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MARKET OF AUDIT SERVICES IN UKRAINE: SITUATION AND WAYS OF REFORMING

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РИНОК АУДИТОРСЬКИХ ПОСЛУГ В УКРАЇНІ: СТАН ТА ШЛЯХИ РЕФОРМУВАННЯ

The author investigated the current situation in Ukrainian audit services market (it's structure, analysis of market concentration, total services volume by economic spheres, audit firms allocation and by the quality of audit conclusion). We defined the main directions of reforms at this market accordingly with harmonization of Ukrainian and European legal system. The author analyzed the consequences of some ways of audit market reforming for market participants.

Автором досліджено поточне становище на ринку аудиторських послуг України (в т.ч. розглянуті структура ринку, концентрація суб'єктів в географічному вимірі та вимірі обсягів наданих послуг). В процесі аналізу визначені основні напрямки майбутнього реформування ринку, що відбудеться згідно процесів узгодження вітчизняного та європейського законодавства в галузі обліку та аудиту. Автором проаналізовано можливі наслідки окремих шляхів реформування ринку для його учасників згідно із підготовленими новими нормативними документами.

Keywords: *audit, Directive №2006/43/EU, audit market reforms, public oversight.*

Ключові слова: *аудиторська діяльність, Директива ЄС №2006/43/ЄС, реформування ринку аудиторських послуг, публічний нагляд.*

Formulation of the problem. Reforms on the market of non-governmental financial control in Ukraine were planned because of convergence and harmonization procedures of Ukrainian and international accounting standards and generally thanks to development of integration processes. Basic requirements for audit services market functioning represented in the Directive №2006/43/EC of the European Parliament and the Council "On statutory audits of annual accounts and consolidated accounts" [1] (hereinafter - EU Directive №43), which was adopted in 2006 year. The need to adopt such a resolution in the European Union was due to increased distrust of individual auditors due to wave of bankruptcies among large companies that were on the eve of crisis positive and qualified audit decisions.

Analysis of recent research and publications. Problems and ways of development of audit services market in Ukraine and in the world dedicated researches of Davydov G.M., Ryadskoyi V.V., Sushko D.S. and others. A significant input to the development of theoretical and methodological foundations of the proceedings of auditing implemented such economists as: Belukha M.T., Butynets F.F., Demyanenko M.J., Zavgorodniy V.P., Kireytshev G.G., Longhorn B.F. and others. However, audit services market in Ukraine is influenced by external and internal factors, and therefore it requires constant research and analysis.

The purpose of the article is researching the current situation of the Ukrainian audit services market, and analysis of the preconditions and consequences of reform on this market.

Main research. According to the Union of Auditors of Ukraine most of the requirements of that Directive EU №43 has been successfully implemented in activity, notably in such spheres:

- registration of auditors and audit firms (list of audit firms and auditors is available on the official website of the Audit Chamber of Ukraine);
 - implementation of International Standards on Auditing (the Audit Chamber of Ukraine Decision "On Adoption of International Standards on Auditing edited in 2006" dated 30.11.2006 №168/7 and making constant updates in 2011 and 2014 after upgrading that ISA);
 - the internal organization of the audit firm;
 - quality control (the Audit Chamber of Ukraine Decision approved the "Concept of Quality Assurance System audit services in Ukraine" dated 26.09.2013 №279/7, and "Regulations on the Committee for audit services quality control" of 29.01.2015 №307/6 and other documents in support of the implementation of quality control over the provision of audit services);
 - permanent training of auditors (the Audit Chamber of Ukraine Decision approved the "Regulation on the continuous improvement of professional skills of auditors of Ukraine" dated 30.07.2015 № 313/8, as well as on the Audit Chamber web site available plans of the improvement of professional skills of auditors and test results) and so on.
- The main requirements of the EU Directive №43 still are: the creation of an independent body of public auditor oversight (for social value enterprises) and improving the procedures of auditor's certification.

Since the adoption of the main in this sphere Law of Ukraine "About Auditing" in 1993 in Ukraine didn't form the sufficient level of audit service's culture. The need to provide professional judgments about the authenticity, completeness and compliance prepared financial statements with the current legislation and standards are forming with the development of the financial market and the whole economy.

