

CONNECTING THE AUDIT ACTIVITY IN THE REPUBLIC MOLDOVA TO THE NEW QUALITY REQUIREMENTS

Anatolie IACHIMOVSCI

*Academy of Economic Studies of Moldova, Chişinău, Republic of Moldova
iachimovschi.anatolie.constantin@ase.md*

Svetlana MIHAILA

*Academy of Economic Studies of Moldova, Chişinău, Republic of Moldova
svetlana.mihaila@ase.md*

Abstract

Reforms in the audit sector in the Republic of Moldova have been marked by a series of regulatory developments in line with international regulations. The current efforts of domestic audit firms to meet the requirements of professional standards in the field, which have been significantly revised in recent years in terms of quality assurance, are a challenge for the business environment. And the traditional linear approach to the concept of internal control in audit can no longer meet today's requirements of a modern quality system. This research aims at highlighting directions for improvement of audit activity in the Republic of Moldova under the new quality requirements. The investigations in question constitute empirical research in the context of the modernization of domestic audit by examining the performance of engagements in line with current audit quality requirements. The research results underline the importance of regulatory reforms to increase the prestige and professionalism of domestic auditing by linking it to international standards.

Keywords: *audit activity; audit entity; auditing standards; normative framework; professionalism; quality requirements.*

JEL Classification: *M42*

INTRODUCTION

The reforms in the field of auditing in the Republic of Moldova have been highlighted by the adoption of numerous normative documents based on international regulations. Following the publication of Law No. 271 of 15 December 2017 on the audit of financial statements, which transposes into national law the Concept of Transposition of Directive 2006/43/EU on Audit, the Rules of Activity of the Public Audit Oversight Board were developed and approved on the basis of Government Decision No.807 of 20.08.2018.

The new audit regulations conditioned the development of the concept of engagement review by replacing ISQC 1 with the current ISQM 1 and ISQM 2 "Engagement Quality Assessment".

Subsequently, further legislation was developed on quality control regulation, audit certification, training and quality control methodology. As a result of this process the Public Audit Oversight Board approved the following normative acts:

- The norms of professional training of audit trainees (Decision of the Public Audit Oversight Board No. 15 of August 06, 2019);
- Regulation on the certification of auditors (Decision of the Public Audit Oversight Board No. 16 of August 06, 2019);
- Regulation on the exercise of external quality control (Decision of the Public Audit Oversight Board No. 17 of August 06, 2019);
- The methodology regarding the external audit quality control (Decision of the Public Audit Oversight Board No. 22 of October 02, 2019).

The research consists of studying the new audit quality regulations as well as examining the importance of modernizing the concept of quality management through the lens of the revised professional framework. The results of the investigations help to address the difficulties of the quality assurance system of audit engagements through the requirements of international quality management standards.

I. MATERIALS AND METHODS APPLIED

In order to carry out the investigations, the provisions of the regulatory framework of the Republic of Moldova on audit activity were analyzed. The research is based on a documentation of the concept of quality, a review of professional standards related to the fundamental principles and modern practices of good governance in managing the quality of engagements carried out by audit subjects.

Based on the results of the investigation of the professional framework as well as international regulations in the field of audit, the importance of legislative reforms in the modernization of the quality system is highlighted. On the basis of the research on the evolution of the audit services market, some findings have been deduced and appropriate conclusions formulated.

II. RESULTS AND DISCUSSION

Although the audit profession is a trusted profession, audit work in recent years has nevertheless faced difficulties in complying with new quality assurance requirements. Discussions that have frequently arisen in public relate to fraud, business continuity, evidence gathered by the auditor and intentions to mitigate audit risk.

Audit quality in DeAngelo's (1981) view is determined by the likelihood of the auditor detecting material misstatements of the client's financial statements. Sometimes long-term commitments between client and auditor, but also due to a smaller domestic labor market in this field, can lead to circumstances that would compromise audit quality. Therefore, trust in auditors in the opinion of Cheffers & Pakaluk (2007) is determined by the observance of ethical values and how to act professionally in gathering audit evidence.

At the same time, the treatment of the concept of audit quality in the view of Păcuraru-Ionescu (2020) is associated with the results of identifying dysfunctions and reporting them. And according to Culda (2009) audit quality is treated as a response to the expectations of users of financial statements, in the sense of credibility and usefulness of information.

The current situation on the audit services market in the Republic of Moldova shows a more modest presence of auditors practicing exclusively audit. According to the data presented in *Figure 1*, in the last period only 3 audit firms have been earning revenues only from audit services.



