# AUDIT IN DEVELOPING COUNTRIES: THE CASE OF EASTERN EUROPE

[a]SVITLANA VITER, [b]OLGA DMYTRENKO, [c]OLENA YARMOLIUK, [d]TETIANA FOMINA, [e]OLHA PUHACHENKO

[a,b,c]*Polissia National University, Zhytomyr, Ukraine,*
[d,e]*Central Ukrainian National Technical University, Kropyvnytskyi, Ukraine*
*email: [a]vitersvitlana@i.ua email, [b]olga.n.dmitrenko@gmail.com [c]radushinskayal@gmail.com, [d]tetynafomina@ukr.net, [e]pugachenkoolga@gmail.com*

Abstract: The purpose of the study is to implement a comparative analysis of audit activity is carried out on the example of Eastern Europe. The article is used methods of comparison, analysis, synthesis. In Eastern Europe, the audit develops in one direction, but has different stages of development, according to the economic and political state of countries. In countries that are not associated with the EU, audit is characterized by formality, pricing problems and low quality and practical usefulness for businessmen. EU-member countries need a more qualitative audit, which is associated with a high level of development of international relations, but depending on the development of the economy of the state.

Keywords: developing countries, Eastern Europe, Audit activity, Adjustment of audit activities

## 1 Introduction

The development of global integration processes pushes audit companies in developing economies to understand the role and significance of using international audit standards to ensure audit quality. Without audit activity, the development of a market economy is impossible, such as understanding the actual economic status (Yurieva et al. (2015)). However, the audit develops in accordance with the development of the economy. It is an instrument of its exit from the shadow and organization of state and public control. Audit activity in Eastern Europe develops following the development of countries. The general trend of the industry is simple: in countries with a more advanced economy and international relations, the audit performs consulting services to improve the efficiency of the enterprise. In developing countries, the audit conducts a more formal function for controlling institutions, so in practice, private businesses do not order audit services because of a one-sided combination of price and benefit that the company will receive as the audit results.

## 2 Literature Review

Not all countries of Eastern Europe are characterized by the same level of audit activity development, since economically and politically, the countries are different, despite the common thirty years old historical roots. Particularly tangible today is the difference between countries that are already European Union members that standardized their accounting and audit standards to European, and countries that only plan to become EU-member. It should be noted that most of the developing Eastern-European countries are already EU members; therefore, their economy is regulated by the system of supranational law, and the mandatory audit is regulated by EU legislation (Maijoor et al (2012)). In order to implement euro integration at the enterprises of these countries, changes in accounting were introduced, and therefore the audit Institute became the basis for financing and cooperation between international companies in the European market (Juhászová et al. (2014)). Today, all countries that have become the EU-members have implemented legislation on the regulation of audit activities.

As for scientific research in audit activity in different countries, there are sufficient quantities of research in the last ten years. In particular, Bralatan (2012) and Kashperska (2018) have made a deep study of the development of audit activities in Ukraine in the direction of standardization according to international requirements. A similar analysis based on Poland is carried out by Dobija (2015), which describes the features of audit activities, the main problems for the current state. Studies on Slovakia are described by Damarcka et al. (2020); The development of Hungary's audit is described in the research of Judit (2015). Nevdakh and Pivchevsky (2012) describe the problems and prospects for developing an audit in Belarus.
Nevertheless, the comparative characteristics of the audit in developing countries were not carried out, so this study has novelty and practical value. The purpose of the research is to create a comparative characteristic of audit activities in developing countries by the case of Eastern Europe. In the course of the study, the peculiarities of audit activity regulation, the current status of audit in each country, and the main problems faced by audit companies and private auditors will be identified.

## 3 Results

First of all, let's classify Eastern European countries based on membership in the European Union to get a more detailed research of audit features in these countries (see Fig. 1).

