

REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC)
TURKMENISTAN

ACCOUNTING AND AUDITING

June 30, 2009

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Executive Summary

This report describes the results of a ROSC assessment of accounting and auditing practices in Turkmenistan. The assessment identifies the strengths of, and areas for improvement in, the accounting and auditing environment that influences the quality of Turkmen corporate financial reporting. It also includes a review of both mandatory requirements and actual practice. The review of actual practice was limited by the lack of availability of financial statements. The report uses International Financial Reporting Standards and International Standards on Auditing as benchmarks, and draws on international experience and good practices in the field of accounting and audit regulation, to assess the quality of the country's financial reporting framework and make policy recommendations for improvement.¹

The objective of this report is to describe the existing corporate financial reporting framework and make policy recommendations to strengthen that framework with a view to improving the quality and the reliability of financial information about economically significant entities. Implementation of these recommendations will facilitate effective monitoring by the government of Turkmenistan of the financial results of state owned entities as well as providing a foundation for enhancing private sector development and developing greater integration of the Turkmen economy into the global marketplace.

The role and regulation of corporate sector accounting and auditing are shaped by the economic context in which they take place, and by the structure of the market they serve. Given the patterns of economic activity in Turkmenistan, and the role of the state, financial information has traditionally been considered an instrument of state monitoring, with a special focus on the collection of information for tax and statistical purposes, and a resource to which access was restricted, available only to those having the power to require its provision. However, as the Government's reform program proceeds, and as the private sector and foreign investors come to play a more significant role, Turkmenistan will see the need to reshape its financial reporting framework in a manner which supports the function of financial information as a public good provided to meet the needs of market participants generally, and to facilitate market discipline. At present each agency (e.g., the tax authorities, the Central Bank of Turkmenistan) has developed its own accounting and auditing/inspection requirements. Despite the provisions of the laws on accounting and auditing, the concept of published, general purpose financial statements meeting the needs of several user groups is not yet deeply established. The audit is associated more with tax compliance than with an independent financial statement audit performed by qualified professionals to lend credibility to the financial information provided to the marketplace. In recent years, progress has been made in the accounting and auditing environment but much remains to be done for Turkmenistan to achieve compliance with international good practices. However, reforms in economic management more generally will lead to changed patterns of demand for high quality audited financial statements, while the availability of this information will in turn support the reform process. The recommendations of this report aim to assist the Turkmen authorities in mapping out the program for successfully achieving these changes.

¹ This report was prepared based on the findings of a diagnostic review carried out in Turkmenistan by a World Bank team in January 2009. The team was led by Pascal Frèrejacque (ECCAT) and included Andrei Busuioc (ECCAT) and Serdar Jepbarov (ECCTM). The review was carried out in close collaboration with the Ministry of Finance and involved the participation of various stakeholders of corporate financial reporting in the country.

Turkmenistan is a middle-income country, with a gross national income per capita of about US\$3,620 in 2008 (as per the Atlas method), mainly derived from its production of hydrocarbons. It is a major exporter of natural gas, oil and oil products, electricity and textile products. Turkmenistan's natural gas reserves rank among the top ten in the world, and it has substantial proven oil reserves and an extensive irrigation system. The government of Turkmenistan still controls and operates all key sectors of the economy. In fact, the state owns all key businesses, including most of those in the banking and hydrocarbon sectors. Many of these businesses have no corporate legal form and are accounted for in the budgets of various ministries; some operate in the form of state-owned entities.

The government recently indicated, however, that it would like to increase the private sector's share of the economy (excluding the oil and gas sector) from 40% to 70%. Until now, that private sector has been limited and tends to be concentrated in the food processing, retail and services sectors. A few foreign companies operate in Turkmenistan, essentially in the construction and hydrocarbon sectors. Private business, both domestic and foreign, can be incorporated in the form of Joint Stock Companies or Limited Liability Companies.

In 2007, newly elected President Gurbanguly Berdymuhamedov launched a program of social and economic reforms aimed at accelerating growth and diversifying the economy, raising living standards, developing the private sector, creating a more market-oriented economy, and smoothly integrating Turkmenistan into international markets. One significant aspect of the reform is the strengthening and further development of the financial sector. In addition, Turkmen authorities are also working on improving financial reporting by beginning to implement International Financial Reporting Standards in the banking and hydrocarbon sectors.

The Accounting Law (1996) and the Audit Law (1996) are the main laws governing financial reporting in Turkmenistan. The Central Bank of Turkmenistan lays down specific requirements for the banking sector. There are separate rules governing tax reporting and the calculation of taxable profit but, in cases of divergence with general purpose financial reporting requirements, enterprises tend to follow tax rules. Auditors, too, focus mainly on issues of tax compliance. The Chamber of Auditors foreseen in the 1996 Audit Law has not yet been established, there is no formal system of audit quality assurance, and the legal status of national auditing standards is uncertain. Neither the Accounting Law nor the Audit Law makes any distinctions between reporting enterprises on the basis of their size, activities, or public interest impact. The non-availability of published financial statements makes it difficult to assess the extent to which accounting and auditing requirements are complied with in practice.

There are two organizations of professional accountants, but both are relatively small and include in their membership only a small share of all of those having accounting functions in Turkmenistan. There are approximately 50 licensed auditors in the country.

The capacity for accounting education needs to develop further. For example, the Turkmen Institute of Economics and Management of Ashgabat, which is one of the key education institutions for accountants, produces around 50 accounting graduates a year. Some accounting graduates study abroad. It should be noted that the institute's curriculum, which was limited to two years under the previous regime, was increased to five years in 2007. Access to professional accounting education is equally limited. A number of training centers prepare candidates to qualify for the Certified Accounting Practitioner qualification. For those wishing to become auditors, however, the Certified International Professional Accountant qualification is probably more suitable. Unfortunately, there is little training available for this purpose.

Core Recommendations of This Report

This report makes recommendations for strengthening the corporate sector financial reporting framework of Turkmenistan. These recommendations should be supported by activities such as conferences and workshops aimed at building awareness and fostering consensus on the nature, direction, and pace of future corporate sector financial reporting reform, with decisions on prioritization and sequencing being made by the authorities so as to ensure alignment with other reforms which are taking place. Financial reporting does not stand alone, and can only make its full contribution to development if it meets the information needs of the economy it seeks to serve.

A typical reform path would start with modifying the legal framework as recommended below. This would be followed by fully implementing existing laws, such as the Audit Law, which contains provisions that have not yet been implemented. Next, the legal framework would be strengthened, and the institutions required by the various laws established. The capacity of existing institutions for fulfilling their mandates would be assessed, and enhanced as necessary. This could be accomplished by providing the required human and financial resources identified in the institutional assessments, and by developing suitable training in cooperation with peer institutions in countries considered by the Turkmen authorities to be most relevant to their reform strategy. Strengthening accounting education and training will be a key priority. The World Bank will be pleased to assist in mobilizing the technical resources needed to support these reforms.