Figure 1. The state of the audit services market in the Republic of Moldova

Source: compiled by the authors based on the information published by the Public Audit Oversight Board (<https://cspa.md/node/58>)

In some countries, audit firms are not allowed to offer related services as it is considered unethical and unethical from the point of view of the ethics and morality of the profession as it may lead to conflicts of interest. According to Article 21, Law no. 271/2017, it is not allowed for the same auditor to carry out audit assignments for more than seven consecutive years. Interference in the performance of audit work, other influences on the audit is prohibited by the legal framework.

With this in mind, it is important to review the decisions taken by the audit entity's management with regard to meeting the standards of professional conduct, including compliance with the procedural steps set out in ISQM 1 and ISQM 2.

In order to improve the existing situation, domestic audit firms are concerned with the development and implementation of quality-related internal controls in line with the new provisions of international quality standards. Starting from 2023, audit firms in the Republic of Moldova are taking steps to make the transition from ISQC 1 to ISQM 1 and ISQM 2. Starting from 2023, audit firms in the Republic of Moldova are taking steps to make the transition from ISQC 1 to ISQM 1 and ISQM 2.

The revised version of ISA 220, which is the only auditing standard with direct relevance to the modernization of the quality of audit engagements, will come into force at the same time as the new quality management standards. In the new version, this standard will be referred to as ISA 220 (Revised) "Quality Management for an Audit of Financial Statements".

Table 1. Fundamental features of a modern system

Regulatory framework	Quality assurance requirements in auditing	Details of system design and functionality assurance
Law no. 271/2017	Quality management within an audit firm	Quality related policies and procedures Accountability for quality Quality compliance report Audit quality assessment
ISQM 1	Fundamental components of the quality management system	Governance process and management of the entity Risk identification, testing and assessment Financial, technical and personnel resources The information base and the communication process Monitoring system and process for correcting deficiencies Customer acceptance and follow-up Professional ethics requirements Quality of audit engagements
ISQM 2	Quality review terms for completed assignments	Reviewer eligibility requirements Quality review procedures Documentation of review work
ISA 220 (Revised)	Reviewing the quality of financial statement audit engagements	Application of quality review work of audit missions Designation of responsibilities for quality assurance of audit engagements

Source: developed by the authors based on the Law no. 271/2017, ISQM 1, ISQM 2, ISA 220 (Revised)

In accordance with the provisions of the Law on the Audit of Financial Statements no. 271 of December 15, 2017 an audit firm must design and apply audit quality management policies. Audit and quality management standards as well as the Code of Ethics shall be applied to achieve this requirement. Under the terms of the named law audit quality policies and procedures are approved by the audit firm's executive body and the responsibility for quality is assigned to an auditor.

The audit firm shall also submit to the Public Audit Oversight Board a report on compliance with audit quality management procedures. This report shall be prepared on the basis of the methodology approved by the Decision of the Public Audit Oversight Board no. 33 of December 23, 2019.

According to the legal provisions the audit firm is entitled to audit public interest entities and large entities if it employs not less than two auditors. Most audit firms in the Republic of Moldova have two or more auditors. However, there are currently a significant number of audit firms operating with only one employed auditor.

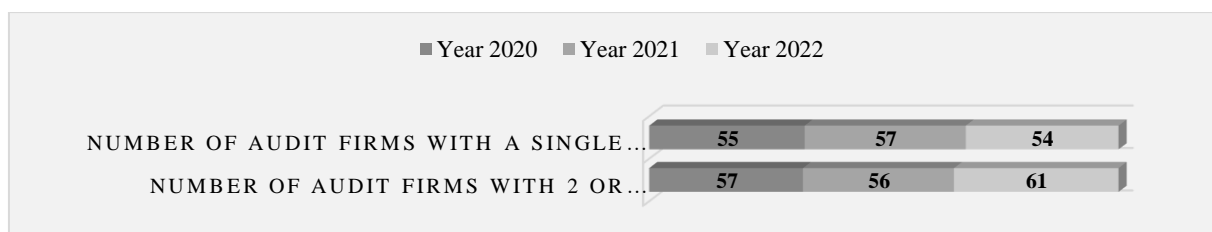


Figure 2. The contingent of auditors within the audit firms

Source: compiled by the authors based on the information published by the Public Audit Oversight Board, Retrieved from: <https://cspa.md/node/58>

Out of 115 audit firms present on the domestic market, about 53% of them operate with two or more auditors employed. According to the data presented in the figure above, there is a tendency to increase the number of audit firms that have more than two auditors in the personnel states. Therefore, it can be said that this trend allows a development of the competition of audit firms eligible to spend the mandatory audit called statutory.

ISQM 1 applies to all audit firms performing engagements in accordance with the International Auditing and Assurance Standards Board (IAASB) international standards. These standard covers quality management for firms performing audits and reviews of financial statements and other assurance and related services engagements.

