

**REPORT
COMPLIANCE EVALUATION**

**EIGHTH COUNCIL DIRECTIVE
of 10 April 1984**

**based on Article 54 (3) (g) of the Treaty on the approval of persons responsible for carrying
out the statutory audits of accounting documents
(84/253/EEC)**

December 2008

This Compliance Report is designed to evaluate the compliance of the Armenian legislation covering audit activity with the requirements laid down in the Eighth Council Directive of 10 April 1984 (84/253/EEC) based on Article 54 (3) (g) of the Treaty on the approval of persons responsible for carrying out the statutory audits of accounting documents.

This Report consists of 3 parts and an appendix

- Description of the EC Directive
- Compliance evaluation
- Conclusion.

1. Description of the EC Directive

The Eighth Council Directive of 10 April 1984 (84/253/EEC) based on Article 54 (3) (g) of the Treaty on the approval of persons responsible for carrying out the statutory audits of accounting documents (hereinafter referred to as ‘the Directive’) is called to govern the licensing of legal persons and natural persons conducting audit of accounting documents of companies. The Directive establishes requirements to qualification of persons conducting audit, the procedure of conducting an audit, as well as the list of scope of audit the inclusion of which in to the examinations for licensing is mandatory. The Directive also contains provisions pertaining to professional integrity and independence of persons conducting audit, and to the transparency of their names (titles) and addresses.

Let us mention that the expression ‘statutory audit’ applied to the heading of the Directive is consistent with the expression ‘external audit’ applicable in the Armenian legislation.

In the Republic of Armenia, the principal legal act that governs aspects of audit is the Armenian Law on Audit Activity¹ (hereinafter referred to ‘the Law’), which establishes the bases on which audit activity is carried out in the Republic of Armenia as well as the aspects in relation to audit activity. Other legal acts that were taken into consideration when

¹ AL-512-N, adopted on 26.12.2002, (Republic of Armenia Official Bulletin 2003/9 (244), 12.02.2003).

preparing this Compliance Report included the Government of Armenia Resolution No. 499-N, April 21, 2005 on ‘Approval of Auditor Code of Conduct’; the Government of Armenia Resolution No. 123-N, February 03, 2005 on ‘Procedure for Qualification Examinations for Auditors and Approval of Examinations Program’; and the Government of Armenia Resolution No. 509-N, April 21, 2005 on ‘Approval of Audit Standards’.

2. Compliance evaluation

1. Can persons conducting audit be natural persons and legal persons, according to the Armenian legislation?

Yes. Article 4 of the Law provides that a person conducting audit is the audit organization and/or sole proprietor providing audit services; and according to Article 26 of the same law, a commercial organization, irrespective of its structural and legal structure whatsoever, except for open joint-stock companies, shall be entitled to receive an activity license.

According to Article 1 of the Directive, the persons conducting audit may, depending on the legislation of each Member State, be natural or legal persons or other types of company, firm or partnership.

Evaluation: the Armenian legal act complies with the requirement of the Directive.

2. Does the Armenian legislation provide for requirements to legal persons conducting audit?

According to Article 26 of the Law, a commercial organization of structural and legal structure whatsoever, except for open joint-stock companies, shall be entitled to receive an activity license, provided that:

- a) at least two of the employees of that organization are auditors;
- b) at least 1/2 of stakeholders of that organization are auditors and at least 50 percent of statutory capital of that organization belongs to them.

Article 2 of the Directive provides that legal persons conducting audit need at least satisfy the following conditions, when they wish to seek an activity license, as follows:

- the natural persons who carry out statutory audits of the documents on behalf of firms of auditors must satisfy at least the requirements to natural persons conducting audit²; the Member States may provide that such natural persons must also be approved;
- a majority of the stakeholders must satisfy the requirements to natural persons conducting audit; the Member States may provide that such natural persons must also be approved;
- a majority of the members of the administrative or management body must satisfy the requirements to natural persons conducting audit; the Member States may provide that such natural persons must also be approved.

Evaluation: the Armenian legal act only partially complies with the requirement of the Directive as it regularizes the aspect in more detail. Besides, the Law does not contain provisions establishing that a majority of natural persons of the firm of audit as well as a majority of the

² The requirements to natural persons conducting audit are disclosed in the general content of the report.

members of the administrative or management body must satisfy the requirements to natural persons conducting audit.