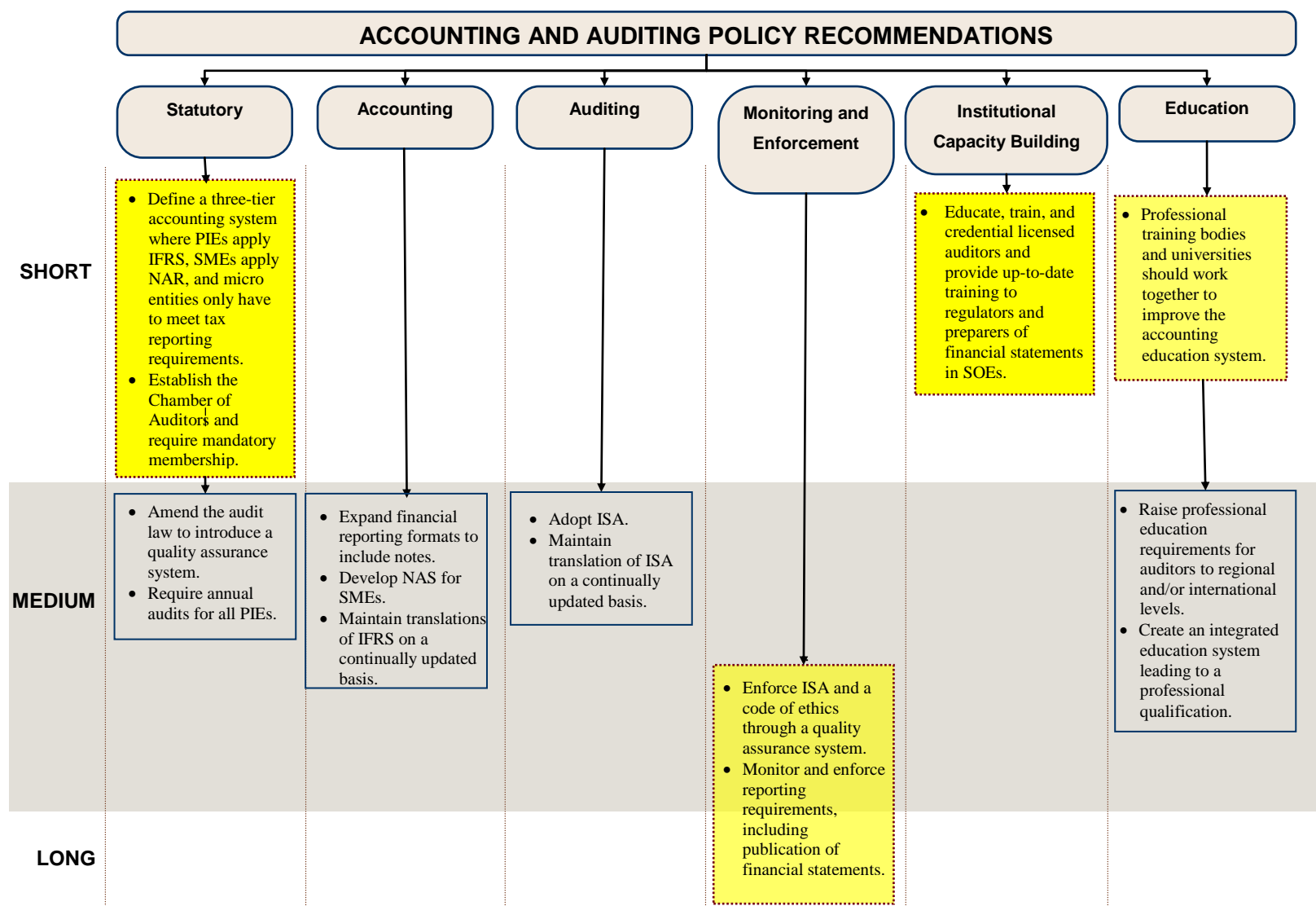
This report recommends the following steps:

Over the short term (one to two years):

- Turkmenistan should educate, train and accredit licensed auditors and also provide up-to-date training to regulators and preparers of state-owned entity financial statements.
- Professional training bodies and universities should work together to improve accounting education and training, leading to an integrated professional qualification system. Universities' syllabi should be improved and standardized, and the Turkmen Institute of Economics and Management could pilot implementation. Twinning arrangements with universities in other countries that have already made similar reforms would be of benefit, and the CAP-CIPA certification program should be promoted.
- The Chamber of Auditors foreseen in the Law on Auditing should be established, with all auditors required to become members of this body. The creation of the Chamber will help to focus efforts to develop, oversee, and regulate the audit function. Twinning with a peer chamber in another country would be of assistance.
- Turkmenistan should further enhance its accounting framework to introduce a classification system which distinguishes between three types of entities, and imposes obligations which are proportionate to the scale and nature of their activities: (i) public interest entities, which would apply International Financial Reporting Standards, (ii) small and medium-sized enterprises, which would apply simplified national accounting standards and regulations, and (iii) micro entities, which would have to meet only tax and statistics requirements. This reform will require agreement on the criteria adapted to the Turkmen context for determining which entities should fall into which categories. With respect to public interest entities, which would have to comply with the most stringent requirements, Turkmenistan may wish initially to focus on state-owned entities of national interest and banks that represent a significant share of the economy.

Over the medium and long term (three to seven years):

- National accounting standards and regulations for small and medium-sized enterprises should be developed, taking into consideration the simplified standard for SMEs issued by the International Accounting Standards Board, and similar standards developed by other countries.
- A mechanism should be developed whereby, in relation to the relevant entities, International Financial Reporting Standards and International Standards on Auditing are translated into the official Turkmen language and adopted as part of the legal framework for financial reporting in Turkmenistan, thus becoming domestic accounting, reporting and auditing standards. The financial statement formats currently prescribed should be adapted to allow for the inclusion of notes to provide further explanations and details on the financial position and operations of reporting entities, both for financial statements prepared under International Financial Reporting Standards and those prepared under National Accounting Standards.
- Only public interest entities should be made subject to an annual audit.
- The Audit Law should be modified to include a quality assurance system for monitoring the quality of audits.
- The Central Bank of Turkmenistan, the Ministry of Finance, and its regulating agencies should enforce the existing accounting, disclosure and auditing regulations, including the publication of financial statements.



MAIN ABBREVIATIONS AND ACRONYMS

ACCA	Association of Chartered Certified Accountants
CAP	Certified Accounting Practitioner
CBT	Central Bank of Turkmenistan
CIPA	Certified International Professional Accountant
CPD	Continuing Professional Development
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IAASB	International Auditing and Assurance Standards Board
IAESB	International Accounting Education Standards Board
IAS	International Accounting Standards (included in IFRS)
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IES	International Education Standard
IESBA	International Ethics Standards Board for Accountants
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards (including IAS)
IPSAS	International Public Sector Accounting Standards
ISA	International Standards on Auditing
JSC	Joint Stock Company
LLC	Limited Liability Company
MoF	Ministry of Finance
NAR	National Accounting Regulations
NSA	National Standards on Auditing
PIE	Public Interest Entity
ROSC	Reports on the Observance and Standards of Codes
SME	Small and Medium-Sized Enterprises
SMO	Statement of Membership Obligations of IFAC
SOE	State Owned Enterprise
TIEM	Turkmen Institute of Economics and Management
UNDP	United Nations Development Program
UoE	Union of Economists
USAID	United States Agency for International Development
UoPA	Union of Professional Accountants

I. INTRODUCTION

1. This assessment of accounting and auditing practices in Turkmenistan is part of a joint initiative of the World Bank and International Monetary Fund (IMF) to prepare Reports on the Observance of Standards and Codes (ROSC). The assessment identifies the strengths of, and areas for improvement in, the accounting and auditing environment that influences the quality of Turkmen corporate financial reporting. It also includes a review of both mandatory requirements and actual practice. The review of actual practice was limited by the lack of availability of financial statements. The report uses International Financial Reporting Standards (IFRS)² and International Standards on Auditing (ISA)³ as benchmarks, and draws on international experience and good practice in the field of accounting and auditing regulation.

2. Turkmenistan is a middle-income country, with a gross national income (GNI) per capita of about US\$3,620 in 2008 (as per the Atlas method), mainly derived from its production of hydrocarbons. As was the case with many other Commonwealth of Independent States (CIS) countries, following independence in 1991, Turkmenistan experienced several years of economic decline as its traditional economic ties disintegrated. The economy was also hit hard in 1997, when non-payments by CIS countries forced a suspension of virtually all natural gas exports. By 1998, however, the economy began to rebound and, with the resumption of natural gas exports to Ukraine and Russia in 1999-2000, recovery accelerated. Large-scale, state-driven investments, averaging more than 22% of the Turkmen gross domestic product (GDP), in oil refineries, textiles, food processing, transportation and various construction projects, also contributed to this recovery. Real GDP has increased by an average of 12% annually since 2004.

