

The Auditor's Use of Third Party Work Based on the Supply Chain Strategy

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Abstract- In current conditions of entrepreneurship development, the role of audit committees in verifying companies' financial and economic activities is increasing, which can be more efficient by using supply chain strategy in organization. The authors aim to attract the attention of external auditors to the work performed by the company's inspectors as third parties. The competence of the audit committee members determines the reduction of business risks, in particular, the threat of pursuing activities and tax risks; the improvement of the quality of information material for management structures, the reliability of internal reports and financial (accounting) statements; compliance with the dividend policy and many other issues. The auditors should rely on the experience of competent members of the audit committee, which is expressed in various official, policy briefs, reports and audit opinion. The auditor must verify the audit committee's competence by conducting various procedures that are documented in accordance with the internal rules (standards) of the audit organization. The authors use such research methods as analysis, synthesis, observation, experiment, based on their theoretical knowledge and developments, participation as auditors in audits, experience in management and relationship director – auditor in the company. The study allows the authors to provide guidance on the development and documentation of relations between auditors and members of the company's audit committee, increasing auditors' responsibility in reviewing and using third party work in their findings, as their conclusions can affect the type of an audit report under formation. The scientific novelty consists in developing the idea of the need and relevance of assessing the extent to which auditors use the results of the work of members of the company's audit committee, since now auditors do not use audit reports for a deeper understanding of the company activities and reducing audit risk. The relationship between auditors and the audit committee members is not regulated by the existing standards, which should be the subject of further research on auditors'

activities to revise Russian companies operating in accordance with the Federal Law No. 14-FZ.

Keywords: Audit, audit committee, company auditor, third parties, International Standards on Auditing, supply chain strategy.

1. Introduction

Audit organizations do not fully apply external evidence and information that may be useful for assessing the risks in external audit, including for analysis of the auditee's tax safety. This is especially important during the period of effective tax control, the increase in the value-added tax rate, the risk of choosing an unreliable counterparty and the requirements for the quality and transparency of the financial statements of an economic entity. Audit committees (auditors) of commercial organizations have accumulated sufficient experience in auditing financial and economic activities, drafting various policy briefs and other documents on auditing non-standard and controversial cases, and developed mechanisms for interrelations with various services and external auditors. The study of the practice of the audit committees and audit organizations, the algorithm of their relationship showed that the auditors do not use as far as is necessary or do not consider the issues of interaction with the auditee's auditors. Audit organizations do not develop internal documents (regulations, instructions, etc.) concerning the implementation of their work outcomes in their practice based on an assessment of third party activities. The authors consider that in this regard there is a need for discussion and standardization of approaches to studying the activities of the audit commission (audit service or auditor) as third parties.

2. Materials and methods

The research subject is the theoretical and methodological aspects of the auditor's use of third party work. The methodological basis of the study was the dialectical method of knowledge, the main

feature of which is a systematic and integrated approach to the phenomenon under study. The research also used a variety of scientific methods: analysis, synthesis, observation, experiment, etc., which are based on theoretical knowledge, the authors' participation in business activities as managers, and interaction with audit committees, inspectors and auditors. The theoretical and informational basis of the study consists of scientific works of leading Russian scientists in the field of accounting, auditing, the theory and practice of taxation in Russia and abroad, materials of scientific and practical conferences, publications in press, reported data of official bodies and rating agencies. The regulatory and legal basis for the study was the legislative and regulatory acts of the Russian Federation on accounting, auditing and taxation, including regulations, instructions, letters, explanations from the RF Ministry of Finance, the RF Federal Tax Service, the RF Rosstat, and compendium of judicial arbitration practice. The control group of the study is the data on the audit committees in limited liability companies that are subject to mandatory audit in 2017.

3. Research results

International Standards on Auditing (ISA), considering the rules of the relationship of the external auditor with third parties [1], allow for their effective interaction with internal auditors and expert auditors [2, 3]. Despite the short period of ISA application by all audit organizations and individual entrepreneurs in Russia, since January 1, 2017, auditors in Russia have had a certain positive experience in using the work of others and documenting the processes of these relationships. Based on the aggregation of the final audit documents of auditors' activity inspection by audit professional associations in Russia, the Classifier of Violations and Deficiencies has been compiled by the Ministry of Finance of Russia which is constantly updated and supplemented [4]. From the point of view of maintaining the successful functioning of the internal system for quality control, this is a very important and useful document for an audit organization of any scope of activities and an individual entrepreneur-auditor. Relevant international standards allow the Russian auditor to correctly create an audit strategy by planning and distributing procedures among the group members. ISA 610, as stated in the introduction to Standards, does not apply to the