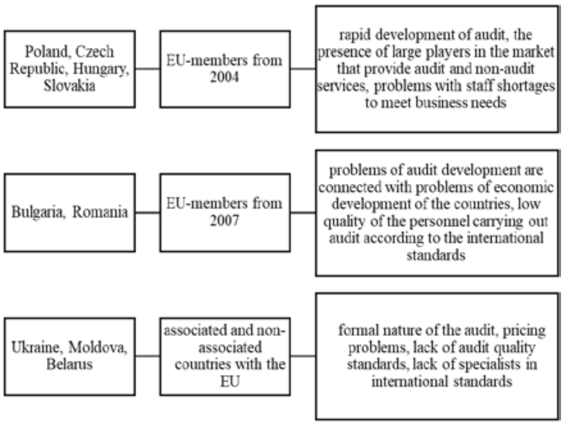


*Figure 1 – Classification of developing countries (on the example of Eastern Europe) according to the peculiarities of audit development*

Ukraine has been associated with the EU since 2014. For this time, governing auditing legislation has already been adapted according to international standards. On the other hand, Belarus, which is not associated with the EU, develop an audit in its unique direction, which is not typical for other countries. The top three non-EU countries include Moldova, which got the association, but auditing in this country is developing differently from Ukraine or Belarus.

In Ukraine, the regulation of auditing is in accordance with the Law of Ukraine "On Auditing", the Statute of the Audit Chamber of Ukraine, the Decision of the Audit Chamber of Ukraine. International auditing standards are applied by auditing entities as National Auditing Standards from 01.01.2007 on a mandatory basis. However, the Law "On Auditing Financial Statements and Auditing" was introduced only in 2018. The transition to international standards was recommended long before the signing of the Association Agreement with the EU, which is associated with long-term preparations for the country's accession to the EU and the interest of Ukrainian companies in attracting foreign investors. To achieve this goal, financial results must be presented following international auditing standards. However, today the accounting processes of most Ukrainian enterprises are not carried out by international standards but following national accounting standards (Bralatan, et al. 2012).

Audit Chamber of Ukraine is the official regulator of the Ukrainian audit, an independent institution, and a legal entity that deals with essential issues in the methodology and organization of audit management. In 2018, the Ukrainian Audit Chamber was reorganized following EU requirements.

In turn, Belarus has introduced its own Law on Auditing. The republican rules of activity are mandatory for audit organizations, auditors-individual entrepreneurs, and persons who have to go through the audit. Based on international auditing standards, 38 national audit rules have been developed, containing the relevant requirements and principles of auditing. The republican rules of auditing were as close as possible to the international auditing standards, and a number of republican measures contained additional norms and provisions that corresponded to the legislation of the Republic of Belarus (Ministry of Finance of the Republic of Belarus).

The Resolution of the Council of Ministers of the Republic of Belarus of 2020 “On the implementation of International Standards on Auditing” in the Republic of Belarus decided to move the standards of auditing to international. Still, in fact, most companies operate in accordance with national rules. That's why international standards mainly apply to a small number of multinational companies. The only self-governing institution of auditing is the Audit Chamber. Each auditor must be a member of the chamber on mandatory terms. The Audit Chamber of Ukraine and Belarus generally coordinates the activities and represents the interests of members in government agencies and organizations, conducts the external evaluation of the quality of audit companies, using external evaluation measures in the form of warnings or suspension of membership, or expulsion from the Audit Chamber.

Thus, as we see, Ukraine and Belarus have some similar auditing regulation features, which consists of the gradual adaptation of legislation and accounting standards to international ones. The primary motivator of these decisions is the desire of the financial to cooperate with international organizations.

In Moldova, during 2012, financial institutions, investment funds, insurance companies, and other financial enterprises had to move to international accounting standards, which in turn should be subject to audit according to international standards. Today in Moldova, auditing is regulated by the relevant Law on Auditing of 2012, according to which all mentioned above financial institutions should be regularly audited. This audit is carried out, but as in Ukraine and Belarus, it is formal. In Moldova, as well as in Ukraine and Belarus, the audit is not mandatory for small and private enterprises. It should be noted that auditing in Moldova does not have its own unique regulator. The regulation of auditing activities in this country is supervised by the Ministry of Finance of Moldova. Despite this, auditors can independently organize different audit unions and act according to national and international law (Ministry of Finance of the Republic of Belarus).