The need to audit confirmation of reports comes for users for obtaining the confidence in decision making. Unfortunately, most part of the audit services market in Ukraine is still statutory audit (≈55% according to the 2014 year), that's indicating the lack of necessity to obtain reports confirmation or get other audit services in a great part of the market.

It further should be noted that revenues from purely audit services, for example, of Deloitte Touche Tohmatsu (which is a so-called Big Four auditors) are only ≈28% in the 2015 fiscal year, and almost 35% - from consulting and the rest 37% of revenue accounted for advice on tax and legal, risk management and financial management [8]. In general,

according to 2014, revenue of Big Four companies reached 120 billion USD (Figure 1).

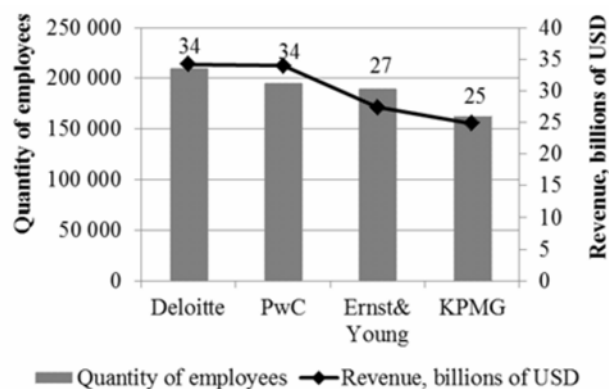


Figure 1. The extent of firms “big four” 2014
Based on: [3; 4; 5; 9]

And this trend is repeated for all major accounting firms, and it's indicating a noticeable imbalance in the development of audit services market in Ukraine compared with a worldwide. However, at the same time this information indicates a blank niche in this market. In the context of sustainable economic growth and recovery in market conditions specified segment has significant growth potential in any country.

Today the market of audit services in Ukraine includes more than 1,200 companies and entrepreneurs, and only 300 companies (or approximately 25%) can provide statutory audit.

Auditor activity in Ukraine engaged in audit firms and individuals - entrepreneurs who are certified auditor. The ratio for 2014 audit firms amounted to 88% of the market, but provided 98% of total services. It should be noted that for the reported year individual entrepreneurs don't provide services in the amount of more than 2 mln UAH.

By volume of the activity domestic market is also quite plural (Figure 2) and enough concentrated, because nearly 60% volume of all provided services assemble services more than 10 mln UAH and they provided by only 10 audit firms. About 23% volumes of all audit services assemble services in the amount of 1 to 10 million UAH, and such volume provides approximately by 150 companies and entrepreneurs in a year. The smallest in value (up to 0,5 mln UAH per year) and market share (10%) the volume of services provided by 800 companies that make up 60% volume of all market players.