interaction of the financial auditor with the previous auditor. The Standard identifies the cooperation of the main auditor with the others, its risks and area of responsibility. This standard does not regulate the interaction of the auditor with an expert, with internal auditors, internal controllers and company inspectors, whose role in Russia currently is not properly evaluated. In our opinion, the status of the inspector is not as high as it can be in commercial organizations. For example, the Company Inspector professional standard has not been developed and at present this task is not issued for professional communities. And Exposure Draft of Financial Auditor professional standard, the approved Standard on Internal Control Specialist (Internal Controller) do not meet the requirements, goals and objectives for the company inspector or audit committee, which are provided for by federal legislation for limited liability and joint-stock companies [5, 6]. The authors consider the feasibility of the use of the results of the auditor's (audit committee) work of a LLC by the auditor in its activities. This experience is also applicable to the joint-stock company's audit group. It should be noted that the presence of an auditor in the staffing table is found not only in organizations, but also in individual entrepreneurs – individuals without a legal entity, most often among those who operate in the retail and catering industry. The qualification requirements for auditors and their functions are different from those of a financial auditor. In the absence of the professional standard on Company Inspector, the management itself defines the auditor's duties and the requirements for it, depending on the business scale, types of economic activity and other specific characteristics. Auditing activities are identified almost as a separate specific type of control according to Russian Federal Laws on LLC and JSC [5,6] and the Civil Code of the Russian Federation [7], the competence of which includes, for example, controlling large transactions, interested party transactions, etc. We note an important change in the legislation of 20.07.2018 No. 209-FZ in relation to auditors – there is no provision for the creation of a single audit body in JSC [8]. If, in accordance with the LLC charter with the number of founders up to 15 people, the presence of an audit commission or an auditor of the Company is provided for, then it should be elected. Organizations with so many participants – founders of LLCs are extremely rare. Moreover, statistics on the number of the company's members

is not gathered; in addition, there is a turnover among the founders. And if the number of members exceeds fifty, then appropriate transformations are needed in accordance with Article 7 of the Federal Law No. 14-FZ, for example, into a JSC. The important conditions for the effective work of the audit committee, which is of a preventive nature, can be considered a possible unimpeded inspection of all documents without restrictions, access of the audit committee members to the primary accounting and other documentation of the organization. This is relevant for operational control, which is not carried out by external auditors. There is a practice when organizations having several founders fix in local documents the possibility of an auditor to work remotely, which not only disciplines economic services, but also prevents risky operations, illegal transactions, dubious schemes for optimizing taxation, splitting a business, attracting unfair counteragent, etc. [9] It is known that the external auditor does not set the main purpose of the audit to check the correctness of budget tax calculations, assessing the risks and materiality in the audit. And inspectors have the ability and should prevent various schemes of illegal tax cuts to increase business transparency, including controlled transactions, know the problems of applying the method for calculating taxes by the tax authorities, etc. [10].

Legislation singles out the auditing commission as a key element– Art. 45 Interest in the Company’s Execution of the Transaction as for approving the report in related party transactions made by the company. The ability to promptly receive answers to auditor’s oral and (or) written requests, provided for in Article 47 The Audit Commission (Auditor)

of the Company is an effective tool for analytical work for the purpose of profit made by an organization. This article stipulates the auditors’ obligation to audit the organization’s financial statements – the annual report and balance sheet. Only after checking by auditors, such statements are approved by the company’s general meeting. The result of the audit of the annual report and financial statements by the auditors is recorded in “the report of the internal audit commission (internal auditor)” (Art. 4.7, Clause 3). The form of the auditors’ report is not provided in the legislation; local documents do not consider this issue too. But this is another topic that is also being studied by the authors. Thus, checking the economic entity, the external auditor may or may not use the information of third parties – auditors in its work. The relationship of auditors and inspectors are not dealt with in the economic literature, specific federal standards have neither regulated nor fixed in the ISA. According to the authors, the external auditor, having studied the charter of the audited entity, should check and make a conclusion about the need to create an audit commission in the auditee and assess the consequences of its absence if it is to be elected. Considering the activities of the company auditors, their status and understanding of the audit commission’s role and importance by the founders and management of organizations, we held a selective survey of LLCs in Sochi, which are subject to audit in 2017, data on data on mandatory audit of which are posted on the Rosstat website [11]. The sample included 100 organizations, 48 of them answered our questions, the answers are analyzed in Table 1.