3. The country is richly endowed with hydrocarbons. Turkmenistan's natural gas reserves rank among the top 10 in the world. It also has substantial proven oil reserves and an extensive irrigation system that supports agriculture, including the production of wheat and cotton. Turkmenistan is a major exporter of natural gas, oil and oil products, electricity, and textile products. Although virtually all cotton and wheat crops are still grown under the state order system and procured by the state, the Turkmen government has recently introduced new incentives in the agricultural sector, such as increased prices and unrestricted access to lines of credit, to boost farmers' productivity. To date, basic commodities such as water, energy, natural gas, and salt are heavily subsidized for Turkmen citizens.

4. The state still maintains a pervasive presence in the economy. Privatization stalled in the late 1990s, with most large and medium-sized enterprises – especially those in the sectors the authorities consider to be essential for the economy of the country – remaining in state hands. A few foreign-owned companies operate in the construction and the hydrocarbon sectors under contract with the state. The domestic private sector is still very limited and is almost exclusively concentrated in the food processing, retail and services sectors. All trade transactions (domestic and foreign) must be registered with the Turkmen State Commodity Exchange. The authorities have, however, recently introduced modest trade liberalization measures such as reduced duty and excise taxes, which may be

² International Financial Reporting Standards are issued by the International Accounting Standards Board (IASB), an independent accounting standard setter based in London, United Kingdom. In April 2001, the IASB announced that it would adopt all of the International Accounting Standards (IAS) issued by the International Accounting Standards Committee. For simplicity's sake, the term IFRS will mean both IFRS and IAS in this report.

³ International Standards on Auditing (ISA) are the standards issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC).

complemented in the future by the removal of some non-tariff trade barriers. Turkmenistan is not covered by the *Doing Business* reviews.⁴

5. The election of new President Gurbanguly Berdymuhamedov in 2007 marked a change in the political and economic orientation of the country. President Berdymukhammedov began a process of constitutional reform, beginning with the election of a new parliament in December 2008. One of the major changes in the constitution was to abolish the People's Council, the Halk Maslahaty (2,500 members), which was the supreme legislative body until September 2008. The remaining parliament, the Mejlis, has doubled in size from 65 to 125 members. There is only one political party in Turkmenistan, the Democratic Party.

6. In 2007, President Berdymuhamedov launched a program of social and economic reforms aimed at accelerating growth and diversifying the economy, raising living standards, developing the private sector, fostering a more market-oriented economy, and smoothly integrating Turkmenistan into international markets. Decisive reforms to the foreign exchange system and administered prices began in early 2008, and steps were taken to attract direct foreign investment. The government recently expressed its intention to increase the share of private sector in the economy from the current 40% (excluding the oil and gas sector) to 70% by 2020. One significant aspect of the reforms is strengthening and further developing the financial sector. A strong corporate financial reporting framework will be key to achieving these objectives, and the authorities are planning to adopt International Financial Reporting Standards (IFRS).

7. In 2008, the government introduced changes in the legislation governing the hydrocarbon sector. These changes aim to facilitate production-sharing agreements with foreign companies by offering special tax incentives and encouraging more transparent financial reporting requirements.

8. The country's banking system is regulated by the Law on Commercial Banks and Banking Activity, and the Law on the Central Bank of Turkmenistan (CBT). The CBT supervises the banking sector. The CBT issues licenses for banking operations and establishes minimum capital requirements. Two types of banks operate in Turkmenistan: state commercial banks and joint stock banks, in most of which the state has a majority share. In fact, the state owns most of the financial sector. There are 12 banks in Turkmenistan, seven being state-owned, one privately owned, two held jointly by the state and foreign investors (one with Russian investors and the other with Turkish investors), and two foreign-owned (one Pakistani and one Iranian). There are no non-banking financial institutions apart from one state-owned insurance company.

9. This report sets out policy recommendations to further enhance the quality of corporate financial reporting in Turkmenistan and lay the foundations for better financial reporting in the corporate sector, but without putting excessive burdens on smaller enterprises. At the same time, the financial reporting regime should meet the needs of the state and other relevant stakeholders, taking into account the size of the corporate sector and the demand for adequate financial information for making economic decisions.

10. The role and regulation of corporate sector accounting and auditing are shaped by the economic context in which they take place, and by the structure of the market they serve. Given the patterns of economic activity in Turkmenistan, and the role of the state, financial information has traditionally been considered an instrument of state monitoring, with a special focus on the collection of

⁴ The World Bank Doing Business program provides objective measures of business regulations and their enforcement across 181 economies.

information for tax and statistical purposes, and a resource to which access was restricted, available only to those having the power to require its provision. However, as the Government's reform program proceeds, and as the private sector and foreign investors come to play a more significant role, Turkmenistan will see the need to reshape its financial reporting framework in a manner which supports the function of financial information as a public good provided to meet the needs of market participants generally, and to facilitate market discipline. At present each agency (e.g., the tax authorities, the CBT) has developed its own accounting and auditing requirements. Despite the provisions of the laws on accounting and auditing, the concept of published, general purpose financial statements meeting the needs of several user groups is not yet deeply established. The audit is associated more with tax compliance than with an independent financial statement audit performed by qualified professionals to lend credibility to the financial information provided to the marketplace. In recent years, progress has been made in the accounting and auditing environment but much remains to be done for Turkmenistan to achieve compliance with international good practices. However, reforms in economic management more generally will lead to changed patterns of demand for high quality audited financial statements, while the availability of this information will in turn support the reform process. The recommendations of this report aim to assist the Turkmen authorities in mapping out the program for successfully achieving these changes.

II. THE INSTITUTIONAL FRAMEWORK FOR ACCOUNTING AND AUDITING⁵

A. The Statutory Framework for Accounting and Auditing

11. The legal framework of Turkmenistan is based on civil law, and is hierarchically organized as follows: the constitution of Turkmenistan (1992); constitutional laws; codes; ordinary laws; Presidential decrees and acts; Parliamentary resolutions; resolutions and orders of the Cabinet of Ministers; normative acts issued by governmental bodies; and resolutions of the governor of each region.

12. Financial institutions and other enterprises are regulated by several laws that describe *inter alia* procedures for incorporation, management, reorganization, transformation and liquidation: the Law on Enterprises (2000), the Law on Joint Stock Companies (JSCs) (1999); the Law on Hydrocarbon Resources (amended in 2008); the Law on Commercial Banks and Banking Activity (1993).

13. The Law on Enterprises prescribes the various legal entities that can be established for carrying out economic activities. Enterprises can be established as state enterprises, cooperative enterprises, JSCs, Limited Liability Companies (LLCs), individual enterprises, or governmental organizations. The state controls the vast majority of economic activities. State-controlled enterprises operate either as state-owned enterprises (SOEs) or are run by specified ministries or agencies, with their activities accounted for in the consolidated state budget.

14. The Accounting Law (1996) and the Audit Law (1996) are the main laws regulating financial reporting in Turkmenistan, and are supplemented by normative acts that complement the provisions of those laws.

⁵ This report outlines the legal principles applicable to accounting, auditing and financial reporting and does not attempt to give anything more than an introduction to the issues. This report is not meant to be an exhaustive rendition of the law, nor does it constitute legal advice to those reading it.

- The Accounting Law applies to all types of entities, private and public, including public entities contributing directly to, or financed by, the state budget. It prescribes the main responsibilities for accounting, state regulation of accounting, organization of accounting, the role of the chief accountant, primary source documentation, and the annual inventory of assets and goods, and also contains provisions on how liabilities and equity should be accounted for.
- The Audit Law regulates auditing activities, including non-audit services that audit firms might provide. The Audit Law defines auditors and audit organizations, which companies must have annual statutory audits, the content of the audit report, independence requirements for auditors, the process for audit appointments, rights and obligations of auditors and audited entities, and responsibility for the regulation and licensing of auditing activities.

15. The responsibility for accounting systems within enterprises is determined by the Accounting Law, which states that the ultimate responsibility rests with the management of an enterprise, while the chief accountant is responsible for the organization, control and preparation of financial statements.⁶ Chief accountants are certified by the Ministry of Finance, and must undergo a recertification examination every five years.

