommendation– see Annex 2.
4. Require public-interest entities to file their annual financial statements with a public registry of companies, to be established possibly under the National Securities Commission (CNVM)	<i>Regulatory framework improved; substantial implementation challenges.</i> A Financial Statements Information Service (aka Public Registry) was established subordinate to the National Bureau of Statistics and the new Accounting Law requires all entities to file their annual financial statements with the Public Registry. However, there are issues with respect to implementation that are described in the main body of this ROSC report.
5. The JSC Law, State Enterprise Law and Law on Enterprises should be amended to require statutory financial statement audits in all public interest entities	<i>Addressed</i> in the new Law on Auditing Activity where statutory audit of financial statements of all public interest entities became mandatory.

2004 ROSC recommendation	Status of implementation
<p>6. Clarify the role of the Censors' Committee with respect to the financial reporting process and restrict the obligation to have Censors to entities not subject to statutory audits</p>	<p><i>Outstanding.</i> The Law on Joint Stock Companies remains unchanged. As described in the main body of this ROSC report, the role of JSCs' Censors' Committee continues to be unclear.</p>
<p>7. CNVM's and SIIS's powers and capacity for enforcing accounting standards and financial reporting requirements should be strengthened</p>	<p><i>Partially addressed. Regulatory framework improved; substantial implementation challenges.</i> The CNVM and SIIS have been superseded by the National Commission on Financial Markets (NCFM) which has the power to enforce accounting standards and financial reporting requirements.</p>
<p>8. Finalize the draft of a new Auditing Law</p>	<p><i>Regulatory framework improved; substantial implementation challenges.</i> A new Law on Auditing Activity was adopted in 2007 and entered into force on January 1, 2008</p>
<p>9. Establish an independent Audit Oversight Council</p>	<p><i>Regulatory framework improved; substantial implementation challenges.</i> An Auditing Oversight Council (AOC) independent of the auditing profession was established under the MOF. However, there are issues with respect to resources and capacity that are described in the main body of this ROSC report.</p>
<p>10. Academic curricula in the field of accounting and auditing, as well as professional education and training should be strengthened.</p>	<p><i>In progress.</i> The leading university in the field of accounting and auditing, the Academy of Economic Studies of Moldova (AESM), has submitted an application for accreditation to ACCA and has started the process of improving its curricula. However, as described in the main body of this ROSC report, there remains considerable scope to strengthen academic curricula in accounting and auditing, particularly at other universities.</p>

Annex 2: Observations on the draft new National Accounting Standards⁵⁹

- 1 A list of the draft new NAS and the basis on which they were developed is presented in Annex 3

Strengths of the draft new NAS

- 2 The new NAS are drafted in a simplified language that is accessible to local preparers of financial statements and contain many examples and application guidelines that make them easier to follow.
- 3 The draft new NAS draw on many principles and concepts from the IASB Conceptual Framework for Financial Reporting as well as IFRS making them easier to understand by users familiar with this Framework and IFRS, particularly, international users.
- 4 The draft new NAS are consistent with the EU's Fourth Company Law Directive⁶⁰ in many respects; also the draft NAS are in part compatible with the requirements of IFRS and IFRS for SMEs.

Comments on the content of the draft new NAS

- 5 **There is no Conceptual Framework underpinning the new NAS.** While certain concepts are established in the Law on Accounting and the new *NAS 1, Presentation of the Financial Statements*, it would greatly assist the NAS standards-setting process if there was such a conceptual framework. In addition, given that both the Law on Accounting and the draft new NAS refer to a conceptual framework for preparing and submitting financial statements, it would seem sensible to develop one.
- 6 **The draft NAS are consistent with the provisions of the Fourth EU Directive in many respects, though the Seventh Directive's requirement for consolidation is not incorporated.** There are certain areas of differences between the draft NAS and the Fourth Directive, including accounting for investments in associates, contingent liabilities, research and development costs, disclosure requirements and the layouts of the financial statements. The requirements for consolidated financial statements are currently obliquely prescribed by Article 37 of the Accounting Law which requires that consolidation should take place only if required by the accounting standards being followed by the entity. However, and consistent with the EU's Seventh Directive, all consolidated financial statements should be prepared in

⁵⁹ These observations are made with reference to the draft new NASs extant as at January 2, 2013.