An audit firm's quality management system is defined by ISQM 1 as a system designed and implemented to ensure that responsibilities for compliance with legal and regulatory requirements related to the performance of engagements, including appropriate reporting in the given circumstances, are fulfilled. Thus, an audit firm will develop policies necessary to operate with a management system intended to review the quality of regular audit missions or other assurance missions.

In the context of the quality standards, the entity shall establish provisions on audit quality assurance that address the fulfillment of relevant professional responsibilities, including those relating to quality. The audit entity shall be guided by clear quality strategies to systematically approach its engagements in accordance with the scope of the quality management system in the field of audit engagements.

Table 2. The scope of quality management in audit in accordance with the legal framework of the Republic of Moldova

Objectives of the management system	Legal framework requirements
Taking responsibility for the design and operation of the quality management system	The assignment of responsibilities for quality management assurance is indicated in the Financial Statements Audit Law no. 271/2017
Exercising quality missions in accordance with the regulations in force	Carrying out quality assignments in the case of statutory audits

Source: own processing according to Law no. 271/2017

Governance and management is one of the building blocks of audit quality management in an audit firm and represents a new approach to quality assurance in audit. This emphasis on the part of the IAASB is explained by several controversial scandals in recent times, the root cause of which has been accountability deficiencies in organizational management.

Responsibility for the quality management system in an audit firm under ISQM 1 is allocated as follows (see Figure 3):

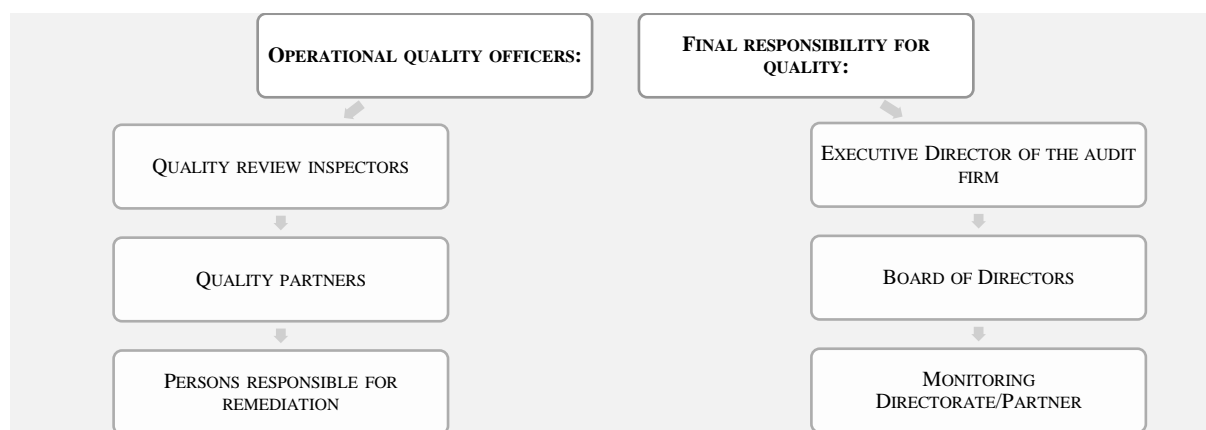


Figure 3. Division of responsibilities for the quality management system

Source: own elaboration according to ISQM 1

In the case of audit firms that are not part of any international network, the practice is to assign the final responsibility to the managing director. Foreign and mixed capital audit firms usually assign this responsibility to the partners' board of directors. Regardless of the level of responsibility assumed, the individuals involved are authoritative and willing to take on this engagement. They must also have the necessary competences proven by experience, knowledge and professional skills. When assuming monitoring responsibility, attendance at inspections should be avoided.

Although the operational responsibilities for the quality system lie with different people, the final responsibility for the assessment and the conclusion reached lies with the audit firm. Under the terms of the Financial Statements Audit Act, the quality review of audit engagements is carried out by an auditor who did not

participate in the audit. It is also allowed on a contractual basis to engage another audit firm to perform quality reviews. At the same time, the nominated law requires the firm to annually evaluate the effectiveness of audit quality management policies and procedures and keep records of the evaluations as well as proposed measures for efficiency.

A modern quality management system is based on a continuous process of risk assessment within the company. The stages of the risk assessment process in an audit firm are as follows:

- design and implementation of the risk assessment procedure;
- developing quality strategies;
- quality risk detection and testing;
- implementing responses to address the risks.

From an organizational point of view, the audit firm's risk assessment process can be centralized or decentralized. The centralized mode is specific to the audit firm network. This mode represents a practice of centrally setting quality-related objectives for all functions and service directorates.

But not in all cases is the centralized option sensible to apply. This is why audit firms also practice the decentralized method of setting quality objectives, risks and responses. The network to which the firm belongs could provide services to the firm on defining quality objectives, identifying quality risks and finding solutions to the deficiencies found.

