



QUALITY CONTROL OF AUDITING: UKRAINIAN PROSPECTS

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ABSTRACT

The authors conducted a study of the current audit quality control system in Ukraine to develop proposals according to the main areas of its development and improvement based on the positive foreign experience and criteria determined by users of audit services. The information base of the empirical study was the data from the reports of the Audit Chamber of Ukraine on the activities of audit companies and their statistical indicators. The results of the study, analytical findings and recommendations for practice and research prospects are presented in the article. The provisions of the current legislation of Ukraine are used as a source of representation of conceptual definitions and methods for assessing the quality of audit in Ukraine.

The research methodology is based on theoretical generalizations and the use of the scientific tools, including comparative analysis, a survey of users of audit services regarding its qualitative characteristics and the study of the experience of foreign countries.



The necessity of introducing social (public) supervision, development of internal audit quality control, increasing the responsibility of audit entities, will help to overcome the identified shortcomings associated with the quality parameters of the provided audit services. A number of hypotheses are formulated, which were confirmed during the study or require additional research. The proposed recommendations can have a positive impact on the overall quality of audit activities, provided that they are put into practice in a comprehensive manner. Thus, it is not necessary that they all be implemented at the same time. sequential implementation option is possible.

Keywords: audit; audit activity; control; model; audit quality; criteria; control subjects.

1. INTRODUCTION

The development of audit activity in Ukraine takes place simultaneously with the improvement of the current accounting legislation, since the latter determines many key points relating to audit. Thus, in particular, from January 1, 2018, the Law No. 2164 was put into force, which introduces many changes to the Law of Ukraine “On Accounting and Financial Reporting in Ukraine”. Pursuant to this law, a list of entities that are required to perform an annual audit and when it is to be conducted is determined.

Compulsory audits in Ukraine are foreseen for a large number of entities, which not only have different ownership, but also belong to different sectors of the national economy. This means that there is an increasing number of entities in Ukraine that are required to audit, and this, in turn, requires the availability of appropriate specialists who need to be well-versed in the industry specific accounting and reporting. At the same time, even the world practice shows that there are deficiencies in the quality control of the activity of audit firms and individual auditors.

2. LITERATURE REVIEW

Scientists studying the problems of quality assurance audit and analyze the factors influencing it, formulate theoretical and economic substantiation for ways to improve the quality of audit, develop proposals for specific audit firms, as well as formulate clarifications and provisions for regulations on this issue.

In particular, the works of such scholars as Soo Kwon, Lim, Simnett (2014) and Kwon, Han (2018), are devoted to issues of the quality of the audit. Named researchers in their work, “The Effect of Mandatory Audit Firm Rotation on Audit Quality and Audit Fees: An Empirical Evidence from the Korean Audit Market”, evaluate the performance of audit firms and the



quality of the audit they perform on the example of South Korea by analyzing relevant financial data.

Using a unique setting in which mandatory audit firm rotation was required from 2006–2010, and in which both audit fees and audit hours were disclosed (South Korea), this study provides empirical evidence of the economic impact of this policy initiative on audit quality, and the associated implications for audit fees. This study compares both pre- and post-policy implementation and, after the implementation of the policy, mandatory long-tenure versus voluntary short-tenure rotation situations (KWON; LIM; SIMNETT, 2014).

Establishing the link between the quality of the audit and the social relations between the auditees is equally important (KWON; HAN, 2018). Such studies make it possible to clearly identify the role of management in auditing quality assurance. In addition, it is fair to conclude that the positive impact of auditor rotation to ensure its impartiality and independence, and the appropriateness of enhancing the relationship between audit fees and audit quality. We believe that the latter position allows us to evaluate the cost of audit services more adequately.

Beardsley, Lassila and Omer (2016) highlight another interesting position in their work. The authors believe that the reduction in audit quality occurs in large audit offices. They provide evidence that audit offices' provision of additional NAS in the presence of fee pressure is an important dimension to consider when examining the effects of declining audit fees on audit quality.

