The Professional and Entrepreneurial Element in Auditing

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Abstract. The trust of society, investors, banks, and the state in the published information of economic entities is ensured through auditing, making auditing a public-legal function. The authors have analyzed the current state of the audit services market in Russia. As a result of the analysis conducted, inconsistencies in the state regulation of this function have been identified. Self-regulation of auditing in Russia, under the conditions of a non-alternative self-regulatory organization and strict control measures by government authorities, leads to a significant reduction in both auditors and auditing organizations, thereby reducing competition in the audit services market. The authors conclude that there are two components in auditing activities: professional and entrepreneurial, which have different goals and objectives. The authors identify insufficient implementation of professional elements in the activities of auditors and auditing organizations, as well as the predominance of entrepreneurial elements, as the prerequisites for problems in the industry's development and a decrease in society's trust in the work of auditors.

Keywords: audit development concept, audit self-regulation, organization of audit activities, state regulation of audit, public-legal function of audit.

1 Introduction

The relationships arising during mandatory audit examinations largely have a public-legal character. The performing auditing organization acts officially as an independent control and supervisory body by virtue of the law, authorized by the state. The conduct of mandatory audits does not imply the initiative of the audited entity but rather represents its duty and a burden of a public-legal nature. The audit report, prepared based on the results of the examination, becomes an integral part of the official financial statements for the year. The financial statements cannot be accepted without it, and users of financial (accounting) statements, including government tax authorities, are not entitled to consider them reliable. Considering the public-legal function of auditing, special measures of state regulation are necessary, which are proposed by the authors.

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for the development of auditing activities and the improvement of the quality of financial reporting.

The implementation of special military operations and sanctions from unfriendly countries have led to certain problems in the development of auditing activities. These problems manifest as "freezing" prices for auditing services (market growth below the country's inflation level [1]), the absence of interested service clients, and inadequate quality of auditing services despite the strict regulatory methods applied by the state and the self-regulatory organization. Some authors question the necessity of mandatory audits for non-public companies. Developing this idea, several researchers have concluded that "automated data processing, electronic document management, and remote access to any information and analytical system make on-site audit inspections impractical" [6, 9]. However, due to Russia's limited access to digital technologies, rapid progress in this direction should not be expected, particularly concerning the intellectual analysis of business processes [16] and business process auditing [10]. These researchers argue that the work of an auditor can be largely replaced by artificial intelligence, which is capable of processing vast amounts of data. However, business intelligence lacks professional judgment, cannot make informed assessments of valuation indicators independently, and cannot deal with the threats of fraudulent actions in financial reporting without the involvement of an auditor's labor.

Another area of study is the post-audit effect [12, 13], which leads to the tendency of forming reliable financial reporting and correctly calculating taxes in subsequent periods based on the experience of working with an auditor. Thus, there is partial merit to the post-audit effect in the fact that the client of an auditing organization operates "correctly."

The authors hypothesize that the public-legal nature of auditing, the professional component, and the entrepreneurial element are in conflict, necessitating the finding of a reasonable balance between them.

The objective of this study is to identify the relationship between the professional and entrepreneurial elements in auditing activities and determine the further direction of the auditor profession's development.

2 Materials and Methods

The research utilized statistical data from reports by the Ministry of Finance of Russia on the state of the audit services market, data from self-regulatory organizations (SROs) of auditors in terms of the registry of audit organizations and auditors, as well as regulatory documents governing auditing activities.

The authors employed recognized general scientific methods, such as analysis and synthesis, logic, induction and deduction, as well as general scientific empirical methods like statistical observation, measurement, and comparison. The authors also utilized their professional judgment [5] as a research method. During the study, the authors analyzed the regulatory framework for auditing in international practice, conducted a logical analysis of the public-legal function of auditing, and examined the implementation of professional elements in auditing activities.

