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**SECTION 31. Economic research, finance,  
innovation, risk management.**

## ACTUAL PROBLEMS OF STATE REGULATION OF AUDITING ACTIVITY AND ORGANIZATION OF TAX AUDIT

**Abstract:** The article is devoted to actual problems of state regulation of auditing activity and organization of tax audit. For this purpose, the main functions, tasks and significance of audit activity and its specific features have been analyzed. Important components of state regulation of audit activity are considered. Optimization of the main mechanisms of tax audit organization under current conditions is justified. The current issues on improving the mechanisms of state regulation of audit activities and organization of tax audit in the context of growing global economic influences are generalized.

**Key words:** audit, audit activity, tax audit, state regulation of audit activity, effectiveness of tax audit mechanisms.

**Language:** English

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### Introduction

In professional literature, the "audit framework" concept is mentioned quite often (in different variations), but the definition of it has not found its reflection yet. Current legislation also does not articulate the concept of the "audit framework" nor determine its structure. The audit framework peculiarity lies in the fact that these activities are performed not only by state authorities but also by non-state institutions. The latter consist of professional associations (autonomous organizations of auditors, i.e. non-governmental and non-profit institutions created on the basis of membership in order to provide conditions for auditing), public organizations, as well as audit organizations and individual auditors who develop company standards. The term "audit framework system" was defined making allowance for the system analysis of legislation and scholarly literature on this issue.

We are of the opinion that this concept means a conjunction of interrelated functions carried out by state authorities, non-state professional and public associations, as well as audit organizations and individual auditors, in adopting the legal regulations within their competence, which are related to the issues of economic actors' relations with regard to the provision of auditing services.

This definition combines main features of the

analyzable concept: the system ("a conjunction of interrelated functions"), the regulation ("in adopting the legal regulations"), and "audit activities" ("the provision of auditing services"). Herewith, it shall be understood that under auditing services we imply the actual auditing services accompanying the audit itself and other services related to audit activities.

It should be noted that the current procedure for adapting international standards in the form of national standards in Azerbaijan has its disadvantages. Thus, the first-hand source of international standards fulfilled in English has no legitimate power over the territory of the country. And any translation is not correct enough despite however carefully it's done. The domestic development, agreement, approval, and enactment of auditing rules (standards) scheme often "lags" from international standards-analogs. Taking into account the necessity of standards' application in practice, the existing order raises concerns because it admits an interpretation of audit norms and principles that is different from the generally accepted one.

### Materials and Methods

A tendency of an increasing volume of requirements for audit organizations and individual auditors was revealed through the analysis of main changes in the sphere of audit activity's state



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regulation. A present-day historic period of audit development is characterized by an implementation of the national concept of transition to self-regulation. In this regard, we propose a new "span of control" term in relation to the analyzed sphere, with the help of which the necessity for measures taken by the state are conditioned by a significant increase in the number of "players" in the audit market and audit-related services.

From the perspective of methodical thoughts and theories of the audit, the clearly differentiated concepts of "audit activity" and "audit"; a significantly expanded scope of requirements for audit organizations and auditors; a legislator's approach changed to the auditing services market players that can perform mandatory annual audits; an introduced list of information and documents that do not constitute an audit secret, as well as its disclosure mechanism; the included regulations for disciplinary actions to audit organizations and individual auditors – should all be considered as the most significant transformations of the legislation on audit activities.

The analysis of audit framework functions has revealed that the subsystem of government regulation is unjustifiably limited by the activities of only one executive body within the framework of the current legislation. The activities of other authorities (legislative, executive, judicial), which adopt statutes and other regulations, such as laws that operate on the territory of the country, would also be necessary to include in this area.

An analysis of the foreign countries' current experience in audit framework (for example the United States and Western European countries) has led to the conclusion that a rapid emergence of new phenomena and tendencies (such as "revenue management" and "aggressive accounting") served as the main reason for the modification of the regulatory bodies' functions and significant tightening of the regulatory standards themselves. The emergence of international standards-analogs, regulating the quality of audit and related services in detail, is due to the reaction of the professional community to the users' "crisis of confidence" over financial statements and auditors' reports. Accepted in Azerbaijan standards correspond to international analogs and represent a detailed internal quality manual addressed to audit organizations and individual auditors. In connection with the introduction of such standards in the Republic, it is believed that our country, to a certain extent, was able to consider a negative experience of its colleagues and take regulatory measures in order to prevent similar tendencies in the future. Thus, the analysis of the acts of standards in Azerbaijan show a significant tightening of requirements for audit organizations and auditors on the part of regulatory bodies. In this regard, we observe a partial shift in emphasis in the audit framework system for

examination and emergence of a "revisionary" audit.