16. The Audit Law stipulates that enterprise owners are responsible for selecting their auditors. The annual general meeting of shareholders is responsible for approving the selection of the auditors and the company's supervisory board sets the audit fees.

A.1 The Statutory Framework for Accounting

17. Under the Accounting Law, similar financial reporting requirements apply to all types of entities, and there is no differentiation between the public and private sectors, or between large, medium-sized and small entities. All entities in Turkmenistan, except for individual entrepreneurs, have to apply the Accounting Law. Individual entrepreneurs need only to prepare an income and expense statement for tax reporting purposes.

18. The Accounting Law mandates the preparation of annual financial statements in accordance with accounting standards and other regulations issued by the Ministry of Finance (MoF). The Central Bank of Turkmenistan is responsible for setting accounting and reporting standards for the banking sector. The other laws, such as those pertaining to banking, insurance or JSCs, do not contain any specific accounting and reporting requirements for these entities, typically referring to the Accounting Law and the Auditing Law for guidance in these matters.

19. An entity's management is responsible for preparing the financial statements in Turkmen Manats (the Turkmen national currency), using an accounting system that is consistent from year to year. The accounting system includes a chart of accounts based on accounting standards issued by the MoF. In addition, the MoF defines the forms of the primary accounting documents, accounting records, and accounting controls. The accounting system is managed by a chief accountant, who reports directly to management. The financial statements of public entities and state owned-enterprises must be prepared by the accounting department, which is separate from other departments within those entities. Both the entity's manager and the chief accountant, or the person acting on behalf of the chief accountant, need to sign those statements. The chief accountant is also responsible

⁶ The Chief Accountant is the head of the Accounting Department.

for cash transfers and has certain other financial obligations. The Accounting Law requires an annual inventory of all assets before the preparation of the financial statements. In addition to prescribing accounting systems and the documentation of transactions, the Accounting Law also prescribes how certain assets, liabilities, or equity are to be accounted for (see also Section III, “Accounting Standards as Designed and as Practiced”).

20. The MoF regulates accounting in Turkmenistan and is responsible for developing secondary legislation on accounting, including accounting standards. The MoF develops National Accounting Regulations (NAR), National Standards on Auditing (NSA), and other secondary regulations. NAR, which are based on historical cost concepts, also prescribe formats for financial statements and specific accounting rules but their scope is limited to relatively simple transactions, such as sales and purchases of goods or assets. They do not address complex transactions such as financial instruments.

21. Although the Accounting Law prescribes publication requirements for the annual financial statements, these obligations are not enforced, so that annual financial statements are not publicly available. The Accounting Law requires open JSCs, banks, insurance companies and investment funds to publish annual financial statements, comprising a balance sheet and income statement, together with an audit report no later than June 1 of the year following the reporting year.⁷ Financial statements should be published in newspapers, journals, booklets, or any other media available to the public. There is no enforcement mechanism to ensure that any of this is done. In addition, there is no repository of financial statements where the public can have access.

22. Entities file their financial statements with (i) the tax and statistical authorities, (ii) their banks so that the banks can determine their clients’ cash needs under the system of directed financing, (iii) regulatory bodies (for example, their respective ministries in case of state-owned enterprises); and (iv) the business licensing authority.

23. The Law on Commercial Banks and Banking Activity assigns the responsibility for regulating banking sector accounting and auditing to the CBT. This law requires banks to maintain accounting records, to prepare periodic financial statements using the formats and accounting regulations set by the CBT, and to submit these financial statements to the CBT. The law allows banks to use either external auditors or CBT bank inspectors to report on their financial statements. The Audit Law, however, requires enterprise financial statement audits to be performed by independent auditors licensed in accordance with that law. Banks are required to publish an audited balance sheet and related documents. The MoF supervises the one non-banking financial institution, which is the State Insurance Company.

24. The Law on Hydrocarbon Resources includes special tax and financial reporting provisions for contractors and sub-contractors that have concluded production-sharing agreements with foreign investors. These entities do not have to comply with the Accounting Law but, rather, must “maintain accounting records and prepare financial statements in accordance with international practices of accounting and financial reporting”. The law does not define international practices but the Agency for Hydrocarbon Resources requires those entities to submit financial statements prepared in accordance with IFRS or US GAAP, and audited by international audit firms.

⁷ Open JSCs are defined as those that can publicly trade issued securities and have more than 50 shareholders. The reporting year is the calendar year.

25. **Taxation has a significant influence on financial reporting in Turkmenistan.** The main users of financial statements in Turkmenistan are the tax authorities, who are concerned with tax compliance. Although the financial statements prepared for taxation purposes are separate from those required under the Law on Accounting, and do not necessarily follow the same recognition and measurement rules, they are based on the same underlying accounting records and systems. Given the diligence with which tax inspections are carried out in Turkmenistan, enterprises are reluctant to record and report transactions in a manner which does not comply with taxation rules so, in cases of differences between the two, the requirements of the tax law rather than the accounting law are normally followed. As a result, as in other countries with similar systems, many accounting practitioners still view taxation compliance as the primary purpose for preparing financial statements and often lack a clear understanding of the differences between general purpose financial reporting requirements and tax regulations.

26. **Under the Law on Accounting, small and medium-sized enterprises in Turkmenistan are required to comply with the same financial reporting regulations as all other enterprises,** even though the needs of their financial statement users may not be as extensive. This can lead to disproportionate compliance costs.

A.2 The Statutory Framework for Auditing

27. **The regulation of auditing in Turkmenistan is governed by the Audit Law, which was enacted in 1996.**⁸ The law regulates not only statutory audits, but also voluntary audits and various advisory services considered as part of “auditing services” under the law. The law defines an audit as an “audit check”, being an independent verification of the correctness of an entity’s accounting and financial reporting and its compliance with Turkmen legislation so that the auditor can arrive at a conclusion on the authenticity, completeness and accuracy of assets, liabilities, equity and financial results for the reporting period. This definition that is not entirely consistent with the concept of an audit as set out in International Standards on Auditing (ISA), whereby the auditor expresses an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. The Law’s emphasis on authenticity, completeness and accuracy rather than materiality is reflective of the tradition of inspection rather than audit. Advisory services regulated by the Audit Law include: (i) maintaining or recovering accounting documents and systems, preparing financial statements, financial and economic analysis, and valuation of assets and liabilities; (ii) valuation of financial backing of securities issuers; (iii) valuation of property; (iv) consulting on IT and various other issues; and (v) other services related to auditing.

28. **The Audit Law defines an auditor as a person holding a certificate and a license, registered in the state registry of auditors.** Once licensed, auditors can work as individual practitioners if they are registered as entrepreneurs, or be employed by an audit firm. The Commission for Audit Certification and Licensing (CACL), created by the Cabinet of Ministers, conducts the certification examinations. At least half of the members of the CACL, which is headed by the Minister of Finance, are required to be auditors, while the other members are chief accountants of enterprises and representatives of various ministries and agencies. The certification examination covers five fields of study: law, tax, accounting, auditing, and financial and economic analysis. The Audit Law permits audit firms to take any legal form, except that of an open JSC. To be licensed as an audit firm, the firm must have at least three certified auditors on staff. Persons who are not certified auditors may not hold more than 49% percent of the shares of an audit firm.

⁸ The 1996 Law of Turkmenistan “On Audit Activity.”

29. **The Audit Law sets out statutory audit requirements for banks, credit institutions, insurance companies, investment funds, JSCs, LLCs, enterprises with foreign investments and their branches and representatives, as well as subsidiary entities.** The Law on Commercial Banks and Banking Activity, however, allows banks to use either external auditors or CBT bank inspectors to report on their financial statements, which is not entirely consistent with the Audit Law requirements.

30. **The Audit Law's requirements for statutory audit do not distinguish between entities based on their size, the public interest impact of their activities, or other criteria.** Some large entities such as large unitary SOEs (where the state is the sole owner) are not included in the scope of the law, while quite small companies may have to undergo an annual audit.⁹ Given the need to focus the efforts of the Turkmen audit function on those entities of greatest significance, and bearing in mind the relatively small number of auditors, it may be desirable, at least in the near term, to limit statutory audit requirements to companies of public interest.