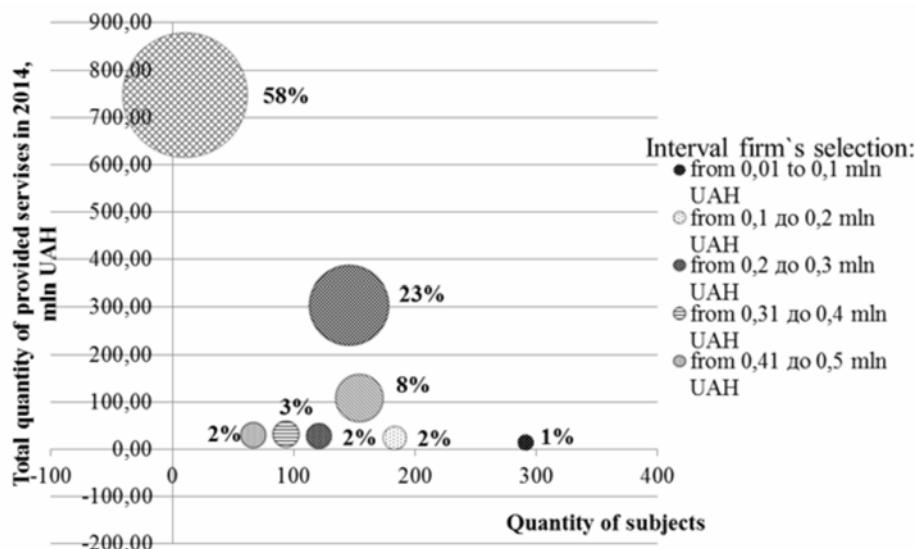


Figure 2. Market concentration of audit services for 2014

Source: compiled according to the Audit Chamber of Ukraine Annual Report [7]

Total number of auditors and audit firms over the past 5 years decreases (Figure 3), which may also indicate about structural changes in the market, increasing competition level and requirements for businesses. Due to potential future changes, the number of firms may fall essentially.

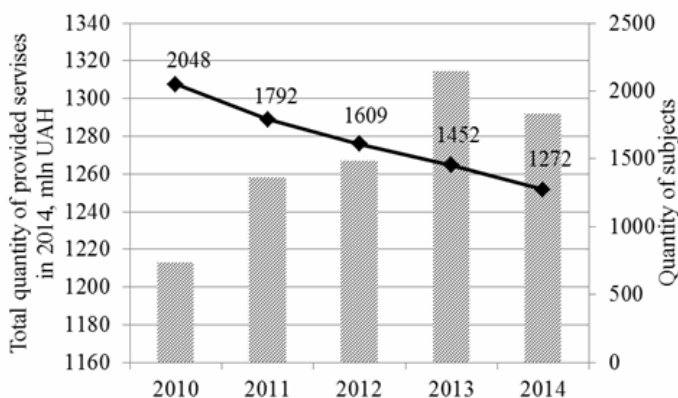


Figure 3. Changes in the number of audit firms and the volume of services provided during 2010 - 2014

Source: compiled according to the Audit Chamber of Ukraine Annual Report [7]

As for the distribution of services provided by industry, the biggest volume of audit services to perform the tasks of assurance (Figure 4) in 2014 was granted to entities operating in the fields of mining, processing industry (21%), financial and insurance activities (21%), wholesale and retail trade (8%).

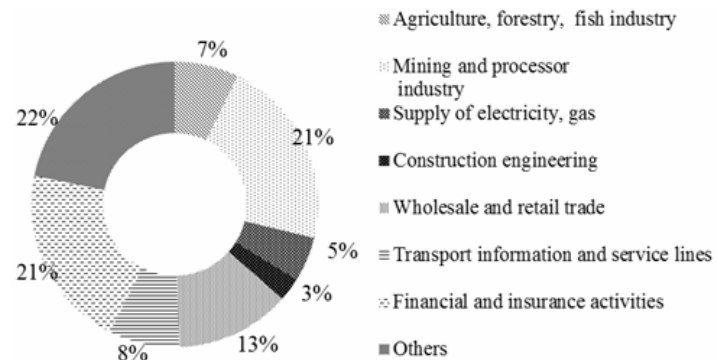


Figure 4. The volume of services provided by economic spheres in 2014
 Source: compiled according to the Audit Chamber of Ukraine Annual Report [7]

These data again show a significant predominance of statutory audit over initiative audit and other audit services in Ukraine, because it is in the aforementioned spheres are mostly act enterprises, whose annual financial statements have to disclosure and statutory audit.

In the regional dimension the number and the volume of services provided the leadership position occupied by the city Kyiv and Kyiv region (48% of the number of orders and 79% by value), Dnipro region performs 7% of number and 6% by value of orders, Kharkiv and Lviv region have in terms of the number of orders by 6.7%, but at a cost of only 2-3%. All other regions have even less significance and do not affect the market of audit services in Ukraine.

The information indicates a significant concentration of ordering audit services in one region of the country. Accordingly, depending on the region is changing and the average cost per order: 60 thousand UAH in Kyiv region to 6 thousand UAH in Ternopil and Ivano-Frankivsk regions.