3 Results

In terms of the ratio of state regulation to self-regulation in the audit market, countries with a higher degree of state regulation (such as France, Germany, and China) and countries with a high degree of self-regulation, such as the United Kingdom, are distinguished [2, 4]. To determine the position of Russia, the authors analyzed the concept of self-regulation. A self-regulatory organization (hereinafter referred to as SRO) of auditors can only establish
additional requirements for audit procedures within a certain range of limitations (Article 7 of the Federal Law on Auditing). Considering that in Russia, only one SRO of auditors is possible and that the SRO has additional obligations to interact with government bodies, with government authorities having the right to attend all meetings of the SRO's management, it can be concluded that SROs of audit organizations in Russia are significantly restricted in rights and capabilities, and our country is predominantly subject to strict control by the state in auditing activities, including control over the activities of the SRO of auditors.

Under the influence of strict control measures by the SRO and government bodies, there is a consolidation of audit firms, and the policy of consolidation is supported by both the SRO of auditors and the Ministry of Finance of the Russian Federation. Some researchers [14] note that the geographic proximity of the client and the presence of social ties (university community, "local clique") allow auditors to charge higher fees. However, these same authors point out that such connections enable auditors to conduct audits more effectively by accessing interactions with individuals responsible for corporate governance (hereinafter referred to as CG). Therefore, the question of the necessity of developing regional audit organizations, according to the authors' opinion, should be positively resolved, as it will contribute to improving the professional quality of audit firms' work and make audits accessible to small regional enterprises.

One direction of audit reform is the expansion of information provided in audit reports. In Russia, for certain types of clients, auditors prepare extended audit opinions, indicating key audit matters. Additional reports are also included in the audit report for credit and insurance companies as required by special laws. This direction of reform is aimed at providing users with a broader understanding of the work performed by auditors. However, as studies have shown, not all users utilize this information. The majority of users, apart from the "Opinion" section, do not examine anything in the audit report. Just as in France when extended reports were initially introduced, researchers in subsequent years did not find a significant market reaction to their disclosure or a substantial impact on audit report delay, audit quality, and audit fees. The extended audit report in France did not have the expected consequences for investors and audits [11].

Auditors offer their clients two different types of services simultaneously, each serving different purposes and nature: audit services and accompanying audit and other services, which are based on different objectives and clients. In Russia, unlike in foreign practice, there are no requirements regarding the proportion of audit and consulting services in the income of an auditing organization [8]. Rarely conducting audit inspections does not encourage the maintenance of adequate professionalism among audit personnel, as they are primarily engaged in consulting rather than auditing. This negatively affects the quality of audit services provided. Therefore, in order to enhance the professional quality of audit services, the authors suggest considering the possibility of establishing similar requirements in Russia.

In 2003, the Constitutional Court of the Russian Federation made several important conclusions regarding the activities of auditors (Resolution of the Constitutional Court dated April 1, 2003, on the case examining the constitutionality of the provision of Article 7, paragraph 2 of the Law "On Auditing Activities" in connection with the complaint of citizen Vyistavkina). In particular, the following conclusion was made: "Although the choice of an auditing organization and the payment for the services provided by it are made on a commercial basis within the framework of a civil contract, i.e., through a private legal form, obligatory auditing is carried out in the interests of an indefinite circle of persons and the state, i.e., in the public interest... The relationships that arise during the mandatory audit inspection largely have a public legal nature" [7]. Indeed, the purpose of an audit is to form an independent opinion for the users of financial statements and is conducted within procedures that are not determined by the client, and the extent of the audit is not within the client's authority to define. Despite signing an agreement with the entity being audited, the entity is not a user of these services, and
the actual users of the audit are the users of the financial statements, that is, an unlimited number of individuals. Thus, the current structure of the relationship with the auditor is based on a civil contract, and the client cannot determine the scope or content of the audit nor is the client a user of this service [7]. Based on the aforementioned, the authors propose excluding the audit from the scope of the civil law mechanism and replacing the agreement with the audited entity with an audit engagement, which would establish the timelines for conducting the audit, delivering the results, as well as the rights and obligations of the auditor and the audited entity, as provided by the law on auditing activities.