31. **The Audit Law requires auditors to include more information in their audit reports than is required under ISA.** The law specifies that an audit report should contain: (i) information on the audited entity and the period covered by the audit; (ii) conclusions on whether the accounting used to prepare the financial statements complies with the legislation of Turkmenistan; (iii) information on completeness, authenticity and accuracy of assets, liabilities, equity and financial results for the reporting period; (iv) data on regulatory violations in accounting and financial reporting discovered but not dealt with during the audit, as well as instances where the Turkmen legislation on financial and economic transactions has been breached; (v) data offered by other experts; (vi) the audit conclusion.

32. **The Audit Law does stipulate some requirements with respect to auditor independence, but these are not as extensive as those contained in the IFAC Code of Ethics.** The law requires that auditors be independent from the audited entity. Auditors cannot perform audits if (i) they are owners, managers or hold a managerial position, or a position involving accounting and reporting, or are close relatives of the afore-mentioned people; (ii) the audit organization owns the audited entity; (iii) the auditor or audit organization offered accounting or financial statements preparation services or had other financial transactions with the audited entity (the law is silent on what is the cooling-off period for such cases); or (iv) the audited entity is an owner, insurer or creditor of the audit organization.

33. **The Audit Law does not contain any provisions governing the dismissal of auditors.** According to the JSC Law, auditors are appointed at the annual general shareholders meeting, while a company's supervisory board approves the audit fees. There are no provisions for audit committees.

34. **The Audit Law stipulates that auditors and audit firms are accountable for any violations of Turkmen legislation.** If auditor negligence leads to any material damage, the auditor or audit firm involved is required to pay for that damage in accordance with contracts and the pertinent legislation. There is no requirement for auditors to have professional indemnity insurance, and the amount of auditor liability is not regulated.

⁹ The EU audit requirements could be considered as an example of good international practice. They require all large and medium-sized companies with limited liability to be audited, but permit EU Member States to exempt small companies from that requirement. The EU sets maximum limits on the size criteria for 'small' companies, but Member States can set even smaller size criteria if that is appropriate in their national circumstances. A company's size is determined by reference to three criteria: assets, turnover, and number of employees.

35. Auditors need to have a special license for auditing banks, investment institutions or insurance organizations (each requires a separate license). Auditors must pass specific CACL exams to get this certification, which must be renewed every five years.

B. The Accounting and Auditing Professions

36. The Chamber of Auditors foreseen in the Audit Law has not yet been established. The Turkmen accounting and auditing professions are in their infancy. Although there are two professional accountancy organizations, their role is limited to promoting the Certified Accounting Practitioner (CAP) and Certified International Professional Accountant (CIPA) certification training programs. They play no role in the licensing of statutory auditors. The Audit Law called for the establishment of a Chamber of Auditors to perform certain oversight functions, but this institution has not been set up yet. Currently, the MoF and the CACL are responsible for auditor oversight.

B.1 The Accounting Profession

37. There is no information on the number of professional accountants in Turkmenistan. Most professional accountants do not belong to either of the two professional organizations described below. Most were trained at university under the former Soviet system.

38. There are two professional organizations in Turkmenistan: The Union of Economists (UoE) and The Union of Professional Accountants (UoPA). Both organizations are voluntary and their main activities are focused on training. Neither performs any quality assurance or oversight activities over members; neither is associated with the International Federation of Accountants (IFAC) in any way.

- The UoE was created in 1982 and has a broad scope of activity. In 2008, the UoE created an Accounting and Auditing Committee and became member of the Eurasian Council of Certified Accountants and Auditors (ECCAA).¹⁰ The UoE's Accounting and Auditing Committee, created in January 2008, has 15 CAP members and around 25 members who graduated in accounting but have not yet obtained a professional certification. It is led by two accountants, one of whom is a licensed auditor. The institution offers training under the CAP/CIPA programs. The Union of Economists has a good standing in the country and is part of the international Union of Economists body based in Russia.
- The Union of Professional Accountants, created in 2004, became an ECCAA member in 2005. During recent years, under new legislation on non-governmental organizations, the organization has had to undergo a re-registration process, which is currently in its final stage. The organization has 276 members, including 145 CAPs and one CIPA. The membership fee is nominal.

39. Except for CAP/CIPA, there are no other international certifications available in Turkmenistan. As a result, very few accountants in the country are familiar with up-to-date accounting standards and practices. Most accountants were educated under the old Soviet system, and the current education system teaches primarily domestic statutory requirements, without focusing much on international accounting and auditing standards and practices.

¹⁰ The ECCAA, based in Almaty, consists of 13 accounting associations from Central Asia, Ukraine, Moldova and Russia. Its mandate is to unite the accounting and auditing associations in the former Soviet Union and to promote the CAP and CIPA programs.

B.2 The Auditing Profession

40. **The auditing profession is very small.** About 50 auditors are licensed by the CACL. Only one member firm of an international network has been operating in the country since the 1990s. Another international network is expected to enter Turkmenistan in the near future. To be authorized to operate in Turkmenistan, member firms of international networks must comply with the same requirements as purely national firms, including the need to employ at least three locally licensed staff auditors.

41. **The CACL is responsible for the oversight and supervision of the auditing profession.** As noted before, while the Audit Law called for the establishment of a Chamber of Auditors, in which all auditors and audit firms had to be members, this institution was never created.

42. **Turkmenistan has no formal audit quality control function.** The CACL does, however, perform certain enforcement activities when tax inspections identify violations of tax legislation in audited entities. In such cases, the CACL requires clarification from the auditors. If matters cannot be resolved satisfactorily, the ultimate penalty is the cancellation of the audit license. The MoF regularly monitors audit reports.

43. **Although Turkmen auditing standards were developed by the MoF and approved by the CACL, the legal status of those standards is uncertain.** According to the Audit Law, the Chamber of Auditors is supposed to develop auditing standards, but this body does not yet exist. In practice, however, in 1999 and 2000, the then Ministry of Economy and Finance (MoEF) developed National Standards on Auditing (NSAs) based on unofficial Russian translations of the ISAs available at the time. The NSAs have never been published officially, since no Turkmen language translation is available. The CACL has made auditors aware of these NSAs, but auditors are reluctant to use them standards because they have not been published as part of the Turkmen legislation.

44. **The Audit Law has no ethical requirements for auditors, except for the independence requirements spelled out earlier (see section A.2 *The Statutory Framework for Auditing*).** The CACL did develop a code of ethics, in Russian, in 1999 as part of the NSA package, based on the IFAC Code of Ethics in place at that time. As is the case with NSAs, however, the legal status of this Turkmen code of ethics is uncertain. There are no mechanisms in place to ensure compliance with its provisions.

C. Professional Education and Training

45. **As noted above, two professional bodies, the UoPA and the Accounting Committee of the UoE, deliver professional accounting and auditing education.** These professional training bodies were created as part of a USAID regional initiative to train and certify bookkeepers and accountants in CIS countries. They train students to obtain the CAP and CIPA designations. Since inception, around 160 CAP bookkeepers and one CIPA have been trained and certified, and some are now members of the above professional bodies. These programs have contributed to enhancing the understanding of modern, principles-based accounting, at least for the accountants who went through the programs. The near-absence of CIPA-certified accountants shows, however, that there is a gap between what current Turkmen accounting practitioners can do and the skills that professional auditors should have.

46. **The Turkmen Institute of Economics and Management (TIEM) is the largest institution in Turkmenistan offering accounting education.** The theoretical accounting education program has

recently been expanded from two to five years.¹¹ Curricula are approved and validated by the Supreme Council of Science and Technology. TIEM professors contributed to the development of the accounting regulations that currently exist. The accounting manuals used for the curricula are developed in both Turkmen and Russian and cover statutory requirements. There is one small course on international accounting, covering IFRS and some basic accounting concepts commonly used in former Soviet countries. This institution also provides training for candidates wanting an audit license under an agreement with the MoF (the MoF requires candidates to have three weeks of audit training before they are licensed).