Many publications by Ukrainian and foreign authors focus on issues related to the rotation of audit firms and their partners and the impact of this process on the quality of audit services. For example, scholars such as Huang, Raghunandan, Huang and Chiou (2015) cite such studies on the example of China. Jenkins and Vermeer (2013) devote their attention to this issue. These scholars have substantially linked the quality and duration of the audit to the rotation of the auditors and believe that it is mandatory. In addition, the named authors draw attention to the development of relations between the audit entities (client-auditor).

Overall, many studies are country-specific, and contain analytical material that confirms the importance of quality criteria when conducting an audit. In this context, practically all researchers are of the opinion that the quality of the audit depends entirely on the audit quality control system and the audit activity.

In this regard, in recent years, there has been a growing focus on public (public) oversight. In 1985, it was first considered in the Organization for Economic Co-operation and Development Report (YEREMENKO, 2010).

Mykhailenko (2011), states based on the analysis of foreign sources that in the world practice, most authors identify three main models of control over audit activity:

- supervision of private public organizations on behalf of the state (1);
- oversight by public authorities (2);
- mixed supervision (3) (Figure 1).

The use of the “Quality Assurance System for Quality Assurance Firms” by the American Institute of Chartered Accountants (AISRA) is recommended for all models.

The global practice of quality control of audit activity is an extremely important element of gaining positive experience for Ukraine. In foreign countries, much attention is paid to this issue, since the state of the country's economy depends on its results.

The most optimal for Ukraine is the public oversight system. Its advantages are independence (including independence from state bodies), transparency, competence, responsibility.

However, it is worth agreeing with one more position of such scholar as Mykhailenko (2011) that each of the above models of audit control has both advantages and disadvantages, therefore, when choosing one of them, the scientist recommends to objectively evaluate and analyze all the all the “pros” and “cons”. The individuality of the choice is determined by the existing national characteristics, which are characteristic for both the internal and external environment.

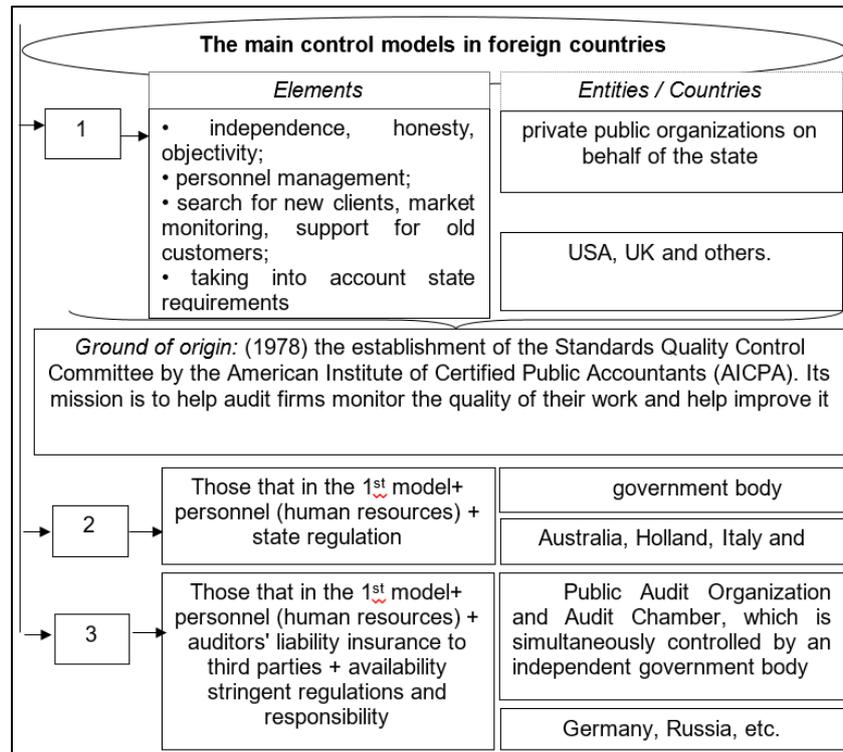


Figure 1: Models of control over audit activity and its quality

Source: generated by authors based on MYKHAILENKO (2011); 1, 2, 3 - respectively: first, second and third control model.