⁶⁰ The team compared the draft NAS using the 4th and 7th directives in force. Currently the directives 4th and 7th are being revised and the standards setter will need to assess the impact of potential changes on the NAS.

accordance with IFRS. If the final NAS do not incorporate the requirement for consolidation, the Accounting Law should be amended to require that groups prepare consolidated financial statements in accordance with full IFRS.

- 7 **The draft new NAS are derived from full IFRS. In many respects this is a good thing because it helps ensure that NAS are consistent with best international practice. However, NAS should be considerably simpler than full IFRS.** NAS should be designed as a simplified set of standards applicable to non-PIEs. In addition, the draft new NAS contain references to full IFRS which results in a very complex set of standards. While recognizing the importance of ensuring consistency of NAS with the IFRS, NAS should nevertheless be developed as a standalone standard as is the case for IFRS for SMEs. One option to help simplify the development of NAS would be to use the IFRS for SMEs as the main benchmark rather than full IFRS.
- 8 **The draft NASs are in various ways incomplete or inconsistent with IFRS and the IFRS for SMEs.** There are certain provisions that appear in IFRS and the IFRS for SMEs but are not addressed in NAS such as consolidation and investments in associates. There are some provisions appearing in NAS that are not fully consistent with IFRS and the IFRS for SMEs such as comprehensive income, some issues relating to financial instruments, and the treatment of expected losses in construction contracts. NAS should be consistent with IFRS and the IFRS for SMEs.
- 9 **The precedence of external sources of authority proposed in the draft NAS 8, *Accounting policies, changes of the accounting estimates, errors and subsequent events*, is inconsistent both with that proposed in the Law on Accounting and the IFRS for SMEs.** NAS 8 essentially advocates that where the standard does not specifically address a particular transaction, event or condition, preparers of financial statements may instead refer, in the following order of precedence, to: (i) other NAS and IFRS; (ii) the conceptual framework; and (iii) other normative acts. By contrast the Law on Accounting advocates the following precedence: (i) the conceptual framework; (ii) other NAS and IFRS; and (iii) other normative acts. The precedence of external sources of authority proposed in the draft NAS 8 should be aligned and consistent with the Law on Accounting. The full IFRS may be part of the hierarchy, but the reference to it should be optional (similar to the approach in the IFRS for SMEs).
- 10 **Simplified accounting standards for small entities are not foreseen in the draft NAS.** The draft of NAS 1, Presentation of the Financial Statements, permits small entities to submit a reduced number of statements; a balance sheet, income statement and explanatory notes. However, this does not appear to exempt small entities from applying full NAS in all other respects. Consistent with the EU's Fourth Company Law Directive, NAS should offer a simplified standard for small entities so that they are not overburdened with financial reporting obligations.
- 11 **Some accounting issues in the draft new NAS are inconsistent with international practices and should be revised.** The specific accounting issues include: (i) NAS 3, Expenditures – an expense should only be capitalized if it satisfies specific assets recognition criteria, otherwise it should remain an expense; (ii) low value and short-term assets – this inherited practice of classifying assets as low value and short-term should be discontinued and such assets should instead, if they satisfy the relevant recognition criteria,

be treated as fixed assets or inventory otherwise they should be treated as an expense; (iii) so-called “amount differences” – this inherited practice of accounting for local currency transactions that are linked to foreign currency equivalent amounts should be discontinued and such differences treated as exchange rate differences as they would be under IFRS or the IFRS for SMEs.