47. Professional bodies do not have any relationships with the TIEM. This university teaches current accounting and auditing standards and practices, while the professional organizations try to bring modern accounting training to Turkmen accountants. TIEM and the professional organizations should collaborate on integrating courses on international standards and practices into the university's curricula, to make them more consistent with the training offered by the professional bodies.

48. Knowledge of modern accounting standards is also limited in the banking sector. Training for bank employees is being provided under a project supported by the United Nations Development Program (UNDP) and the United States Agency for International Development (USAID). It has not been possible, however, to re-train the entire community of accountants in the banking sector so that they can properly implement IFRS. Where banks do prepare IFRS-based financial statements, this is generally done by restating their statutory financial statements with significant assistance from their auditors, which may lead some to question the independence with which the audits are carried out.

49. There are no compulsory continuing professional development (CPD) requirements for auditors in Turkmenistan. This poses a risk in terms of maintaining and developing professional knowledge.

50. Enhanced professional education and training, in both accounting and auditing, are needed by all participants in the Turkmen financial reporting system so that they have the skills required to support the Government's reform program. Different participants need different levels of education and training: preparers of financial statements need a good working knowledge of the accounting requirements for the different sectors of the economy; bookkeepers need to be familiar with the accounting systems they use; auditors need a higher level of knowledge, covering auditing standards and techniques in addition to accounting standards; regulators need specific knowledge of the law and regulations related to financial reporting in their field; and taxation officers need to be knowledgeable about tax regulations and the interactions between those regulations and the accounting standards used to prepare financial statements. The Turkmenistan government, regulators, professional bodies and education providers should work together to determine appropriate target educational standards and qualifications suitable for the country's needs.

D. Setting Accounting and Auditing Standards

51. The Ministry of Finance issues standards, methodological guidelines and other secondary legislation in the area of accounting and financial reporting. According to the Accounting Law, the body responsible for the regulation of accounting, including standard setting, is the Cabinet of Ministers. It has delegated this responsibility to the MoF. National Accounting Regulations (NAR)

¹¹ Tertiary theoretical education was previously limited to two years, which was completed by a mandatory three-year training period with SOEs.

include various instructions and guidelines, including a mandatory chart of accounts and mandatory forms of financial statements that have been approved by the President of Turkmenistan or the Cabinet of Ministers, or issued by the Minister of Economy and Finance.¹² The respective documents are prepared by the relevant government authorities, in most cases the MoF. Draft standards and guidance are circulated for comment prior to adoption within the relevant ministries and agencies.

52. The Central Bank of Turkmenistan is responsible for setting accounting standards and guidelines in the banking sector. Most of the current accounting requirements for banks rely largely on cash accounting concepts, with some disclosures on accrued assets and liabilities, which are not posted on the face of the balance sheet.

53. The MoF sets the general accounting regulations, as well as the capital and prudential requirements, for the insurance sector.

54. The Audit Law stipulates that the Chamber of Auditors should be responsible for drafting auditing standards, subject to approval of the CACL, but the Chamber has not yet been established. The Ministry of Economy and Finance developed the existing NSAs, but although auditors have been made aware of them, these have not been published.

55. Current arrangements for setting accounting and auditing standards give understandable precedence to the interests of the state as regulator, tax collector, and owner of the bulk of the economy. However, as the Government's reform program advances, and as the economy becomes more developed and diversified, the authorities should consider opening up the standard-setting process and including consultation of other stakeholders, including preparers, users, and auditors of financial statements. In many countries, the consultation process has proven to be a key factor in building awareness and consensus on accounting and auditing standards, which in turn has led to better implementation of those standards.

E. Enforcing Accounting and Auditing Standards

E.1 Enforcing Accounting and Financial Reporting Standards

56. The Tax Administration plays a major role in the enforcement of accounting standards, through its comprehensive tax inspection process. The Accounting Law also gives the MoF responsibilities for enforcing the Law and other accounting related legislation. However, in case where the requirements of tax and accounting legislation differ, enterprises tend to apply tax requirements, even in their separate general purpose financial statements.

57. Enforcement in the banking and insurance sectors, in addition to ensuring tax compliance, focuses on prudential and regulatory reporting. The role of the CBT and the MoF department for insurance supervision is to monitor compliance with the prudential and capital requirements set by the Law on Accounting and other pertinent regulations.

¹² The Ministry of Economy and Finance has been divided into two ministries, the Ministry of Economy and the Ministry of Finance, but with a single Minister. The Ministry of Finance is the regulator of accounting and auditing in Turkmenistan.

E.2 Enforcing Auditing Standards

58. **There is limited enforcement of auditing standards.** The MoF monitors audit activities through audit firm reports setting out information on the firm's clients, number of audits, and results of audits, including any legislative violations their clients might have committed. However, NSAs have not been officially published, so their legal status is uncertain, some auditors may not be aware of them, and most auditors seem not to apply them. The MoF does have some enforcement powers over auditors, but only where tax inspections have uncovered a violation of tax legislation in an audited entity. In such cases, auditors may lose their license, so that MoF enforcement relates more to the tax rules rather than to auditing standards.

59. **There is no formal audit quality assurance system in Turkmenistan.** Such a system, if created, would monitor the use of NSA, and improve the quality of audits. To introduce a quality assurance review regime in Turkmenistan would, however, require cooperation between the MoF, the audit profession and other interested parties. In particular, an audit quality control regime must balance the need for having specialists perform quality inspections, with the necessity of maintaining independence and objectivity.

III. ACCOUNTING STANDARDS AS DESIGNED AND AS PRACTICED

60. **This section analyzes the significant differences between Turkmenistan NAR and IFRS (the standards gap) and the compliance of statutory financial statements with NAR (the compliance gap) to identify any systemic non-compliance issues.** The potential adverse impact of both gaps on the reliability of NAR-compliant financial statements is also analyzed.

61. **Because financial statements are not publicly available in Turkmenistan, it was not possible to review any non-bank financial statements.** Turkmenistan does not have an institution that would collect and make financial statements available to the public, nor do most banks publish their condensed financial statements in the Turkmen newspapers.

62. **The provisions of the Accounting Law, MoF accounting guidelines and instructions, and IFRS differ significantly.** The existing requirements of the Accounting Law and NAR were mostly inherited from the previous Soviet accounting system, which was developed to serve the tax, statistics and other needs of a centrally managed and controlled economy. Formats for the balance sheet, income statement, and statement of changes in equity were developed in 2004 but did not introduce any new accounting concepts.

63. **The Accounting Law contains detailed accounting requirements dealing with assets, liabilities and equity items.** These are:

- Art. 14 defines fixed and intangible assets and prescribes initial recognition and subsequent measurement methods; generally, they are measured at historical cost. The Cabinet of Ministers sets subsequent depreciation methods and rates. Revaluations may be prescribed by legislation.
- Art. 15 deals with financial investments, including securities investments and bank deposits, initially recognized at cost. Any difference between initial recognition and actual value is recognized in the income statement.
- Art. 17 provides that goods for sale and inventories be measured either at cost or at realizable value but does not prescribe any valuation method. There are no specific

standards for valuing natural resources such as agricultural or forest products and minerals and mineral products.

- Art. 18 defines cash as cash in hand and/or at the bank and provides that cash flows should be reported separately for operating, investing and financing activities. The reporting format prescribed by the MoF does not, however, match the Law on Accounting requirements.
- Art. 20 defines accounting for equity. Equity reserves may be created for specific purposes. This practice was inherited from the old Soviet system, which required the profit to be distributed to reserves and retained earnings or transferred to statutory capital.
- Art. 21 specifies that loans are to be measured at their recoverable amount.