Slobodyanik, Kondriuk and Haibura (2019) consider that proposed strategy realization the transforming the control system according to world standards and good governance requirements must take place focused on economic development maintenance and Sustainable Development Goals achievement.

Antoniuk, Chyzhevskaya and Semenyshena (2019) conducted a study aimed to identify discrepancies between the practice in providing audit services and the regulatory framework for their implementation in Ukraine.

The quality control system of audit activity in Ukraine is not perfect, it is just being formed. Therefore, the use of positive foreign experience is promising and useful. However, due to its specificity and the presence of a corruption component in Ukraine, professional, public and state interests in these issues should be optimally combined.

Accordingly, the process of development of an audit institute, or rather an institute of quality audit, is already actively underway in Ukraine. It can even be called reforming, as a number of measures have been taken, including amendments to existing legislation, standards implementation and so on.

The aim and method of research. The purpose of the study was the analysis the existing quality control system of audit activity in Ukraine and to develop proposals on the main areas of development in the context of quality improvement.

3. RESULTS AND DISCUSSION

The analysis of the current audit activity in force and its legislative regulation on quality issues in Ukraine shows that the system of its control has at least 3 levels: the state level, the level of professional audit organizations, the internal control. Each of these levels has its own actors that it involves in exercising control. For example, at the state level, quality control is carried out by the Audit Chamber and the bodies to which it delegates such powers (through appropriate accreditation).

According to Article 21-22 of the Law of Ukraine “On Audit Activities”, for improper performance of their obligations the auditor (audit firm) bears property and other civil liability in accordance with the contract and the law. For improper performance of professional duties to the auditor, the Audit Chamber of Ukraine may apply the following penalties: suspension of the certificate for up to one year; certificate revocation (LAW OF UKRAINE “ON AUDIT OF FINANCIAL REPORTING AND AUDITING ACTIVITIES”, 2017).

The practice of performing quality control of audit and audit activity in Ukraine is characterized by the use and availability of certain control mechanisms. They follow from the provisions laid down in the relevant regulatory documents. The main purpose of quality control of audit and audit activity, which follows from the Ukrainian regulatory acts, is to check compliance with the license requirements and conditions.

Accordingly, the first step in carrying out quality control of audit activity is to establish compliance of the activity of audit organizations and individual auditors with the requirements of the Law of Ukraine “On Audit Activities”, the Regulations on Licensing of Audit Activities and (Standards) of Audit Activities. However, it seems incorrect to limit the purpose of control to only these quality criteria.

The study of the points of view of 30 users of audit services (heads of companies and accountants) and employees of 4 audit firms suggests that the main criteria for the quality of audit activity should be considered compliance with:

- a) the provisions of the Law of Ukraine “On Audit Activities”;
- b) compliance with the license requirements and conditions;



- c) standards of professional ethics;
- d) requirements of national (standards) audit activity;
- e) requirements of international standards, in part that does not contradict the Ukrainian ones;
- f) requirements of internal rules (standards) of the audit firm and professional audit organizations;
- g) the terms of the contract for the provision of audit services and the obligations arising therefrom.

Some of these criteria are implemented in accordance with the requirements set out in the Regulation on external audits of the quality control system of audit services, approved by the decision of ACU No. 231 / 12 as of 30.10.2014, No. 302/9 (as amended) (REGULATION ON EXTERNAL AUDITS OF THE QUALITY CONTROL SYSTEM OF AUDIT SERVICES, 2011).

This regulation broadens the scope of audit quality and audit performance. And in our view, it is the change in quality approaches that is the main reason for the negative dynamics of the number of audit entities in Ukraine in 2013-2018 (Fig. 2).