3. Does the Armenian legislation provide for a possibility for the specialized authority to organize the qualification of persons conducting audit?

Article 21 of the Law provides that qualification of auditors shall involve a procedure whereby an auditor receives an auditor qualification certificate based on the results of check of professional knowledge of a natural person having applied to the Specialized Unit. So, the specialized authority also may license an audit activity.

According to Article 2(2) of the Directive, the authorities of the Member States may be professional associations provided that they are authorized by national law to grant approval.

Evaluation: the Armenian legal act complies with the requirement of the Directive.

4. Does the Armenian legislation establish requisite conditions for the qualification of persons conducting audit?

Yes. According to Article 21 of the Law, 1. Auditor qualification shall be carried out through examination which is those natural persons who have:

a) higher education as economist and at least 3 years of professional work experience within the last 5 years preceding application for the qualification certificate; or

b) higher education and at least 5 years of professional work experience within the last 7 years preceding application for qualification certificate.

Article 4 of the Directive contains a stipulation that a natural person may be approved to carry out statutory audits of the documents only after having attained university entrance level, then completed a course of theoretical instruction, undergone practical training and passed an examination of professional competence of university, final examination level organized or recognized by the State.

Evaluation: the Armenian legal act complies with the requirement of the Directive.

5. Does the Armenian legislation provide for the issuance of a qualification certificate only to persons of good repute and who are not engaged in any activities incompatible with the audit activities under the Armenian law?

Article 12 of the Law provides that persons conducting audit shall not be allowed to engage in any entrepreneurial activity other than audit activity and provision of services as specified in paragraph 2 of the same Article.

The Law does not contain provisions concerning good reputation of a person conducting audit. However, as described in Paragraph 7 of the Auditor Code of Conduct, principles of behavior governing professional duties of the auditor are independence, honesty, objectivity, professional capacities and due diligence, confidentiality, professional behavior, adherence to technical standards.

According to Article 3 of the Directive, the authorities of a Member State shall grant approval only to persons of good repute who are not carrying on any activity which is incompatible, under the law of that Member State, with the statutory auditing.

Evaluation: the provisions in the Armenian legal acts only partially comply with the requirement of the Directive as the stipulation of a good repute refers only to the person having applied for an activity license, while the requirements established under the Armenian legislation are pertinent to the persons engaged in audit activities.

6. Does the Armenian legislation provide for a requirement whereby qualification examinations designed for the persons conducting audit should be equipped with an appropriate level of theoretic knowledge and an ability to use such knowledge in practice?

Yes. Although the Armenian legislation fails to explicitly provide for such a stipulation, Article 23 of the Law, however, provides that auditor qualification examinations shall be open to persons who have higher education professional work experience, which ensures an appropriate level of knowledge and ability to use that knowledge in practice. Therefore, the provisions of the Armenian legislation comply, in principle, with the requirement of the Directive.

According to Article 5 of the Directive, the examination of professional competence must guarantee the necessary level of theoretical knowledge of subjects relevant to the statutory auditing of the documents and the ability to apply such knowledge in practice.

Evaluation: the Armenian legal act complies with the requirement of the Directive.

7. Does the Armenian legislation provide that at least part of the qualification examination should be in a written form?

Yes. Paragraph 13 of the procedure for taking qualification examinations provides that an examination shall be conducted in a written form, through a random taking of a test question (designed for a test phase) and of a problem (designed for a problem resolution phase) out of the questionnaire which has been inserted in a computer.

According to Article 5(2) of the Directive, at least part of the qualification examination should be in a written form.

Evaluation: the Armenian legal act complies with the requirement of the Directive.

8. Does the Armenian legislation specify the areas included in the qualification examinations for licensing the provision of audit activity?

Yes. The procedure for taking qualification examinations specifies the areas that should cover the issues included in the program for qualification examinations. Though the list of these areas names various spheres, it does not contain areas such as information science, mathematics and statistics.