In connection with the new management concept in audit, quality risk is analysed through the prism of professional judgement, including a focus on the extent to which engagement quality objectives are achieved. In determining risk, the manner and degree of negative influence on quality objectives of particular situations is examined, including:

- the small number of auditors in the audit firm;
- merger with another audit firm;
- audit entities' business plans depend on income from other activities.

The above-mentioned problem of the small number of auditors in domestic firms is a basis for understanding the conditions that could affect the achievement of quality objectives. Such firms may face quality risks if management's commitment to quality is partially recognized and assumed, and management does not demonstrate behavior that promotes quality.

Difficulties of this kind can be established in the case of mergers of audit firms. Incompatibility of the technologies applied by the two merged firms may cause quality risks. In this case, the given risks may arise from the inconsistency of intellectual resources used before the merger with the use of a new methodology.

Another problem identified in the analysis of the audit and related services market relates to conflicts of interest. According to the data presented in Figure 1, a significant number of audit firms, which for the year 2022 constitute 71 entities, provide other services in addition to auditing. The business model of these firms is a condition for achieving the overall financial objectives. For this reason, this condition may generate certain quality risks, such as:

- how the audit entity's resources are allocated and managed;
- financial priorities in promoting quality missions.

The risk to quality can be determined by the way resources are allocated and assigned. Such an approach does not prioritize services that are not covered by quality management standards. Sometimes financial priorities are to the disadvantage of promoting the quality of missions covered by the standards in question.

There are other aspects of quality risk that are tangential to the firm's modern management system. As well as the business atmosphere, which of course determines the style of leadership and spreads it more or less to all organizational structures of the audit entity. Taking into account the most recent changes in the corporate governance codes of the world's major economies the standards in question emphasize specific management requirements, in particular the following organizational aspects are emphasized:

- discipline, punctuality, reliability, promptness of response;
- engagement teams are aware of and take responsibility for audit engagements;
- commitment to team activities;
- the computer software stores and archives relevant and reliable information with which the quality management system operates;
- the design and conduct of monitoring ensures that deficiencies in the process of carrying out missions are detected;
- rational management of the work of allocating financial and staff resources.

ISQM 2 is a modern standard for quality assurance and is designed to develop the quality of finished

assignments. Although a more modern approach is being taken, the assessment of audit assignments remains a priority of quality-based strategies. We note that to a large extent ISQM 2 is based on the requirements of former IAASB standards such as the same ISQC 1 and, by implication, ISA 220 (Revised).

The basic issues covered by ISQM 2:

- Terms of reference when appointing the quality reviewer;
- Review process for completed assignments;
- The compilation of the review dossier.

Law no.271/2017 provides for the application of quality management and risk assessment procedures. In the context of this law, the review is performed by an auditor or partner who did not participate in the audit. The audit firm must keep records of the assessments and proposed actions based on the results of the engagement review activity. According to the provisions of the relevant law it is mandatory to review financial statement audit engagements for the following entities:

- 1) Public interest entities;
- 2) Large entities.

Public interest entities and large entities are defined in the Law no. 287/2017. Also, based on internal policies the audit firm may review other assignments. According to ISQM1 quality review is exercised for the following engagements:

- audit of listed entities;
- engagements required to be reviewed by the legal framework;
- audit and other quality risk engagements.

Although the review is not intended to assess the compliance of the engagement with the applicable legal and professional framework, the purpose of the review is to assess the significant judgements and conclusions of the engagement team. The reviewer is neutral, does not participate in any way in the exercise of the work of the engagement, nor does he/she intervene in the process of coordinating and supervising the work carried out by the members of the engagement team.

III. CONCLUSION

In our opinion the application of the provisions of the nominated standards will strengthen and streamline the quality system of a domestic audit firm. All the more so as the standards mentioned encourage entities to design a system based on the fundamental components of quality management. Thus, in the current version the quality system is characterized by a reciprocal approach to the importance of the managerial decision-making factor. Under these circumstances, an audit entity should be concerned with quality risk testing activities and improve them in the context of developing future strategies.

The standards set out deal with the entire quality management process in a proactive way that responds to the corporate transformation of an audit entity and its engagements. Audit firms must therefore take account of the new requirements and upgrade their own quality control systems, i.e. bring them into line with the requirements of the nominated standards.

Also, a reformation of the notion of quality control and its replacement with the notion of quality management can be noted. This reformation is not a formality in modernizing the process of assessing the quality of audit missions, as long as the management of the audit firm will assume this responsibility. According to the new provisions, the audit firm must apply a risk-based approach to the development of quality management components in an interconnected and coordinated manner.

The transition to quality management standards will bring important benefits for audit entities in the Republic of Moldova. And the addition of new elements to the internal control system will develop important aspects such as the risk identification process and human resources involved in quality assurance.

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