- 12 **The matching principle described in both draft NAS 2- Inventories and draft NAS 3- Expenses, is not consistent with IFRS or IFRS for SMEs and should be removed.** The accrual basis of accounting is now considered sufficient to provide guidance relating to revenue and expense recognition issues of the sort that once was within the scope of the matching principle (for example an item will be either recognised as an asset when it satisfies definition and recognition criteria, or expensed if it does not).
- 13 **Some draft NAS are internally inconsistent.** For example: NAS 1, Presentation of Financial Statements, requires the cash flow statement to present separately exchange-rate differences relating to operational, investment and financing activities. However, this is not consistent with the form of the cash flow statement presented elsewhere in the same draft of NAS 1, which provides only one line item for all exchange rate differences. In another example, the NAS currently drafted for Impairment of assets contains a reference to a “revaluation method” that is supposedly defined in NAS 16, Tangible and Intangible assets, although NAS 16 contains no such definition.
- 14 **The proposed content of the balance sheet and profit and loss account is inconsistent with the EU’s Fourth Company Law Directive and should be revised.** NAS 1, Presentation of Financial Statements, prescribes the content of the balance sheet and profit and loss account. However, the proposed format of the balance sheet does not require the following to be shown separately: share premium, revaluation reserve and payments on account related to non-current and/or current assets. The proposed content of the profit and loss account is very much more abridged than any of the formats offered by the EU’s Fourth Company Law Directive. It is recommended that the content of the NAS 1-prescribed balance sheet and profit and loss account be at least equivalent to the requirements of the EU’s Fourth Company Law Directive.
- 15 **The current approach of the draft NASs to require annexes and disclosures to the financial statements could be revised.** More specifically, and consistent with the approach taken in IFRS and the IFRS for SMEs, an annex or disclosure should only be required by a NAS if it provides further information in respect of a specific item appearing on the face of one of the main financial statements and indeed the annex or disclosure should be cross-referenced from that item. In addition to the NAS, guidance could be developed which contain examples of as well as checklists for any tables or other quantitative or qualitative information required by any annexe and disclosure. This would greatly help preparers of financial statements and thus represent a significant step forward as compared with current NAS in terms of compliance.
- 16 **Alignment where possible with tax law.** Since the draft NASs are designed to be a simplified set of standards for non-PIEs, it would be desirable if these standards are closely aligned with tax rules and prescribe the same accounting treatments where there is neither a conflict with the conceptual framework nor an economic benefit.

- 17 **The provisions in the Accounting Law relating to double-entry and simplified systems of accounting should be revised.** More specifically, article 15 should not include references to the acceptability or otherwise of double-entry and simplified systems of accounting. Rather, the Law should require all entities to maintain robust systems of accounting and internal controls that *inter alia* enable them to produce reliable and timely financial statements in accordance with prescribed financial reporting standards. One consequence of such an approach is that it would almost certainly require all entities other than the very small to maintain double-entry systems of accounting because otherwise it would be very difficult for them to assert that their systems are indeed robust.

Annex 3: List of draft new National Accounting Standards

Draft NASs	Developed on the basis of
NAS 1 Financial statements presentation	EU Directives, Conceptual framework for financial reporting, IAS 1 Presentation of Financial Statements and IAS 7 statement of Cash Flow (2011)
NAS 2 Inventories	IAS 2 Inventories (2011)
NAS 3 Expenses	EU Directives, Conceptual framework for financial reporting, and IFRSs (2011)
NAS 8 Accounting policies, changes of accounting estimates, errors and subsequent events	EU Directives, IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors and IAS 10 events after the reporting period (2011)
NAS 11 Construction contracts	EU Directives, IAS 11 Construction contracts (2011)
NAS 16 Intangible and tangible assets	EU Directives, IAS 16 Tangible assets, IAS 38 Intangible assets, IFRS 6 Exploration for and Evaluation of Mineral Resources (2009)
NAS 17 Leases	EU Directives, IAS 17 Leases (2009)
NAS 18 Revenue	EU Directives, Conceptual framework for financial reporting and IAS 18 Revenue (2009)
NAS 21 Foreign currency translation and amount differences	EU Directives, IAS 21 The Effects of Changes in Foreign Exchange Rates (2011)
NAS 23 Borrowing costs	EU Directives, IAS 23 Borrowing costs (2011)
NAS Receivables and financial investments	EU Directives, Conceptual framework for financial reporting, IAS 19 Employee Benefits, IAS 32 Financial Instruments: Presentation, IFRS 7 Financial Instruments: Disclosures, IFRS 9 Financial instruments (2011)
NAS Impairment of assets	IAS 39 Impairment of assets (2009)
NAS Investment property	EU Directives, IAS 40 Investment property (2011)
NAS Related party and investments in joint ventures	EU Directives, Conceptual framework for financial reporting, IAS 24 Related Party Disclosures, IAS 31 Interests In Joint Ventures

Draft NASs	Developed on the basis of
NAS Equity and liabilities	EU Directives, Conceptual framework for financial reporting, IAS 19 Employee Benefits, IAS 20 Accounting for Government Grants and Disclosure of Government Assistance and IAS 37 Provisions, Contingent Liabilities and Contingent Assets (2011)
NAS Accounting peculiarities in agriculture	The draft NASs was not available to the A&A ROSC team
Accounting peculiarities for physical persons who undertakes entrepreneurial activity	Accounting Law and Fiscal Code