The structure of total audit services rendered in 2014 dominated assigns assurance as to the reliability, completeness and compliance of financial reporting (47%), other professional services cover 43% of the market (Figure 5).

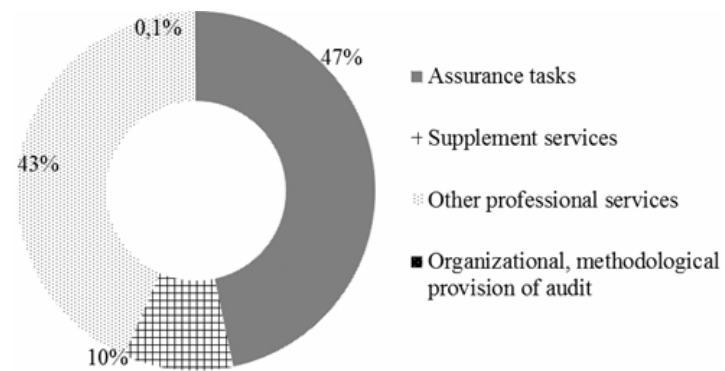


Figure 5. Structure of total services rendered in 2014
 Source: compiled according to the Audit Chamber of Ukraine Annual Report [7]

As part of other professional services provided by 2014, the largest proportion of consulting services (48%), accounting occupies 30% in a designated niche market, occupying 20% tax advice and other services (Figure 6).

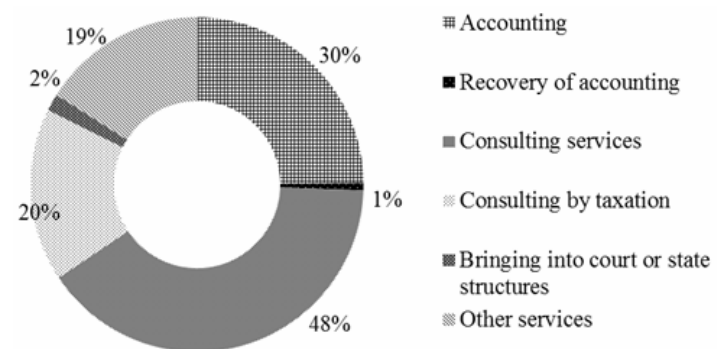


Figure 6. Market share other professional services provided in 2014
 Source: compiled according to the Audit Chamber of Ukraine Annual Report [7]

Today, there are a lot of factors influencing the market of audit services in Ukraine, including the negative (unstable economic and political situation, temporary occupation part of the country etc.) and positive (improving quality control of audit services, proximity to the requirements of the EU Directive №43 etc.).

Compliance with EU Directives №43 will take place under the responsibility of the harmonization of Ukrainian legislation and EU legislation. Implementation of this directive became necessary in the EU by increasing distrust in the results of audits of public interest entities.

Although reputation is one of the most important achievements of the audit firm, some companies neglected their professional obligations and ethical principles, and lost objectivity. Unprofessional activities of employees of firm Arthur Andersen, which was one of the largest accounting firms in the world (at that time was part of the “Big Five”), led to the unexpected bankruptcy of Enron in 2001, and its other clients (WorldCom, Qwest Communications, Merck, Global Crossing), as well as the collapse of that audit firm. Before its collapse Arthur Andersen was one of the largest accounting firms in the world. And still the companies of Big Four, that remaining at the market control approximately 70% of global orders in the field of accounting and auditing [11]. Lost reputation of one of the largest firms continues to affect the credibility of the auditor as a whole. It should be noted that in Ukraine there are offices of audit firms Big Four, but they all work by franchise because under national law the main founders of the audit firm should be only certified auditors - individuals who are citizens of Ukraine.

As a result of events outlined above, in the legislative field of many countries intensified requirements for financial reporting of companies whose shares are traded on the stock exchanges (e.g. Sarbanes-Oxley Act in USA). And the EU adopted Directive №43, whose main goal was to strength public oversight of the audit activity, including the prescribed requirements for statutory audit of entities that cause public concern.