Table 1. Data on audit commissions in LLCs subject to mandatory audit in 2017 by economic criteria

Number		Availability of audit commissions		Auditing checks (+/-)	Availability of auditor’s conclusion (report)	Availability of an auditor’s request to management for an auditor’s report	Company’s consideration of the auditor’s report
founders, people	companies,	in the Charter	in fact				
1	26	21	8	14	-	-	
2	7	7	2	2	-	-	
3 and more	14	14	5	9	3	-	3
More than 15	1	1	1	1	1	-	1
Total	48	43	16	26	4	-	4

The data obtained testify not only about the evasion from the timely conduct of mandatory audit by

economic entities: only 26 (54.2%) out of 48 organizations conducted an audit. Among them,

64.3% organizations carried out their activities in the area of raising funds from real estate investors for construction and they needed an audit report to control the relevant department in the field of construction. It should be noted that almost all the organization charters (89.6%), being typical, contained a provision on the functioning of the internal audit commission (internal auditor). In fact, a formal approach to the charter provisions did not contribute to the creation and functioning of audit commissions in violation of the charter. It can be concluded that, despite the presence in the company charter of the provisions for the need to create an audit commission, as a matter of fact, they are not created and do not function. Federal Law No. 14-FZ Art. 50 define that meeting minutes and audit commission or auditor reports should be provided to a company member upon his request. The auditor needs to pay attention to the fact that the audited organizations do not comply with the provisions of Federal Law No. 14-FZ to be considered:

1) Violation of the obligation of the audit commission to audit the annual report and financial statements prior to their consideration and approval by the company's general meeting;

2) Annual report and balance sheet cannot be approved by the general meeting without the conclusion (or the report) of the audit commission.

In our study, only 8.3% of organizations had the conclusion of the audit commission. Moreover, the functioning of the audit commission is directly related to the number of founders. Also, if the director is not the company owner or a person affiliated with the owner, then he takes interest in the presence and activities of the audit commission. None of the societies under survey received from the auditors performing mandatory audits an information letter requesting the audit committee activities, review of the annual report and balance sheets by the audit committee, the availability of its report and other information for a more detailed overview with the audited entity activities, which is important when auditing an economic entity for the first time. Even in those organizations where the audit commission issued its conclusion on the annual report and balance sheet, it did not arouse any interest from the audit organization and was not considered.

4. Discussion of Research Findings

The authors suggest to audit organizations either to use or not in the audit the results of the company audit committee work, but be sure to request the auditee about inspectors' activities and prepare the

relevant working documents of the auditor, and to document the facts of reviewing inspectors' activities as third parties.

Written requests of the audit organization to the company about the presence and functioning of the audit commission will facilitate a review of the relationship of the organization to the audit commission activities. At present, the audit committees, as a rule, most often participate in inventories and in those checks that are associated with the movement of inventory items and the organization's funds when there are other important issues related to their competence [12, 13]. These are such issues as, for example, analysis of net assets, participation in the development of arrangements to increase this indicator [14]. Auditors should pay great attention to the issue of various adjustments to the accounting (financial) statements, which are allowed by chief accountants, providing dissimilar reporting figures to different institutions, making changes after submission of reports with an "approved" mark, which is requested by digital reporting resource [15]. Issues on relationships, documentation of the third party work by the audit organization, as we have said above, namely, experts and internal auditors, have been considered by the relevant ISA. They have been worked out by audit organizations and auditors in Russia, including those in the automation software for audit. For example, the proven Audit XP, which is common in Russia and adapted for ISA, offers auditors relevant working papers on the procedures "using an expert work" and "using internal auditors' work". We consider it advisable for audit organizations (individual auditors) to review the results of the audit committee's activities in the company, analyze them, and take them into account when drawing up the audit program and plan. It is possible that information obtained from the inspectors, who may have higher competence and knowledge of the specific economic activities of the organization [16], will help external auditors to reduce the audit risks and to prevent the consequences of "splitting up" the business and other tax sanctions, which in recent years has become relevant for entrepreneurs. The auditor should remember that the form of the inspector's report or opinion on the annual report is not provided by the legislation, but its preparation is mandatory based on Clause 3, Art. 36 of Federal Law No. 14-FZ. Such an inspector's opinion is the object of study for the audit team at the planning stage of the audit and assignment of tasks among the members of the audit team. We offer auditing organizations to develop and implement a standard (instruction) "Using work

performed by others – the audit committee (auditors) of the company”, which should presumably contain the form (draft) of an information request or letter to the auditee, regulation of possible relationships with auditors and other working documents.