64. **Art. 22 describes the components of financial statements.** These include: a balance sheet, profit and loss statement, annexes to the balance sheet, explanatory notes and the audit report (when an entity has been audited). The explanatory notes should include the main financial indicators, compared over several years, forecasts and any other significant factors that have influenced the results of an entity's activities. **In addition to the provisions of the law, there are instructions and guidelines (NAR).** The main characteristics of the NAR are:

- Because the guidelines and instructions were developed primarily to serve statistical and tax purposes, they do not result in general purpose financial statements that aim to present a true and fair view of an enterprise's financial position and operations for the year. Although the existing guidelines use the accrual basis for recording expenditures and revenues, they impose restrictions on what can be considered as expenses and revenues. These restrictions closely mirror limitations on the deductibility of certain expenditures for tax purposes. The existing guidelines prescribe the documentation required for certain asset transactions, as well as some elements of controls (such as who should authorize and process the transaction). They also prescribe the description of entries in the accounts using the mandatory chart of accounts.
- There are detailed instructions on how to apply the mandatory chart of accounts to accounting entries.
- Assets are initially measured at historical cost and then depreciated according to prescribed methods and rates.
- The required explanatory notes focus mainly on management's report on a company's activities, present and future, and do not include disclosure of accounting policies or explanations of material items in the financial statements. According to the accounting regulations, they describe the significant events of the period and the economic indicators that influenced an entity's financial position, and how those indicators changed over time.
- NAR expand the list of financial statement components to include a cash-flow statement and prescribe the content and the format of financial statements.

65. **The banking sector's accounting regulations prescribe formats and detailed accounting entries.** Disclosure requirements are limited and focus mostly on the breakdown of figures that the CBT uses for regulatory purposes. The accounting regulations are mostly cash-based; accruals are used for business and financial management purposes. For example, interest on loans is recorded only when the cash is received. Detailed CBT regulations and instructions were not available for review, and the standards gap analysis for the banking sector was done based on discussions with the CBT and commercial banks.

66. **Accounting reform has been initiated in the banking sector.** The reform is led by the CBT under a UNDP/USAID project, using two banks as pilot studies. The focus of the project is to: (i) convert the chart of accounts into one compatible with IFRS; (ii) convert financial statement formats into formats that would be compatible with IFRS; and (iii) develop methodological guidelines for banks on how to account for their transactions in accordance with IFRS. The accounting reform will take time to complete as the banking sector's transition to IFRS requires modification of business processes and IT systems.

67. **While the reform activities are useful, particularly those raising awareness among preparers of financial statements in the banking sector, there are several elements that should be taken into account:**

- Implementation of IFRS in the banking sector is a complex exercise and is not only about converting the chart of accounts and reporting formats. Moreover, IFRS have no mandatory prescribed reporting formats, nor a chart of accounts.
- There are fundamental conceptual differences between existing guidelines and IFRS when it comes to accruals, fair value, financial instruments, etc. Practical implementation of IFRS has a large impact on how financial information is collected before the financial statements are prepared, and requires significant professional judgment in preparing the financial statements. IFRS implementation is not just a mechanical transformation of data but, rather, requires complex and fundamental changes.
- IFRS require a significant number of disclosures in the financial statements, including accounting policies and specific events, assets and liabilities.
- IFRS need to be implemented without amendments. If domestic circumstances require some additional methodological guidelines for preparers so that they can apply IFRS correctly, these guidelines should not lead to departures from IFRS.
- Finally, if IFRS are to be binding, they need to be formally adopted by Turkmenistan, using an appropriate official translation.

IV. AUDITING STANDARDS AS DESIGNED AND AS PRACTICED

68. **There is a significant gap between NSAs and ISAs.** NSAs were developed based on ISA translations available around 1998, were issued in 1999-2000, and have not been updated subsequently. Since 2000, many significant changes were made to ISAs, including as a result of the "Clarity Project" which was completed in 2009, and this has created a significant auditing standards gap. The basic definitions pertaining to audit activities set out in the Audit Law are not entirely consistent with ISAs, and the legal status of NSAs is uncertain (see also Section A.2, "Statutory Framework for Auditing").

69. **Because financial statements and related audit reports are not publicly available, it was not possible to review audit reports to carry out the auditing standards gap analysis.** Other sources of information confirmed, however, that the main focus of auditors, when auditing financial statements, is compliance with tax legislation, and this, therefore, is the main factor determining the scope of audit work.

V. PERCEPTIONS OF THE QUALITY OF CORPORATE FINANCIAL REPORTING

70. **The main users of financial statements in Turkmenistan are tax and statistics authorities.** Banks also look at corporate financial statements for cash management purposes. Financial statements are generally not publicly available.

71. As the government intends to promote the development of the private sector by encouraging private ownership in all sectors of the economy, except for the hydrocarbon sector, the demand for financial reporting will grow. The future perception of the quality of financial reporting will depend on the importance that the Turkmen authorities place on the training of regulators, accounting practitioners, auditors and preparers, as well as on the implementation of a robust corporate financial reporting framework.

VI. POLICY RECOMMENDATIONS

72. **Without attempting to provide a detailed tactical design for reforms,** this report makes policy recommendations to support the implementation of accounting and auditing reform that would enhance the quality of corporate financial reporting in Turkmenistan, which would be a precondition to opening up private sector development.

73. The implementation of the following recommendations will take some time as it will need to be accompanied by activities aiming at building awareness and fostering consensus on how changes in the field of accounting and auditing are required to support the Government's overall reform program. In addition, consultations with relevant stakeholders having an interest in corporate financial sector reporting will help in identifying potential challenges in reform implementation and solutions for overcoming those challenges. Changes will be required to Turkmenistan's legal framework, institutions, accounting and auditing professions, and the education system. The pace of change, however, should pay due regard to the country's capabilities and progress in other areas of reform, and to the interdependencies between the different areas where changes take place. A relatively lenient rule that is robustly and consistently enforced is preferable to a more rigorous one that is unenforceable, as the lenient rule can be progressively made more rigorous as the circumstances allow. The policy recommendations below, while challenging and sometimes ambitious, will help to achieve Turkmenistan's long-term objectives. They fall into three key areas:

- Statutory Framework
- Institutional Capacity Building
- Professional Education and Training

74. **The current accounting and reporting framework serves the needs of both the Turkmen economy and the state.** The country's business market has voiced little demand for more robust financial reporting standards and, therefore, reform should focus first on areas of significant public and government interest. If the country decides to implement IFRS and ISAs, the potential conversion should be thoroughly analyzed in terms of user needs and the capacity of preparers of financial information to apply such complex financial reporting standards. Initially, the reforms in Turkmenistan should focus on the banking and hydrocarbon sectors, followed by reforms for other large enterprises in the SOE sector.

75. **These recommendations require a holistic approach to implementation.** The authorities could either establish a multidisciplinary (inter-departmental) Coordination Working Group (CWG) or designate an existing working group to champion and coordinate the accounting and auditing reforms.¹³ The CWG would advise policymakers and regulators on the implementation of the recommendations. Based on the successful experience of other countries, this report recommends that the CWG develop a Country Strategy and a detailed Country Action Plan (CAP) that clearly sets out the key actions and allocates responsibilities for implementing the necessary reforms. The CAP should include an itemized budget indicating the resources (both technical and financial) necessary for successful implementation and the government, policymakers, and development partners should work together to secure those resources.

76. **In making plans for improving the corporate financial reporting environment, the Turkmen authorities may wish to draw on the experience of peer countries** which have recently undergone reforms similar to those which are now being considered for Turkmenistan. A possible example is Kazakhstan, which was among the first CIS countries to issue accounting standards designed to meet the needs of a market economy. In 1995, it decided to develop National Accounting Standards derived from International Accounting Standards and to adopt International Financial Reporting Standards in their entirety for certain companies in 2002. Furthermore, Kazakhstan was one of the first CIS countries to adopt a law on audit activities, which established the concept of auditing standards. In 2007, the Kazakh Accounting Law was amended to introduce a three-tier financial reporting structure. Under this structure, micro-enterprises apply simplified tax-based rules, small and medium-sized enterprises apply National Accounting Standards, and public interest entities, including state-owned entities of national interest, apply International Financial Reporting Standards. Kazakhstan also prescribed specific accounting requirements for banks, insurance companies and listed companies. The recently amended Kazak Audit Law requires the country's professional associations to enforce quality control over their members. Quality control inspections are to be carried out once every three years. Auditors can be members of only one professional association. These regulatory reforms have been accompanied by a strong emphasis on the provision of education and training to support the proper implementation of the new requirements.