And in Ukraine the audit activity wasn't controlled by the executive authorities, it regulates by Audit Chamber of Ukraine. However, the Ministry of Finance of Ukraine proposed bill ("On the audit of financial statements and audit activities" [6]), which included a body of public oversight of audit firms and auditors that would be indirectly controlled by the Ministry. This approach is the opposite with Directive №43, which insists on the independence of the supervisory authority of the state, the transparency of its formation and more.

Representatives of the Ministry of Finance have doubts about the quality control on audit services by the Audit Chamber of Ukraine. However, although the majority of audit reports with the statutory audit recently saturate definitely (27%) or conditionally positive (71%) character (Figure 7), checking of the quality of service by Chamber continues, as evidenced by the annual external audit plans of Audit Chamber.

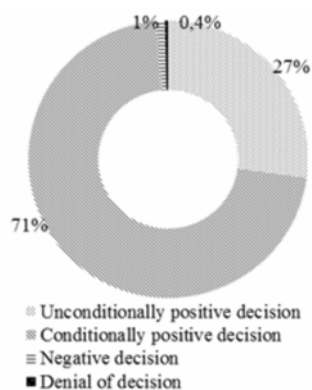


Figure 7.1. Structure of the decision in the statutory audit for 2012

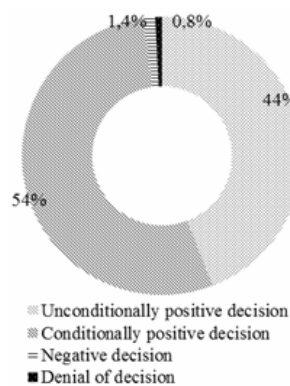


Figure 7.2. Structure of the decision in the audit initiative for 2012

Source: compiled according to the summary information from Audit Chamber of Ukraine [10]

At the same time in the List of audit firms and auditors provided information on the results of external review quality control system of each subject from the list, and the duration of the certificate of compliance of quality control system.

Additionally, it should be noted that an unqualified audit decisions at the initiative audit issued in 1.5 times more (44% versus 27% for statutory audit). This can be attributed to the real needs of such a conclusion to obtain additional financial resources on domestic or foreign markets and so on. So, companies with relatively smaller distortions and disturbances in the conduct of accounting and financial reporting ask for initiative audit more often than companies with the problems in reports.

Positive consequences and prospects. Thus, at the 2014 the market of audit services is fairly concentrated, the largest volume of orders is controlling by the 10 largest accounting firms, including the representatives of the Big Four. Number and value of audit services varies from region to maximize performance data is in Kiev region, there is the same and the largest number of registered audit firms and entrepreneurs.

In the case of audit service market reforming as suggested by bill of the government:

- significantly reducing the number of small accounting firms and entrepreneurs through the implementation of more stringent requirements for entities that can perform the statutory audit (including on the number of certified auditors in auditing firms);
- held part-monopolization of the market of statutory audit of enterprises that have social value (increased requirements will meet the firms of Big Four as well as several other large firms);
- changing of eligibility requirements to obtain certificate of auditor (certification will conduct by the Commission certification, which is formed by the state supervision in the field of accounting and audit; there will not be necessary requirement of higher education and the citizenship of Ukraine for the applicant; there indicates a obligatory probation for 3 years in the already registered audit entities);
- reduced cost of exam for certificate (the size of three minimum wages) and others.

In general, the bill is intended to strengthen state control over the market for audit services in Ukraine and switch all possible levers of regulation and cash flows of the Audit Chamber of Ukraine on the complex of institutions, which will have an indirect effect by Ministry of Finance of Ukraine (including public oversight body audit activities: board of auditor oversight and inspection of quality control certification committee of auditors, Supervisory board on the application of sanctions by the audit quality control and so on).

However, the EU №43, which supports the Ministry of Finance in developing its law aimed at a transparent and independent public oversight of audits of reporting only enterprises of public interest, not all checks provided by audit firms and entrepreneurs. However, it should be noted that in a country where the shadow economy is over 60%, which assessed the perception of corruption (Corruption Perceptions Index) [2] gave the country at 142 out of 176, increased state regulation of audit services is fairly predictable.

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