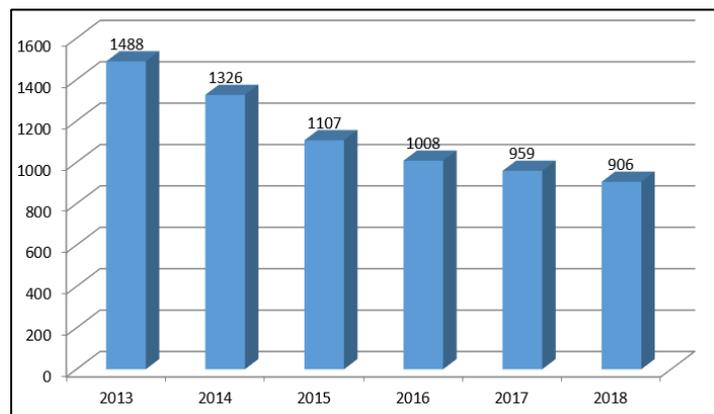


Figure 2: Dynamics of the number of subjects of audit activity in Ukraine in 2013-2018.

Note: Number of audit entities included to the register of audit firms and auditors as of January 1

Source: it is created on the basis of Audit Chamber of Ukraine report, 2018

From Figure 2 we can see a clear downward trend in the number of audit entities. At the beginning of 2018, it was 906 units, compared to 1488 in 2013, which is 582 subjects lower than in 2013.

The dynamics of the number of auditors (Figure 3), as well as the number of certificates issued to candidates for auditing, is negative, as evidenced by the study of the audit data of the Audit Chamber of Ukraine.

The information presented in the Audit Chamber report indicates an annual decrease in the number of auditors and the number of certificates received. The same trend continued in 2018 and a negative regression indicates a significant decrease in the number of auditors. Instead, the volume of services provided by audit entities in Ukraine in 2016 increased by 12% compared to 2015.

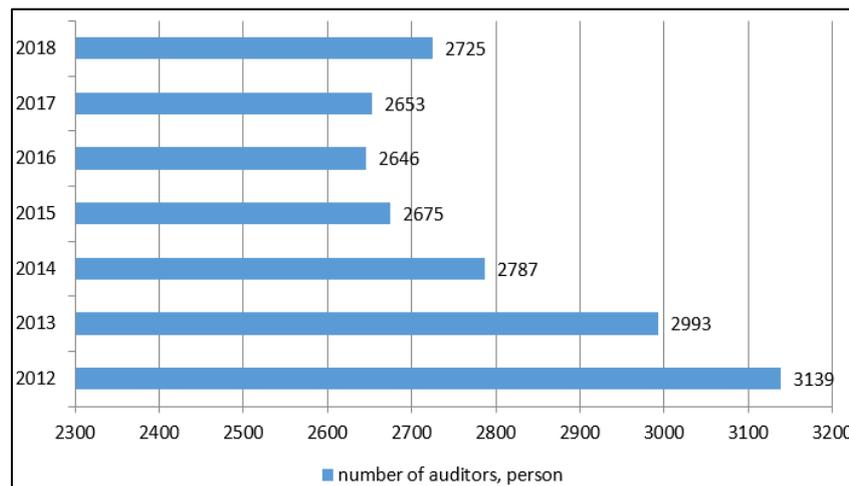


Figure 3: Dynamics of the number of auditors in 2012-2018 (as of 31.12)
 Source: Get is created on the basis of Audit Chamber of Ukraine report, 2018

In particular, in 2015, in value terms, this indicator amounted to UAH 1,761.2 million, in 2016 – UAH 1973.1 million. The exception to this is 2017, when there was a decline in the number of audited entities by different customers. In quantitative terms, this figure was 1124 units lower. An indisputable fact that emerges from the reports submitted by the audit firms is the increase in average revenue per entity. It increased by 19.7% (from 1644.5 thousand UAH in 2015 to 1969.2 thousand UAH in 2016) (REPORT TO THE CABINET OF MINISTERS OF UKRAINE, 2016).

In 2018, the quantitative and cost indicators of the services provided changed. For example, assurance services, such as statutory and proactive audits. The total cost of such services to users of financial statements increased by UAH 143.1 million compared to 2016 and amounted to UAH 990.3 million.