It is possible to apply the regulatory experience of notarial and legal professions to auditing within the framework of a non-profit organization that unites audit professionals (establishment of non-profit corporate organizations - audit associations, alongside other forms of non-profit corporate organizations such as a bar association or notarial chamber). This form of conducting activities involves professionals-partners carrying out non-profit-based activities within the organization, the purpose of which is not to generate profit but to fulfill a public legal function. In such a form of conducting audit activities, the strategy and objectives of the activities are determined not by business owners but by auditors engaged in professional activities. The specific features of corporate regulation of such non-profit corporate organizations can be defined by industry-specific legislation, particularly the Law on Auditing Activities. As members (partners) of the non-profit organization, auditors make collective decisions directly influencing the quality of audit activities, including:
- Making decisions on admitting new members to the non-profit organization;
- Determining the budget and staffing schedule;
- Approving internal standards/quality management system;
- Approving a code of professional ethics and monitoring its compliance.

Such an organization can operate alongside existing subjects of auditing activities, for example, by conducting audits of state-owned companies, defense industry contractors, and the like. In Russia, unlike foreign experience (in the European Union, for instance), there are no requirements for the rotation of audit firms [8]. According to the authors, it would be advisable to develop and introduce similar norms in our country since long-term cooperation between a client and an auditor, in some cases, poses a threat of familiarity and insufficient professional skepticism on the part of the auditor, despite the rotation of the audit team.

The establishment of an optimal price for an audit is one of the main issues in ensuring the fulfillment of this function by high-class professionals in a volume that allows for the implementation of all audit procedures required by standards, without imposing unwarranted burdens on businesses.

Traditionally, in marketing theory, three groups of pricing methods are distinguished:
1) Cost-based methods (an audit costs as much as the auditor incurs in expenses plus profitability).
2) Market-based methods (an audit costs as much as determined by the market, for example, through auctions or requests for proposals).
3) Parametric (production) methods (based on comparing new products with old ones).

Parametric methods are not suitable for auditing due to its specificity. Thus, in the auditing profession, either cost-based methods or market-based pricing methods can be applied. Considering that the provision of audit services is a sufficiently competitive market (despite a significant decline in the number of auditors and audit firms over the past three years), the application of tariff pricing is not expedient.

At the same time, today, auditing is highly susceptible to unfair competition due to the use of professional judgment at virtually every stage of service provision. Therefore, the professional community periodically discusses the issue of establishing a minimum pricing threshold (a minimum economically justified price), which would lead to the following benefits for society:
1) If the minimum price for an audit allows for covering all expenses incurred in its conduct, offers from "unscrupulous" auditors will automatically disappear from the market. The reason for this is the fact that businesses will not need to purchase a service in the form of "auditing simulation" when they can acquire real audit services for the same amount of money.

2) This will contribute to improving the overall quality of provided audit services throughout the Russian Federation since the price will include the minimum necessary costs for conducting audit procedures.

Unlike related to auditing and other services, auditing is a service where the scope of activity is always associated with the volume of audit procedures. However, the International Standard on Auditing (ISA) 530 "Audit Sampling" does not provide a formalized mechanism for its determination; instead, the use of in-house standards is assumed. Sampling of both 10 and 1000 tested units can be considered justified, and the audit evidence obtained from such sampling is deemed sufficient and appropriate. Thus, it is challenging to formalize and standardize the workload in the provision of audit services, leading to difficulties in establishing a minimum price.

To establish a minimum price, the following approach is proposed:

1) A formula determining the workload for conducting an audit based on the economic performance indicators of the audited entity and its industry-specific characteristics.

2) Calculation of the average hourly rate of an auditor, taking into account remuneration data and staff numbers from audit organizations.

3) Determination of expenses related to supporting the activities of an audit organization as a percentage of labor costs.