During the analysis of the main statutes that regulate auditing activity in a number of the former USSR's countries-republics the following was established:

- In comparison with other countries, Azerbaijan is characterized by a more late formation of a system of legislative audit framework. This, undoubtedly, is the main factor restraining the application of the practice of rules for audit framework. It also caused a realization of a limited volume of functions on the part of regulatory bodies in the 1990s of the last century;

- Being one of the first countries-republics of the former Soviet Union, Azerbaijan has radically changed its regulation system in the sphere of interest, having transferred most of the functions to autonomous organizations;

- The legislation on audit activities of the FSU countries (except Russia) contains a classification of auditing services types and also provides for the priority of international treaties over national-level acts in the field of audit activity, which, at the same time, proves the necessity of the development of measures on audit framework system's improvement by consolidating the principle priority of international standards with direct effect;

- The legislation of many countries does not limit the list of vital terms of a treaty on the provision of auditing services with regulations on the procedure for terms and conditions of payment and the amount of monetary reward, as well as the timing of the services delivery period. In our opinion, this list should also be completed with other conditions, taking into account the specifics of the auditing services' provision, in order to ensure the full implementation of audit organizations' as well as individual auditors' functions;

- Certain aspects of the audit framework in the countries of the former Soviet Union is proposed to be used in our country:

- Limit the possibility of carrying out the work by an individual - an auditor in an audit organization;

- In view of the socio-economic significance of certain economic actors' categories - audited persons, a mandatory annual audit should also be determined for users of subsoil assets, as well as juridical entities that enter into investment contracts providing for various benefits;

- Commencement of proceedings in the bankruptcy is considered to be the basis for setting a compulsory audit, taking into account the public capacity of the insolvency officials' activities, which is confirmed by the decision of the highest court;

- Considering the increased volume of requirements for audit organizations and individual auditors, at the stage of developing a general plan and audit program, afford them a right to conduct a prior acquaintance with the constitutive corporate

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documents, as well as accounting records and financial statements of the economic entity;

- Introduce a law on the responsibility of economic entities for avoidance of compulsory annual audit;

- In order to identify a clearer "boundaries of responsibility" for audit organizations and individual auditors for their work results, define a concept and criteria for assessing the materiality level in the law "On Auditing activity".

Analyzing the functions of implementing the mandatory audit as an instrument for providing the economic resilience of the State, it can be established that for 10-15 years in terms of legislation there was a concept, according to which the mandatory audit could be conducted exclusively by audit organizations. While not having an opportunity to carry out an audit of socially relevant economic entities, individual auditors were excluded from this market segment. And despite the fact that the validity of this legislative provision was criticized by representatives of the academic community and the audit profession, the accuracy and its compliance with the Basic Law was confirmed by the highest court. In support of these conclusions, we can say that "by ensuring the implementation of the constitutional right to information in the field of business and economy based on the principle of equality of arms and contractual relationship, competition and risk, statutory accounting is considered to be one of the guarantees of the single market and the unity of economic territory". In this regard, the issues of providing the economic resilience of the State, the necessary presence of reliable accounting statements of socially relevant economic entities and guaranteeing the high quality of auditing services, which at that time could be provided only by audit organizations that had certified specialists and were obliged to insure their professional responsibility, became key arguments in favor of the decision to keep the controversial legislative provision in force.

In this aspect, special attention should also be given to the issues of improving the tax audit in the country. So that, ensuring the sustainable development of the national economy is entirely dependent on the state regulation of the economy and the efficient tax policy. Ensuring continuity of financial stability and budget revenues in the country, development of the real sector of the economy are impossible without efficient financial and tax control mechanisms [1;2;3]. Tax audit, one of the key tax control mechanisms, plays an important role in achieving these goals. From this point of view, the development and application of efficient activity mechanisms of organizing tax audits and the state regulation system are of paramount importance.

Market economy is mainly regulated by tax

mechanisms. And accordingly, the role of tax administration and tax audit which has a significant impact on the central position and recycling process in the development of the market economy, is increasing in the economy. There is a need for deep researches in the field of tax identification of the directions of finding and improvement of existing problems in the sphere of organizing tax audit and its state regulation in the modern period [4;5;6]. In the mid-and long-term perspective, acute debates on the development of audit activity and its state regulation affairs in the field of scientific and practical fields in the country need to conduct research in the field of analysis and resolution of these problems [7;8;9]. During the review of this issue, the main point is the appearing of the necessity of ensuring country's transition to a new stage of economic development and financial stability, as well as development of efficient mechanisms of financial and tax control. To achieve this goal is possible only in the condition of creating a more transparent, effective tax audit and audit technology for all economic entities in the country [10;11;12].