In the information request of the audit organization it is advisable to reflect the following provisions:

1) availability in the company charter of the information about the establishment of the audit committee;

2) availability of documents (regulations, decisions, etc.) on the establishment of the audit committee;

3) the number of the audit commission members and documentation for their approval;

4) whether the audit committee was formed correctly or the company auditor was elected (based on Article 11 “Procedure for Establishing a Company” of Federal Law No. 14-FZ);

5) elected members of the audit commission are not members of the Board of Directors and do not violate other conditions of Art. 32 “Company Bodies” of Federal Law No. 14-FZ;

6) list of valid local documents regulating the procedure for auditing activities (auditor);

7) the audit committee plans for the year being audited;

8) whether the facts of early resignation of auditors took place and for what reasons this occurred;

9) the audit commission opinion on the company’s annual report and balance;

10) documents and correspondence of the audit commission with the organization officials, with the Board of Directors, etc.;

11) whether extraordinary general meetings initiated by auditors took place;

12) whether the auditor approved a report on transactions in which there is an interest in accordance with Art. 45 Interest in the Company’s Execution of the Transaction;

13) other issues based on the range of activity of the entity being audited, the number of owners, etc.

The auditor’s working papers related to the reliability of information on the activities of the auditee’s auditors can presumably include the following issues, the answers to which will require analysis and relevant audit findings:

1) type of education and experience in the economic specialty of the audit team members;

2) availability of auditor certificates, certificates and other documents confirming the auditors’ qualification;

3) compliance of the organization’s scope of activities with the functions assigned to the audit;

4) compliance with the company structure, including the presence of structural subdivisions and subsidiaries, the number of the audit committee members;

5) recurrence of auditors’ advanced training;

6) knowledge of the organization’s specific activities by the auditors;

7) knowledge of business splitting signs by auditors;

8) auditors’ participation in approving balance sheets for joint activities and their awareness of their existence and specificity [17];

9) existence of a confirmed fact of approval of the annual report and the company balance by the audit team;

10) availability of the audit team conclusions on the annual report and balance sheet;

11) absence of signs of auditors’ dependence on the auditee. The audit organization needs to develop criteria for verifying the fact of such dependence based on the organization structure, the number of founders, the number of members in the audit team and other characteristics.;

12) experience and professional competence in taxation of controlled transactions and interest on them [18];

13) other issues related to the auditee’s economic activity, tax regimes, number of staff members, etc.

Considering issues regarding customer integrity, one should also analyze the activities of the members of the auditee’s audit team, in which case the list of questions we offer, such as the possibility of their direct or indirect commercial interest in the activities of the company, etc., will help.

Based on the answers received, the audit team conducts an analysis of the competence of the audit team members (auditor) and eliminates the formal approach of auditors to their duties. The main conclusion of the audit team is the degree of confidence in the information received from the company audit team (auditor), its usefulness, relevance and the need to apply in its activities. In our opinion, an audit organization in any case (1) in the absence of an audit team, despite the need to create it in conformity with the company charter; 2) in case of its improper absence in accordance with the charter; 3) when creating an audit team, but its actual inaction) should document all issues related to the audit team activities, use the results of its audits of the company’s financial and economic activities to reduce audit risks and improve the audit quality [19].

5. Conclusion

The third-party auditor concluded that, to effectively address the human rights risks in our supply chain, C&A should continue moving towards a more *strategic* and systematic approach. In our opinion, similar to the above ISA 610 and 620 when using the work of internal auditors and an expert auditor, considering the requirements of Federal Law No. 14-FZ regarding the activities of the audit committee (auditor), external auditors need to perform a number of procedures. First, those charged with governance should be informed about the planning of the use of the audit committee work and the extent of its participation in the audit. Secondly, to ensure receipt of a letter of consent from the auditee that there will be no pressure on the audit committee members if it is necessary to receive requests and explanations from them by external auditors, as well as to get the letter of consent of the auditing committee members in case of at threat of lack of objectivity [20-26]. Thirdly, to involve in the audit plan a cross-audit of the data used by the auditors for particular conclusions that are important for the audit and affecting any audit opinion. Fourth, it is advisable to include in the audit working papers the documents confirming the findings on the audit committee members 'competence, a description of the procedures used by auditors to monitor the audit opinion with regard to their legality, validity, impartiality, etc. [27,28]. Fifth, it is necessary in accordance with the rules of the internal regulations of the audit organization on the issued audit reports to analyze and document the provision that the auditors' responsibility is not limited to referring to the findings of the audit commission in the unmodified or modified opinions on the financial (accounting) statements of the client.

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