Article 6 of the Directive establishes that the text of theoretical knowledge included in the examination must cover the following subjects in particular:

- auditing of accounts;

- analysis and critical assessment of annual accounts;
- general accounting;
- consolidated accounts;
- cost and management accounting;
- internal audit;
- legal and professional standards relating to the statutory auditing of accounting documents and to those carrying out such audits;
- in so far as they are relevant to auditing: - company law;
- the law of insolvency and similar procedures;
- tax law;
- civil and commercial law;
- social-security law and law of employment;
- information and computer systems;
- business, general and financial economics;
- mathematics and statistics;
- basic principles of the financial management of undertakings.

Evaluation: the Armenian legal act only partially complies with the requirement of the Directive as the fields such as information science, mathematics and statistics are not included in the program for the qualification examination.

9. Does the Armenian legislation provide for a possible lack of the need to take theoretic study or practical education for a person if he or she has been a university graduate or taken university exams or received practical education within the framework of university teaching, which is certified by a diploma or another equivalent document recognized by the State?

No. The Armenian legislation does not provide for such possibilities.

According to Article 7 of the Directive, a Member State may provide that a person who has passed a university or equivalent examination or holds a university degree or equivalent qualification may be exempted from the test of theoretical knowledge in the subjects covered by that examination or degree; and

a Member State may provide that a holder of a university degree or equivalent qualification may be exempted from the test of the ability to apply in practice his theoretical knowledge of such subjects when he has received practical training in them attested by an examination or diploma recognized by the State.

10. Does the Armenian Law provide for a necessity for experience in practical study in order to ensure that theoretic knowledge is used in practice?

Yes. According to Article 21 of the Law, persons who have:

- a) at least 3 years of professional work experience within the last 5 years preceding application for qualification certificate; or
 - b) at least 5 years of professional work experience within the last 7 years preceding application for qualification certificate,
- may take part in the qualification examination.

Article 8 of the Directive establishes that in order to ensure the ability to apply theoretical knowledge in practice, a test of which is included in the examination, a trainee must complete a

minimum of three years' practical training in the auditing of annual accounts, consolidated accounts or similar financial statements. At least two-thirds of such practical training must be completed under a person approved under the law of the Member State. Further, Member States shall ensure that all training is carried out under persons providing adequate guarantees regarding training.

Evaluation: the Armenian legal act complies with the requirement of the Directive.

11. Does the Armenian legislation provide for a possibility to issue an activity license to persons who do not meet the requirements to natural persons conducting audit activity?

No. The Armenian legislation does not provide for a possibility for such exceptions.

According to Article 9 of the Directive, Member States may approve persons to carry out statutory audits even if they do not fulfill the conditions, provided that they can show either:

- a) they have, for 15 years, engaged in professional activities which have enabled them to acquire sufficient experience in the fields of finance, law and accountancy and have passed the examination of professional competence, or
- b) they have, for seven years, engaged in professional activities in those fields and have, in addition, undergone the practical training and passed the examination of professional competence.

12. Does the Armenian legislation provide that persons having been licensed to carry out audit activity must render these services in a professional manner?

Yes. According to Paragraph 7 of the Auditor Code of Conduct, one of the principles of behavior governing professional duties of the auditor is the availability of his or her professional abilities.

According to Article 23 of the Directive, Member States shall prescribe that persons approved for the statutory auditing shall carry out such audits with professional integrity.

Evaluation: the Armenian legal act complies with the requirement of the Directive.

13. Does the Armenian legislation envisage provisions regarding the independence of the persons having been licensed to carry out audit activity?

Yes. Article 12(4) of the Law establishes the following:

The provision of auditory service shall not be allowed to:

- the auditor: i) which is the stakeholder (participant), insurer (save for certain types of mandatory insurance) of any given legal entity, or is the manager of that legal entity or institution, or is the accountant or person in charge of accounting or preparation of financial accounts of any given auditee, and ii) which is related in kinship (child, spouse, parent, sister, brother, grandfather, grandmother, grandchild, and spouse's child, parent, sister, brother, grandfather, grandmother, grandchild) with these parties;
- the audit organization which is the insurer (save for certain types of mandatory insurance) of any given legal entity, or is the stakeholder (participant) of that legal entity or institution;
- the audit organization the head or any member of management of which: i) is the stakeholder (participant), insurer (save for certain types of mandatory insurance) of any given legal entity, or is the manager of that legal entity or institution, or is the accountant

- or person in charge of accounting or preparation of financial accounts of any given auditee, and ii) is related in kinship (child, spouse, parent, sister, brother, grandfather, grandmother, grandchild, and spouse's child, parent, sister, brother, grandfather, grandmother, grandchild) with these parties;
- the audit organization which operates as an audit organization established by any given legal entity or sole proprietor, or created upon participation by such entities; and
 - the audit organization which has any common stakeholder (participant) with any given legal entity or institution.