There were 339 fewer statutory audits, but 203 more audit engagement missions. In our view, the experts we fully support indicate that the interest of business entities to engage in voluntary cooperation with auditors is increasing. Attention should also be paid to the fact that

in 2017 the average cost of the initiative audit service (UAH 279.06 thousand) exceeded the average cost of the statutory audit (UAH 46.8 thousand).

These indicators detail the dynamic movement in the field of auditing. However, they are not informative enough to draw conclusions about the quality of the audit activity. The growth in service delivery may not be determined entirely by quality. In Ukraine, many audits are carried out in connection with the obligation of audit for many entities. Therefore, the increase in their volume may be related to this requirement.

Alarming is the fact that the highest cost of audit services (over UAH 1 million) was recorded by 226 audit firms, while services worth over UAH 10 million were provided by 18 firms. That is, the market is growing revenue of large companies. This may result in the monopolization of the audit market and the decline in competitiveness of other participants identified as medium and small entities. They will be restricted from accessing the audit services market. Therefore, the question of the need to improve the quality control mechanisms of auditors is really relevant.

Usually such audits are carried out through the receipt by the Audit Chamber of complaints and complaints about dissatisfaction with the quality of the audit, unethical behaviour of auditors, etc. The analysis of ACU reports submitted to the Cabinet of Ministers of Ukraine for the last 5 years shows that such audits were carried out only through appeals of top (state) legal entities (National Bank of Ukraine, National Securities and Stock Market Commission, National Commission for Implementation) state regulation in the field of financial services markets, etc.). The list of appeals does not include individuals and legal entities (including those audited).

This can be seen in two ways:

- the fact that at the non-state level, the counterparties are completely satisfied with the audit, or its results are quite satisfactory.
- ignorance of procedures for challenging audit results and their quality and unwillingness to engage in appeal procedures.

In the latter case, one of the reasons is not so much the complexity of the appeal procedures as the insufficiently stringent requirements in matters of responsibility of the audited entities for its results presented in the audit findings. Concerning the state institutions

interested in the quality of the audit, the Audit Chamber of Ukraine adopted 26 decisions in 2017 (Table 1).

Table 1: Information on recoveries applied by the Audit Chamber of Ukraine in 2017 to auditors (audit firms) based on the results of routine and unscheduled audits

Kind of charge	The amount of charges	Number of registered entities	% of the number of registered entities	
			by types of charges	by group of entities
Prevention	20	2653 persons	0.75	0.87
Termination of the certificate for a period of three months	1		0.0004	
Termination of the certificate for a period of five months	1		0.0004	
Revocation of certificate	1		0.0004	
Exemptions from the Register of Auditing Firms and Auditors	3	959 entities of audit activity	0.31	0.31
TOTAL	26	X	X	X

Source: it is calculated on the basis of data Audit Chamber of Ukraine report, 2018, p.29.

In general, the data in the Table 1 indicate minor irregularities identified as a result of the audit performed by the Audit Board of control. In particular, only 0.31% of the audited entities were excluded from the Register of Auditing Firms and Auditors. And for less than 0.87% of the total number of auditors, a termination charge was applied. However, such metrics are not positive and as objective as possible. There are several reasons for this. One of them is that in 2017, the Plan of external audits of the quality control system was performed only by 49.5% (200 audits were planned, in fact only 99 were audited, including additionally unscheduled) (AUDIT SUMMARY IN UKRAINE IN 2017. AUDIT CHAMBER OF UKRAINE (REPORT), 2018).

Another equally important reason is the low level of participation in the quality control system of audit and audit activity of non-state, including independent and public institutions. We can now support the position of many authors (BONDAR V. and BONDAR Yu, 2013; PROSKURYNA and KOVALENKO, 2010) that the quality control of audit services in Ukraine is not yet sufficiently balanced and does not produce high results. This is evidenced by the failure of many quality control firms and their closure.