As for the general audit situation in Ukraine, Belarus, and Moldova, the audit services market is similar in some ways. The number of audit companies is declining in Ukraine due to some negative factors: the crisis in society, the strengthening of audit requirements and changes in domestic legislation. As a result, the volume of audit and non-audit tasks is declining, while the volume of initiative audit services, which decreased until 2016, in recent years increases. The same situation occurs in the scope of financial information review. Today, about 250 Ukrainian audit companies can conduct mandatory audits for public interest companies (Kashperska (2018)). As of 2020, about 1,390 auditors and 80 audit companies are registered in Belarus. The dynamics of the number of companies has a declining trend, but despite this, audit companies provide more services (Ministry of Finance of the Republic of Belarus (2020)). Moldova's audit activity is developing ambiguously. It is significantly affected by the economic crisis and the lack of political stability in the country. Moldovan business people, unlike foreign ones, often do not understand how necessary auditing is. Despite the fact that there are more than 100 audit companies in the country, and very few professional firms among them, that take a comprehensive approach to the client. Also, there is almost no healthy competition and questionable services quality provided by small audit companies in the country.

Today, Moldova, Ukraine, and Belarus have the four largest international companies whose services are most trusted. They are KPMG, Ernst & Young, Deloitte & Touche, PricewaterhouseCoopers. However, if we talk about audit development, it depends on the local market's growth (economic agents, investment, and business environment in the country). Given these circumstances, as well as instability in the political arena and the economy, the pace of audit market development is negligible. Therefore, demand for it will grow only in conditions of positive economic dynamics.

In these countries, the auditors do not yet understand the feasibility of moving to ISAs, as this need is understandable only by foreign investors. Domestic companies consider the audit only as a “shield” from the tax authorities. The most popular audit services on the market are financial audit and tax consulting. Also, Ukrainian, Belarusian and Moldovan businesses are interested in outsourcing services: accounting, payroll, and related consulting services, and interest is mostly shown by companies with foreign investment (IFAC, 2020).

Let's consider the features of auditing in EU member states. It should be noted that each of the studied countries carried out reforms in accounting and auditing at different times, which was reflected in the level of auditing development. The first group of developed countries includes Poland, Hungary, the Czech Republic, and Slovakia.

To begin with, it must be pointed out that auditing in Poland has been operating and regulated as a separate activity since 1991. The legislation was constantly amended and supplemented, and in 2009 Poland provides a law on audit regulation following international standards. Under the current Accounting Act, the companies that are PIEs are subject to mandatory financial audits. They are important companies for the state, chosen by the type of activity or number of employees and the financial and public sector companies.

In accordance with European legislation, the status of certified auditors has been finally approved. From that time, their self-government and organizations were entitled to audit financial statements and public oversight. Since then, it has been permitted to include auditors on the supervisory boards of companies to oversee financial reporting, internal control systems, internal audit, risk management, and external audit, in addition, to establish audit independence. The experience of Poland is of great interest to scientific research. In Poland, private property has never been completely eradicated, and there has always been a lively spirit of entrepreneurship, which has greatly facilitated the country's transition to a market economy. Both in Poland, Hungary, and the Czech Republic, the category of the expert-accountant has existed for a long time. The technique of accounting examination, professional and ethical requirements for expert accountants largely coincided with the methods of audit, business, and moral standards that meet the requirements for accountants-auditors. For example, expert accountants and auditors audited the reports and, above all, the balance sheets of enterprises, the state of accounting. They prepared their conclusions on the audit results, giving recommendations for improving the enterprise as a whole, not only in financial activities. Polish auditors quickly began to attend retraining courses funded by European Funds.

The Chamber of Auditors of the Czech Republic (PACR) was established in 1993 to implement a regulatory function over auditing in the Czech Republic. The powers of the Chamber are enshrined in the Law on Auditors of 2009, as amended in 2016. By law, external auditors must be licensed members of the PACR. The Chamber is responsible for issuing auditing licenses, maintaining registers of auditors and revoked licenses, organizing and conducting examinations for auditors, and implementing continuing professional development, ensuring compliance with applicable auditing and ethical standards, initiating investigations and disciplinary procedures for members, conducting research on the professionalism of its members, carrying out any other activities that promote high professional standards and improve the quality of audit services (IFAC, 2020).

Since 2004, Slovakia has been one of the countries with a regulated economy with statutory audit requirements in all EU countries. Changes in accounting are intended to integrate the country's financial market into the EU common market, where these amendments are already in force. However, in the EU, small businesses are exempt from statutory audit, as this leads to an additional administrative burden on this category of business. If the amendments are made, it will be necessary to create new audit companies, as the number of inspections may increase to about 10 thousand (Damarcka, 2020).