In addition to these provisions, Paragraph 7 of the Auditor Code of Conduct states that of the principles of behavior governing professional duties of the auditor is independence.

Article 24 of the Directive provides that Member States shall prescribe that such persons shall not carry out statutory audits which they have required if such persons are not independent in accordance with the law of the Member State which requires the audit.

Evaluation: the Armenian legal act complies with the requirement of the Directive.

14. Does the Armenian Law require that the principles of professional and independent provision of auditory services be applied to the persons who conduct audit on behalf of audit firms?

Yes. According to Audit Standard 220(6), the staff of audit firm shall remain committed to the principles of independence, honesty, objectivity, confidentiality and to the rules of auditor behavior.

According to Article 25 of the Directive, the principles of professional and independent provision of auditory services shall apply to natural persons conducting audit and to persons who carry out the statutory audit of the documents on behalf of a firm of auditors.

Evaluation: the Armenian legal act complies with the requirement of the Directive.

15. Does the Armenian legislation provide for liability for natural persons who, when providing auditory services, violate the principles of professional and independent provision of auditory services?

Yes. Article 31 of the Law establishes that for infringement of the requirements of this law, auditors, persons conducting audit, and auditees shall be held liable under the law. Further, the same article specifies the warning with an assignment to remedy the violation and the penalty as measures of sanction.

According to Article 26 of the Directive, Member States shall ensure that approved persons are liable to appropriate sanctions when they do not carry out audits in accordance with the requirements pertaining to professional and independent provision of auditory services.

Evaluation: the Armenian legal act complies with the requirement of the Directive.

16. Does the Armenian legislation establish provisions setting out liability for the members and shareholders of the audit firm as well as for the members of managerial, administrative and supervisory bodies of such firms, who do not meet the requirements to the auditors of the audit firm, not to intervene in the execution of audit?

No. The Armenian legislation does not contain such provisions.

According to Article 27 of the Directive, Member States shall ensure at least that the members and shareholders of approved firms of auditors and the members of the administrative, management and supervisory bodies of such firms who do not personally satisfy the requirements to auditors do not intervene in the execution of audits in any way which jeopardizes the independence of the natural persons auditing the documents.

Evaluation: the Armenian legal act does not comply with the requirement of the Directive.

<i>17. Does the Armenian legislation establish a requirement for public disclosure of the name, address of persons conducting auditory services?</i>
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No. The Armenian legislation does not contain such provisions.

Article 28 of the Directive provides the following:

Member States shall ensure that the names and addresses of all natural persons and firms of auditors approved by them to carry out statutory audits of the documents are made available to the public.

- a) the names and addresses of the natural persons who provide auditory service on behalf of the firm of auditors;
- b) the names and addresses of the members or shareholders of the firm of auditors;
- c) the names and addresses of the members of the administrative or management body of the firm of auditors.

Evaluation: the Armenian legal act does not comply with the requirement of the Directive.

3. Conclusion

The results of review of this Compliance Report show that the Armenian legislation covering audit activity is mostly in compliance with the provisions of the Directive (the Eighth Council Directive of 10 April 1984 (84/253/EEC) based on Article 54 (3) (g) of the Treaty on the approval of persons responsible for carrying out the statutory audits of accounting documents). Nevertheless, there have been aspects identified as being only partially compliant with the requirements of the Directive. The inclusion of not all the fields in to the list of audit qualification examinations is one of such aspects. The Armenian legislation does not contain a requirement to public disclosure of name and address of persons who provide auditory services.

It is worth mentioning in the meantime that some conditions are not mandatory under the Directive either, and an analysis regarding them may be a non-mandatory benchmark for further development of the Armenian legislation. One of such conditions is the issuance of an activity license to persons who do not satisfy the requirements to natural persons conducting audit.