77. **Statutory Framework for Accounting**

The accounting framework of Turkmenistan should be modified to allow for a three-tier system, whereby different accounting requirements would apply to enterprises depending on whether they are Public Interest Entities (PIEs), Small and Medium-sized Entities (SMEs), or micro-entities. In such a three-tier system, PIEs should apply IFRS. (Where activities are carried out by budget entities, it may be more appropriate to use International Public Sector Accounting Standards (IPSAS). IFRS were designed for large corporate entities carrying out commercial activities in either the private or the public sector, while IPSAS are better suited for budget entities.¹⁴) SMEs would apply NAR (once they have been developed and successfully implemented), while micro-entities would report solely for tax purposes. In addition, SMEs should be given the option to prepare financial statements according to IFRS. To achieve this objective:

¹³ This working group should include as members representatives of state authorities such as the CBT, the Ministry of Finance and professional associations. The group may also include representatives of development partners as observers.

¹⁴ For the purpose of the financial statements of governments prepared under IPSAS, IPSAS 6 requires the consolidation of all government activities. In several instances, while using IPSAS for all budget entities, governments consolidate financial statements of SOEs that are prepared under IFRS.

- The legal framework should be amended to provide clear definitions of PIEs, SMEs and micro-entities for corporate financial reporting purposes. A generic definition of PIEs would include banks and other credit institutions, insurance and reinsurance companies, other companies providing financial investment services, investment managers and mutual funds, companies with securities traded on a regulated market, and significant state-owned enterprises. While the whole range of these companies may not yet exist in Turkmenistan, it would be timely to define them in the law now, as they may begin to emerge as the private sector develops in line with the Government's reform plans.
- Standard formats of financial statements should be adapted to the new accounting requirements and allow both more flexibility in disclosure requirements for IFRS financial statements by expanding the forms to allow for additional disclosures, and minimum mandatory disclosures for SMEs under newly developed national accounting standards and regulations. At present, SMEs generally do not provide any notes to the financial statements.
- National accounting standards and regulations for small and medium-sized enterprises should be developed, taking into consideration the simplified standard for SMEs issued by the International Accounting Standards Board, and similar standards developed by other countries.
- In implementing international standards, Turkmen authorities should set up a system that would ensure a continuous translation process for the accounting and auditing standards to be adopted. Copies of the translations should be made readily available to educators and the various preparers, users and auditors of financial statements. In the area of prudential reporting, the CBT should pursue its efforts to link prudential reporting with IFRS, by requiring a reconciliation between prudential reports and IFRS general purpose financial statements. Institutions involved in financial sector supervision and the monitoring of SOEs should be empowered to enforce financial reporting requirements.

78. Statutory Framework for Auditing

As noted earlier in this report, auditors are primarily concerned with tax compliance. There is a need to raise auditors' awareness about their broader role in serving the broader group of users of general purpose financial statements, and to create a quality assurance and oversight mechanism. Audit requirements should be set at a level appropriate to the public interest in financial reporting and should take into account the capacity of the audit profession in Turkmenistan. The audit requirement should apply to all PIEs and other companies above certain thresholds.

- All PIEs of national interest should be subject to audit requirements. In the near term, statutory audits should be performed according to NSA. The Turkmen authorities should aim, over the medium to long term, to adopt ISAs and the IFAC Code of Ethics.

The MoF's audit oversight function should be improved by implementing the following steps:

- The MoF should review its audit certification program for compliance with IFAC's International Education Standards. The MoF should also review professional qualifications, such as the CAP and CIPA, and other internationally recognized qualifications, including ACCA and CPA, to determine if holders of these professional qualifications could be given exemptions for certain relevant components of the MoF audit certification process.

- The Audit Law should be modified to update the definition of an audit and include a quality assurance system for monitoring the quality of audits.
- The MoF should require, monitor and enforce CPD for certified and licensed auditors.
- Over the medium term, the audit licensing authority, currently the MoF, should develop and implement an external audit quality assurance review program. Quality assurance reviews should be carried out either by dedicated full-time inspection staff or through a system of peer review. In the initial stages, the quality assurance review program would benefit from direct support and input from foreign experts or agencies with established experience in such audit quality control. The program's focus and objective should be to improve audit quality by identifying gaps in the implementation of existing national auditing standards and encouraging training and improvements in methodology to address the gaps. The program should also have a mechanism to review, implement and enforce current requirements, which in the future should evolve to the requirements set by IFAC, including ISAs and the Code of Ethics.
- The Code of Ethics requirements should be enforced by a MoF disciplinary committee, which would develop appropriate disciplinary procedures, including an appeal process and sanctions for transgressions. Auditors should be required to have professional liability insurance and should prove annually that they have subscribed to it.

79. Institutional Capacity Building

- The Chamber of Auditors mandated by the Law on Auditing should be established, and all licensed auditors should be required to be members. The Chamber of Auditors would create a focal point for assistance to, and the development of, the country's auditing profession. For example, a twinning arrangement with a European professional body could help develop the foundations of the Chamber. The providers of accounting and auditing education in Turkmenistan, including university lecturers and professional trainers, should be given the necessary support and assistance to update their knowledge and skills to include international best practice in accounting and auditing, including IFRS and ISA. This may involve a major program of re-tooling accounting lecturers at universities, particularly in the state sector, and could also involve some tuition in the English language, in which much relevant technical material is published.
- The CBT and the MoF should receive significant support for enforcing high-quality financial reporting by the entities they regulate. They should have the necessary powers to require compliance with the relevant financial reporting requirements and, in particular, to compel entities to remedy any deficiencies noted in the reviews of their financial statements.
- Each regulatory agency should publish on their websites the financial statements of the entities they regulate and also should require companies to publish the statements on their own websites, thus enforcing the current legal requirement that financial statements should be made publicly available. Over the longer term, all companies should be required to file their financial statements with a single central financial statement registry, where they would be available to the public.

80. Professional Education and Training

The Government of Turkmenistan should develop, promote and implement an integrated education and training system for accounting and auditing in line with IFAC's International Education

Standards. It should require professional organizations, university educators and relevant government ministries to work together on reforming accounting courses to better meet future market needs. It would be helpful if TIEM, the UoE and the UoPA were to work together on professional training, building on the CAP-CIPA program to develop better trained accountants and auditors. Education and training should also cover civil servants, regulators and supervisory staff involved in designing or enforcing accounting regulations.

- The curricula and teaching approach for university courses with significant accounting and auditing components should be reviewed to ensure that they focus on modern accounting concepts, including those underpinning IFRS and ISAs, as well as relevant legislation in Turkmenistan. Emphasis should be placed on better integration of professional certification and licensing requirements and university programs.
- The authorities should encourage the professional training institutes and the universities to provide relevant and up-to-date training to regulators, auditors, future auditors, preparers of financial statements and civil servants involved in accounting. To achieve this objective, the authorities should seek help from other professional bodies, perhaps through twinning arrangements, to benefit from their experience in reforming their own accounting and auditing education and professional training.
- Greater support should be given to activities aimed at raising the quality of university accounting and auditing education nation-wide. Supporting these activities may help achieve many of the other recommendations set forth in this section, such as updating and enhancing university syllabi to be compliant with the most recent IFRS and ISAs and current legislation in Turkmenistan, assisting university professors in keeping their accounting and auditing knowledge current and in aligning university education programs with professional qualifications.
- Over the medium to long term, and to enhance the capacity of the auditing profession, the MoF should seek to raise professional education requirements for licensed auditors, for example, by obtaining an international professional auditing qualification. Currently, the only locally available international qualification is the CIPA.