In Hungary, auditing activities have started to comply with European standards since 2006, when the EM Directive 2006/43 established requirements for auditors and audit firms. Subsequently, a number of additional regulations were implemented that allowed to establish the Chamber of Hungarian Auditors on their basis. Its main tasks are licensing, registration of audit companies, organization of auditors' examinations, etc. The main mission of the audit in the country is to legalize the economic activity. Still, according to experts, the real results of the audit differ significantly from the expected (Chamber of Hungarian Auditors).

In Poland, Hungary, the Czech Republic, and Slovakia, the transition to a market economy faced a lack of auditors, but an effective training system allowed getting a sufficient number of high-quality auditors in a few years. For this time, Polish business is rather ambivalent with experts from the Audit Committee (the main regulator of auditors in the country). Most often, audit clients are foreign-owned companies (Dobija (2015)) (see Fig. 2).

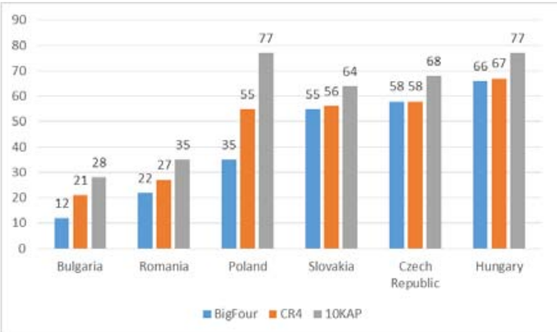


*Figure 2 – Share of Statutory audit firms that carry out mandatory audits of PIEs*
Source: European Commission, 2021

The companies of the Big Four include (European Commission (2021)):

- PWC (market capacity 19%);
- KPMG (18%);
- Deloitte (14%);
- EY (13%).
- In addition to these four, 10KAP is formed by:
- Mazars (market capacity 4%);
- BDO (4%);
- Grant Thornton (3%);
- Nexia (1%);
- Baker Tilly (1%);
- RSM (1%) and other small companies (22%).

In addition to auditing, such companies generally perform risk assessments (according to (ISA 330) 39), assessing the company value (according to (ISA 540) 41), testing internal control systems (according to (ISA 315) 42), perform group audits (according to (ISA 600) 43).

As for other countries that have recently joined the EU, the situation is in some ways similar. For example, in the audit services market of Bulgaria, Hungary, and Romania, there are a small number of audit companies whose main activity is focused on joint ventures and auditing in foreign subsidiaries in the market. The main market players are four audit companies, while other companies are characterized by a lack of qualified staff and low standards of audit quality, which is formal in nature.

In Romania, the Romanian Chamber of Financial Auditors (CAFR) was established in 1999 to regulate auditing. Since 1999, the legal framework for Romania's financial audit has been constantly updated. The Chamber has fully adopted international auditing standards. In order to integrate the country's economy into the EU, a law on the mandatory audit of annual corporate accounts and consolidated annual financial statements was adopted (GEO № 90/2008).

In Bulgaria, regulatory support for audits is provided by the National Assembly and the Institute of Certified Public Accountants (IDEB). IDEB is the regulator of the practice of independent auditing. Let's summarize the study in Table.1 and make a comparative analysis of auditing activities in Eastern Europe.
In general, we can say that auditing in Eastern Europe (even those that have joined the European Union), is still far from perfect for the following reasons:

- In Hungary, auditors agree to perform only those functions assigned to them by auditing standards, and the unprofessionalism of customer managers does not allow them to understand the audit findings properly.
- There is a shortage of qualified auditors in Romania.
- The introduction of EU auditing standards in Slovakia may lead to the decline of small businesses, etc.

Table 1. Comparative analysis of auditing in Eastern Europe

| Country | Regulator | Legislation | Audit current status | Main Problems |
|---|---|---|---|---|
| Ukraine | Audit Chamber of Ukraine | About auditing activity<br>On the audit of financial statements and auditing activities | Reducing the number of enterprises, centralized concentration;<br>The presence of a big 4 players | Formality of services;<br>Lack of audit quality criteria;<br>Low level of IT services;<br>Low qualification of personnel working under IFRS. |
| Belarus | Audit Chamber of the Republic of Belarus | About auditing activity<br>On the introduction of the ISA on the territory of the Republic of Belarus | Reduction in the number of enterprises, a small number of audit companies | Inaccuracy of audit due to inconsistency of financial statements;<br>Lack of audit quality criteria;<br>Problems of pricing and tendering. |
| Moldova | Ministry of Finance of Moldova | About auditing activity | A small number of audit companies in the market that provide formal services.<br>Foreign companies are serviced by auditing companies of the | Non-compliance of the audit with international standards due to non-compliance with international financial reporting standards;<br>Low qualification of personnel |