	Question	Yes	No	Partially	Notes
1.	Can persons conducting audit be natural persons and legal persons, according to the Armenian legislation?	√			This aspect has been regularized under Articles 4 and 26 of the Law.
2.	Does the Armenian legislation provide for requirements to legal persons conducting audit?			√	The arrangement specified in the Law is only partially compliant with the requirement of the Directive, as the Directive has regularized that aspect in more detail. Also, the Law does not contain provisions establishing that a majority of natural persons of the firm of audit as well as a majority of the members of the administrative or management body must satisfy the requirements to natural persons conducting audit.
3.	Does the Armenian legislation provide for a possibility for the specialized authority to organize the qualification of persons conducting audit?	√			This aspect has been regularized under Article 23 of the Law.
4.	Does the Armenian legislation establish requisite conditions for the qualification of persons conducting audit?	√			This aspect has been regularized under Article 21 of the Law.
5.	Does the Armenian legislation provide for the issuance of a qualification certificate only to persons of good repute and who are not engaged in any activities incompatible with the audit activities under the Armenian			√	The provisions in the Armenian legal acts only partially comply with the requirement of the Directive as the stipulation of a good repute refers only to the person having applied for an activity license, while the requirements established under the Armenian legislation are pertinent to the persons engaged in audit activities.

	law?				
6.	Does the Armenian legislation provide for a requirement whereby qualification examinations designed for the persons conducting audit should be equipped with an appropriate level of theoretic knowledge and an ability to use such knowledge in practice?	√			This aspect has been regularized under Article 23 of the Law.
7.	Does the Armenian legislation provide that at least part of the qualification examination should be in a written form?	√			This aspect has been regularized under Paragraph 13 of the Auditor qualification examinations.
8.	Does the Armenian legislation specify the areas included in the qualification examinations for licensing the provision of audit activity?			√	The Armenian legal act only partially complies with the requirement of the Directive as the fields such as information science, mathematics and statistics are not included in the program for the qualification examination.
9.	Does the Armenian legislation provide for a possible lack of the need to take theoretic study or practical education for a person if he or she has been a university graduate or taken university exams or received practical education within the framework of university teaching, which is certified				The Armenian legislation does not provide for such a possibility; nor is this a mandatory requirement under the Directive, too.

	by a diploma or another equivalent document recognized by the State?				
10.	Does the Armenian Law provide for a necessity for experience in practical study in order to ensure that theoretic knowledge is used in practice?	√			This aspect has been regularized under Article 21 of the Law.
11.	Does the Armenian legislation provide for a possibility to issue an activity license to persons who do not meet the requirements to natural persons conducting audit activity?				The Armenian legislation does not provide for such a possibility; nor is this a mandatory requirement under the Directive, as well.
12.	Does the Armenian legislation provide that persons having been licensed to carry out audit activity must provide these services in a professional manner?	√			This aspect has been regularized under Auditor Code of Conduct, Paragraph 7.
13.	Does the Armenian legislation envisage provisions regarding the independence of the persons having been licensed to carry out audit activity?	√			This aspect has been regularized under the Law (Article 12(4)) and Auditor Code of Conduct, Paragraph 7.
14.	Does the Armenian Law require that the principles of professional and independent				This aspect has been regularized under Audit Standard 220(6).

	provision of auditory services be applied to the persons who conduct audit on behalf of audit firms?	√			
15.	Does the Armenian legislation provide for liability for natural persons who, when providing auditory services, violate the principles of professional and independent provision of auditory services?	√			This aspect has been regularized under Articles 31 and 31.1 of the Law.
16.	Does the Armenian legislation establish provisions setting out liability for the members and shareholders of the audit firm as well as for the members of managerial, administrative and supervisory bodies of such firms, who do not meet the requirements to the auditors of the audit firm, not to intervene in the execution of audit?		√		
17.	Does the Armenian legislation establish a requirement for public disclosure of the name, address of persons conducting auditory services?		√		
Total, 17 questions		10	2	3	No assessment has been made in respect of Question 2 (9 and

				11), as those conditions are not mandatory under the Directive as well.
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