Annex 4: Options for Audit Oversight

- 1 As described in the main body of the report, all the elements of an audit oversight system as prescribed in the EU's Statutory Audit Directive are incorporated in the Law on Auditing Activity. However, the audit oversight system is fragmented with different aspects of the oversight system being performed by different departments and entities.** Thus: certification of auditors is performed by the Certification Commission under the MOF; licensing of audit firms is performed by the Licensing Chamber; the registry of auditors is maintained by the MOF; professional auditing standards are adopted by the MOF; CPD is monitored by the AOC, while the information is gathered by the secretary of the Certification Commission; quality assurance is performed by the AOC's CVS; warning sanctions are issued by the AOC; the AOC decide that an audit certificate is revoked and MOF will withdraw the certificate based on that decision; and the AOC may propose that an audit license is revoked and Licensing Chamber will withdraw the license based on that decision. This fragmentation makes it difficult for anyone and, particularly, the AOC to claim to be responsible for or be held fully accountable for the oversight of statutory audits and auditors in a manner consistent with the EU's Statutory Audit Directive. This lack of clear accountability is likely to lead to confusion and inconsistent enforcement of auditing standards.
- 2 In addition to fragmented responsibility, audit oversight also suffers from significant capacity and resource constraints.** More specifically, the staff of the CVS, which is the executive arm of the AOC, has staff inexperienced in IFRS and ISAs and is constricted in its ability to recruit staff with appropriate experience because of civil service pay scales. In addition, the AOC and CVS have inadequate resources for staff training, for developing methodologies and working practices, and for IT and other infrastructure.
- 3 The lines of responsibility and accountability for oversight of the audit profession and enforcing auditing standards should be streamlined. One body or authority should be invested with all audit oversight responsibilities.** The selected body or authority should be given resources sufficient to enable it to strengthen its organizational structure, develop its staff, formulate appropriate working practices and procedures, and devise robust risk-based tools and methodologies. There are four main options to achieving this: (i) build on the existing Audit Oversight Council; (ii) create a new body such as an Audit Chamber with the AOC overseeing its activities; (iii) build on an existing professional association with the AOC overseeing its activities; and (iv) build on an existing independent regulator. Each of these options is discussed below.

Build on the existing Audit Oversight Council.

- 4 Under this option, the AOC would assume all responsibilities for quality assurance and oversight activities with no initial reliance placed on other institutions including the professional associations.** Thus, the AOC would be responsible for: overseeing the certification of auditors; liaising with the Licensing Chamber in respect of audit licenses; maintaining the registry of auditors; stipulating professional auditing standards; monitoring

auditors' compliance with CPD requirements; performing or being responsible through delegated measures for audit quality assurance inspections; issuing sanctions and disciplining statutory auditors including deciding whether to revoke an auditor's audit certificate.

- 5 The main advantage of this option is that the AOC already exists. The AOC should have more autonomy with respect to managing their funds and deciding on alternative restructuring options. One way of doing this would be for the AOC to take over the responsibility for registration of auditors and collect fees from auditors and audited PIEs that should pay for the oversight function. This would provide the required funding to the oversight system on top of the contributions from the state budget. One disadvantage that the Government needs to overcome in this option includes the relative difficulty of recruiting staff of the experience required to the AOC given the civil service salary constraints; addressing this may require a changing in the legal status of the AOC. Additionally, the AOC could revisit whether and to what extent it can rely on the work of the professional associations in terms of any quality assurance that they perform of their auditor members. The AOC would adopt a reliable quality assurance mechanism that will obviate the need for both the professional associations and the AOC separately to devise and maintain audit quality assurance systems resulting in a very high overall total cost.
- 6 The disadvantage of this option is that this is a new regulatory institution, it will need significant time and resources to develop an image of an institution serving public interest, to build strong links and collaboration with financial sector regulators, as well as evolve as an institution that ensures that external audit is of good quality and can be relied on by users of financial information.

Create a new Audit Chamber with the AOC overseeing its activities.