From an organizational point of view, some steps should be taken to address this. These include the following steps:

- a) development of a system of informing the audit subjects about the qualitative parameters and requirements for the quality of their activity;
- b) introduce mandatory audit quality control of all audit entities at least once every 2 years;

- c) development and promulgation of criteria, standards and methods of quality assessment of audit activity;
- d) organization of training courses for auditors.

The main condition for progress in auditing services and auditing activities is the establishment of appropriate independent supervisory and regulatory institutions (or institutions with extensive territorial bodies). Together with the ACU and other professional organizations, they can improve the quality control of audit activity and provide the desired financial transparency for the entire Ukrainian economy.

At the same time, there is a need to identify and facilitate the development of opportunities for professional self-organization of domestic audit entities in order to facilitate their access to the market.

In our opinion, the realization of the function of professional self-government of the Audit Chamber of Ukraine should be an indisputable factor in solving these problems. In particular, we consider it appropriate to consider legislative restrictions on the size of each entity's income.

For example, if in 2017 the market volume was UAH 2126868.7 thousand, then in 2018 the maximum revenue of one audit entity would be advisable to limit 1% of the total market volume for the previous year, which would be 21268.7 thousand UAH. An excess of this value can be considered, in particular, as one of the signs of violation of the requirements of the antitrust legislation, which will give grounds for the measures taken by the Audit Chamber of Ukraine (AUDIT IN 2017: FIGURES AND TRENDS, 2017).

4. CONCLUSIONS AND RECOMMENDATIONS

The conducted research shows that in Ukraine there is an objective need and favorable conditions for development not only of the system of quality control of audit and audit activity, but also good preconditions for improvement of quality of audit services. The Ukrainian quality assurance system is under development. There are many approved legal acts, a network of institutions has been developed that have relevant powers in these matters, methodological and instructional materials have been developed that allow effective control.

The control bodies include both state and professional organizations. It is advisable to form social (public) control bodies (organizations) in order to enhance the effectiveness of control and increase its effectiveness and efficiency, as well as to provide greater truthfulness.



In addition, a number of measures should be implemented in order to achieve better results:

- strengthen requirements for certification and licenses for audit activities;
- introduce clearer recommendations on auditing quality indicators themselves and set them at the legislative level;
- build an algorithm and prescribe formulas for assessing the quality of audit activity;
- to develop audit institutions with regard to the establishment of independent audit quality assurance commissioners;
- to develop standard guidelines for quality control of audit activities.

The suggested recommendations can have a positive impact on the overall quality of the audit activity, provided that they are put into practice. It is not necessary that they all be implemented at the same time. Consistent implementation is possible. It is also advisable in Ukraine to apply the experience of European countries to strengthen the quality control of audits and certification of auditors by international standards.

This task is relevant especially in the context of opening European borders, including in the context of the international recognition of domestic auditors and the corresponding prospects of their entry into the international market of audit services.

Although audit firms are responsible for the inaccuracy of the findings, it appears that this responsibility is not sufficiently effective. Therefore, it can be reasonably argued that an important real way to improve the quality of audit activities and services is to increase the accountability of the audit entities.

In Ukraine, the size of the auditors' property liability cannot exceed the amount actually caused to the customer by the auditor's fault. Also, auditors who have repeatedly admitted low-quality audits are subject to a fine (penalty) in the form of a warning, suspension of the certificate for up to one year or revocation. The auditor shall return the revoked certificate no more than 10 days from the date of receipt of the excerpt from the decision of the ACU.

The first part of the charge (damages) is difficult to establish because of the presence of not only objective but also subjective data. For example, if ethical misconduct has been committed and a positive conclusion has been reached about financial position and performance, it is practically impossible to estimate the potential investors' losses. Therefore,

to solve this, as well as a number of other problems, it is worth developing research in this area, including the use of positive foreign experience.

The individualism of choosing acceptable foreign approaches should be combined with the assessment and consideration of national peculiarities of the internal and external environment of the functioning of audit firms. For example, the presence of a corruption component in Ukraine requires the optimum combination and cooperation of professional, public and governmental organizations that monitor the quality of audit activity.

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