4) Determination of work time utilization norms (training, leave, organizational events, etc.), where utilization is a measure of labor efficiency, calculated as the ratio of paid (client-billable) time to total time.

5) Other expenses.

This minimum price can serve as a criterion below which an auditor cannot set the price for their services. This criterion can be adopted by the self-regulatory organization of auditors or the regulator and communicated to all members for the upcoming financial year. The criterion should be regularly reviewed to ensure it aligns with the actual expenses of audit firms.

In this situation, dumping and price competition are eliminated, and the ethical principle of independence is implemented not only de jure but also de facto.

However, the complexity of this approach lies in the fact that audit pricing typically includes not only the costs of audit firms but also a risk premium [15, 17].

In the future, the establishment of a unified market for audit services within the Eurasian Economic Union (EAEU) is anticipated [3]. This work is already underway, with public organizations being created to unite auditors, and joint conferences on the development of audit activities are held. Within this line of work, it is important to enhance the auditor's and audit organizations' responsibility to stakeholders.

The risk premium forms additional funds for the liability of audit firms and payments under insurance policies, contributing to the protection of investors' interests, who rely on information confirmed by the auditor. According to the authors, it is necessary to consider issues of mandatory liability insurance not only for audit firms but also for audit engagement leaders. A key change in the scope of the auditor's and audit organization's responsibility should be the establishment of civil liability for the audit engagement leader (the individual signing the audit opinion) to an unlimited range of parties for damages caused by knowingly false audit opinions. Thus, the auditor as an individual should become the party liable for compensating damages to third parties. Consequently, it is advisable to introduce mandatory professional liability insurance for auditors who sign the audit opinion.
4 Discussion

The authors have concluded that there is a need to establish a relationship between the interests of the state, users of audit services, and entities engaged in audit activities, in the case of shifting the focus from regulating entrepreneurial activities to regulating professional activities. The proposed measures, in the authors' opinion, will provide the auditing profession with an incentive for development and improvement of service quality and will contribute to the sustainable development of the Russian economy.

5 Conclusion

During the study, the group of authors arrived at the following conclusions:

1) In the Russian Federation, a model of state regulation is employed, characterized by "rigid" government control. The role of the sole self-regulatory organization (SRO) is essentially reduced to control functions under the supervision of the regulator. The authors propose considering a transition to the regulation of professional activities, which entails expanding the powers of SROs for auditors and the emergence of alternative SROs for auditors.

2) It is necessary to develop regional auditing and regional representations of SROs for auditors, as this would better implement the professional aspect in regulating auditing activities. This proposal is supported by the presence of social and other connections that more effectively facilitate regional-level interactions with local communities, thereby increasing the usefulness of auditing activities for society as a whole.

3) To enhance the independence of auditing organizations and reduce the threat of familiarity, requirements for the rotation of auditing organizations after a certain number of years are suggested, along with criteria regarding the proportion of income from auditing activities in the revenues of auditing organizations. This would further enable the realization of auditors' professional competencies in service provision.

4) The authors propose a legislative change to the status of mandatory audit activity, recognizing it as a public function. To implement the public status, regulation of mandatory audits by civil law norms should be excluded.

5) To eliminate unfair competition, rules for calculating the minimum price for audits need to be developed. The authors concluded that in this case, a cost-based approach should be adopted, and a general concept for calculating the minimum price, including a risk premium, is proposed.

6) In light of the establishment of a unified market within the Eurasian Economic Union (EAEU), a revision of the concept of auditors' and auditing organizations' responsibility is required. The authors suggest introducing liability for audit leaders alongside the auditing organization, as well as mandatory insurance for their responsibility.

7) In the context of a mobilization economy, the public-legal function of auditing takes precedence. It may be necessary to create another subject of auditing activity in the form of a corporate non-profit organization that, alongside existing subjects, contributes to enhancing the reliability of corporate information and promoting sustainable economic development.

References