| | | | | |
|---|---|---|---|---|
| | | | big 4. | working under IFRS. |
| Bulgaria | Institute of Certified Public Accountants | Law on Independent Financial Audit | The presence of a large 4 players, a small number of audit companies, the concentration of companies in large cities. The most popular services: financial audit and tax consulting. Mandatory for all businesses except small businesses | Lack of audit quality criteria; Insufficient regulation of audit activities; Low qualification and responsibility of personnel working under IFRS. |
| Romania | Romanian Chamber of Financial Auditors (CAFR) | Law on Mandatory Audit of Annual Reporting of Enterprises | | |
| Hungary | Chamber of Hungarian Auditors | Hungarian Chamber of Auditors, auditors' activities and public oversight of auditors | There are companies in the market that provide services only to public interest entities, as well as those that serve the requests of other companies. There are a big four, as well as audit networks. | Insufficient number of specialists who can provide qualified services, low level of motivation to conduct audits by private companies. |
| Poland | Polish Chamber of Statutory Auditors Polish Audit Oversight Agency | Law on Statutory Auditors, Audit Firms and Public Oversight | | |
| Czech Republic | Chamber of Auditors of the Czech Republic (PACR) | Law on Auditors | | |
| Slovakia | Audit oversight management | Statutory Audit Act | | |

Note: developed by the authors

- At the same time, in non-EU Eastern European countries, the situation is even more ambiguous:
- There is no audit regulator in Moldova, so many companies on the market are only called auditors but, in fact, are not ones.
- In Belarus, auditing only in 2020 came out of the Ministry of Finance, and ISA standards were introduced.
- Ukraine feels the lack of qualified personnel, there is high competition from foreign companies, and no regulatory framework for auditing.

**4 Discussion**

Today the issue of statutory audit of PIEs companies is quite researched and regulated. However, the problem of developing audits for the needs of small businesses and the private sector remains open. On this issue, many discussions arise since some researchers believe that it is necessary to make auditing mandatory for all activities, which will help bring the economy out of the shadows (Ojala et al., 2016; Iwisi et al., 2002). On the other hand, audit services are quite expensive, so not all small businesses can plan regular expenses for these services. At the same time, when the quality of audit is not regulated, it is not permissible to impose such a service by the state (Ojala, 2014, Kňažková, 2016).

The main reason is in audit objectives; the audit should not have a formal but a recommendation function. Its main task should be not just confirmation of financial statements but also searching for weak points of activity and offering recommendations for their elimination.

However, along with this, practically all countries were released of small businesses from a mandatory audit. The discussion on the need for small businesses is very active in recent decades (Ojala et al., 2016). Today, according to the Accounting Directive 2013/34/EU, small businesses with assets under 4 million euros, the net turnover under 8 million euros, and the average number of employees under 50 people may not be audited.

Some countries have established their own restrictions on small businesses, which depend on the peculiarities of the country's economy. In particular, the question of the audit in small enterprises is regulated by several institutions. The International Federation of Accountants (IFAC) protects the business using rules and standards for reliability and information protection. However, if the country will need to provide an audit for small enterprises, the state may require it following international standards of the audit (ISA) (Kňažková. 2016).

**5 Conclusion**

Auditing in developing countries is mainly characterized by a transition to international auditing standards. Since not all Eastern European countries are the same in economic and political terms, the preconditions for the development of audit are different. In particular, EU-associated countries are gradually reforming the regulatory framework for auditing, although auditors work mostly according to national standards. Auditing in such countries is formal, it is applied to socially significant enterprises that have state or joint ownership, and mainly financial sector institutions. Private companies rarely turn to auditors for advice and financial calculations. As for the EU member states, they make full use of the services of auditors, as any international business relationship requires an independent audit or legal assessment, and therefore there are more audit firms and auditors in these markets, so they are more competent in international accounting standards and auditing, and therefore can provide more informative and valuable services for businesses. However, in all developing countries, auditing is faced with a number of problems, including staff shortages, lack of quality criteria, reliability of the information, standardization, and pricing problems.

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