### Conclusion

In our view, the following measures to increase the effectiveness of the mechanisms of organizing tax control in separate areas in Azerbaijan may be the impetus for significant advances in this area in the medium and long term perspective.

1. Rapidly developing construction sector in the Republic of Azerbaijan increases demand for construction materials of local importance every day. The report on construction material of local importance produced by the taxpayers is presented to municipalities pursuant to Article 217.3 of the Tax Code and the calculated mining tax is paid to the local budget (municipality budget) under Article 217.5 of the Tax Code.

When we review statistical indicators for the production of construction materials of local significance, we witness no realities. Thus, the production of goods of local significance, we witness incompliance with the reality. So that, based on statistical indicators, production of the products on construction materials of local significance is estimated slightly more than 1,600,000 tonnes (approximately 1000,000 m<sup>3</sup>) across the country in 2015, and less than 1,300,000 tonnes (approximately 800,000 m<sup>3</sup>) in 2016.

Our society conducted monitoring on 8-10 January 2018 to study production capacity and actual production of carers operating in Guba and Khachmaz regions. According to the results of monitoring, there are 50 gravel quarries in Guba and Khachmaz districts of Karachay, Valvala and Gudyalchay, of which 41 are currently operating at full capacity. Gravel quarries having weak production produce approximately more than 25,000

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m<sup>3</sup> per month and gravel quarries having strong production capacity produce materials of approximately 60,000 m<sup>3</sup> per month. Totally, over 1700 thousand m<sup>3</sup> of material is produced by the gravel quarries. Given the average loss of 15% of the raw material during the production, it shows that more than 2,000,000 m<sup>3</sup> of raw materials are removed from the surface of the earth through crushed quarries.

Based on the monitoring results and calculations, only the Guba and Khachmaz districts produce more than 24,000,000 m<sup>3</sup> of construction materials annually. It can be concluded from here that more than 24,000,000 manats should be collected in Quba and Khachmaz regions alone. Taking into consideration the gravel, stone and sand quarries operating in other regions, this figure will increase dramatically.

The above-mentioned data show that the country's annual production (about 1,000,000 m<sup>3</sup>) mentioned in statistical indicators is less than the monthly production volumes of crushed quarries operating only in Guba and Khachmaz regions.

The reason for such a serious difference is the fact that the collection of the mining tax is the responsibility of the municipalities. Mining tax collection and submission of reports should be transferred to the Ministry of Taxes distinctly so as not to avoid large amounts of funds to be collected for the state budget.

As a mechanism to control the production of quarries, we propose to integrate the meters into the base of Ministry of Taxes, which will register the production of quarries, and the meters belonging to "Azerishig" OJSC, which are constructed in parishes by using pure electric energy.

2. The list of the settlements stipulated conducted in only cashless form is mentioned in the article 3.4 of the Law of the Republic of Azerbaijan about "on

Cashless Settlements". We propose to add some additions to that list:

- writing in such manner: "Payments to touragents and travel ticket sellers" by changing the text of the article 3.4.9.

It should be noted that the only touragents were made payments in the current law. If travel tickets are sold within the tourpackages, the touragents will be made payments via the bank. However, the sale of only travel tickets is carried out by those touragents in cash form. Its' reason is that touragent's activity covers only the sale of tourpacket.

3. In terms of wholesale sales of excise goods, it should be noted ensuring wholesale sale of alcoholic beverages and tobacco products in cashless form is regulated by relevant decrees and orders. Mention of carrying out such settlements in cashless form in the law of Azerbaijan Republic about "cashless settlements" will have an impact on taxpayers' more serious approach to their settlement.

4. Regarding payments to independent auditors and audit firms, it should be noted that, based on the Law "about Audit" being in force in 1999, taxpayers must ensure that their independent financial statements are audited by an independent auditor. From that time penalties for avoiding mandatory audit are intended in the "Code of administrative offenses". According to the relevant decree of the President of the Republic of Azerbaijan dated on May 03, 2017, the Chamber of Auditors has the authority to draw up a protocol on these fines. After that decree, notification letters were sent to many taxpayers by the Chamber of Auditors. The real situation indicates that auditors' involvement in auditing will increase from 2018. This, in turn, will lead to a decrease in the quality of the audit. Cashless payment for auditor services will have an impact on auditors' honesty in auditing.

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