- 7 Under this option, all auditors would be obliged to become members of an Audit Chamber which would be responsible for certification of auditors; stipulating professional auditing standards; monitoring auditors' compliance with CPD requirements; performing audit quality assurance inspections; issuing sanctions and disciplining statutory auditors including deciding whether to revoke an auditor's audit certificate. The AOC in turn would liaise with the Licensing Chamber in respect of the audit licenses; maintaining the registry of auditors; performing oversight of the Audit Chamber and, perhaps, also of auditors of PIEs in order to ensure that the Chamber is properly discharging its audit quality assurance responsibilities. This option would be far less onerous for the AOC than requiring it to run a full non-delegated audit oversight function as proposed in option 1.
- 8 The main advantage of this approach is that it will be easier eventually to move to a self-financed model of audit quality assurance with the Audit Chamber collecting fees directly from its members and perhaps also from PIEs and other companies. In addition, the Chamber would not be bound by civil service pay constraints. Finally, there would be considerable economies of scale with only one institution needing to devise and maintain audit quality assurance systems rather than possibly requiring each of the three main professional bodies as well as the AOC to do so.

- 9 The disadvantage of this option is that it requires building a new professional body and the capacity of existing professional bodies will not be used. The profession is fragmented in Moldova and this option may contribute to further fragmentation.

Build on existing professional associations with the AOC overseeing its activities.

- 10 This option is similar to the option described immediately above except that instead of creating a new Audit Chamber, one or several of the existing professional associations would be selected and all auditors would be required to become members of that association. Thus the professional association would be responsible for certificating auditors; stipulating professional auditing standards; monitoring auditors' compliance with CPD requirements; performing audit quality assurance inspections; and issuing sanctions and disciplining statutory auditors including deciding whether to revoke an auditor's audit certificate. The AOC in turn would liaise with the Licensing Chamber in respect of audit licenses; maintaining the registry of auditors; and performing oversight of the professional association and, perhaps, also of auditors of PIEs in order to ensure that the professional association is properly discharging its audit quality assurance responsibilities. This option would be far less onerous for the AOC than requiring it to run a full non-delegated audit oversight function as proposed in option 1.
- 11 The main advantage of this option is that the professional associations already exist and have initiated some activities to develop and implement audit quality assurance systems. As with the option to create a new Audit Chamber, an advantage of this approach is that it will be easier eventually to move to a self-financed model of audit quality assurance with the professional association collecting fees directly from its members and perhaps also PIEs and other companies. In addition, the professional association would not be bound by civil service pay constraints. Finally, there would be considerable economies of scale in terms of devising and maintaining audit quality assurance systems. Indeed some of the professional associations have already taken steps to develop and implement audit quality assurance systems.
- 12 A variant on this option which would create competition amongst professional associations and perhaps drive up standards would be for the AOC to devise objective criteria that professional associations must satisfy in order to become an authorized professional body for the purposes of assuming the roles and responsibilities outlined above. The AOC would thus, in addition to the role described above, also need to assess professional bodies to establish whether or not they meet the objective criteria.
- 13 The disadvantage of this option is that it reinforces fragmentation of the profession and it needs a sound and credible system of accreditation for professional bodies. The challenge would be also for AOC to ensure that all the eligible professional bodies adhere to the same standards applicable to their members.

Build on an existing regulator

- 14 Under this option, an existing regulator such as the NCFM (or NCFM jointly with NBM) would assume the responsibilities of the AOC under option 1. Thus the regulator would be responsible for: certification of auditors; liaising with the Licensing Chamber in respect of the audit licenses; maintaining the registry of auditors; stipulating professional auditing standards; monitoring auditors' compliance with CPD requirements; performing or being responsible through delegated measures for audit quality assurance inspections; and issuing sanctions and disciplining statutory auditors including deciding whether to revoke an auditor's audit certificate.
- 15 The main advantage of this option is that the regulator already exists and in all likelihood has assumed some role and responsibility to ensure that auditors are of a high quality albeit solely in the narrow regulated sector; it also enhances the ability of collaboration and information sharing between various sector regulators, so that audit oversight has a positive impact over supervision of the other sector, such as banking, insurance and stock market. Thus the regulator is likely to be familiar with auditors and the audit process. In addition, the regulator is not likely to be bound by civil service pay constraints and therefore would be free to recruit and pay market rates to appropriately qualified and experienced staff. It may also be easier eventually to move to a self-financed model of audit quality assurance with the regulator collecting fees directly from auditors and perhaps also PIEs. Finally, this option would foster very close collaboration between the audit regulator and financial sector regulators. This would help greatly in the early identification of systemic and other cross-cutting issues in the country's financial architecture.
- 16 The disadvantage of this approach is that the audit oversight may be diluted inside the existing regulator that is responsible for supervision of various areas.



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