

REPUBLIC OF AZERBAIJAN

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ABSTRACT

of the dissertation for the degree of Doctor of Science

**WAYS OF EVALUATING THE ECONOMIC EFFICIENCY
OF INDEPENDENT AUDITOR SERVICES IN THE
REPUBLIC OF AZERBAIJAN AND IMPROVING IT**

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Thematic justification and current state of knowledge of the research subject. Conceptual documents, programs and strategic roadmaps adopted in Azerbaijan over the last decade make it necessary to set-up and develop the audit system in accordance with up-to-date requirements. Basic features and requirements of such an approach are clearly reflected in “Azerbaijan 2020: Vision for the Future” Development Concept, “Development Concept of the Audit Service of the Republic of Azerbaijan”, “Strategic Roadmap for the Development of Financial Services in the Republic of Azerbaijan” and other similar documents. Particularly from this point of view, it is possible to put forward such an important vision: there is an urgent need to address the development of the national audit system. There is also a need for serious practical and theoretical extensive research aimed to solving these problems. Thus, theoretical and practical research in such fields as improving the mechanism of audit organization and regulation, determining audit workload and efficiency in this field, building entity-auditor relationships on the basis of up-to-date requirements, improving professionalism of auditors, improving quality of audit services results from special need.

Study of theoretical fundamentals and problems of audit development became target of research by well-known foreign scholars R. Adams (Fundamentals of Audit, 1995), E.A.Arens, C.K.Lobbeck (Audit, 2001), F.L.Deflis, Q.R.Djenik (Audit Montgomery, 1997), L. Pacholi (Treatise on Accounts and Records, 1994), C.K.Robertson (Audit, 1994), J. Richard (Audit and analysis of the economic activity of the enterprise, 1997) and others. There are two important distinct directions in these studies. First, study of the fundamentals, normative and methodological basis of arrangement and conduct of audits at the international level. The second study of audit characteristics as a field, reveal of its importance for different entities. All these studies, along with the assessment of audit fundamentals and methodological framework, can also be considered important in terms of development of this service field.

Among well-known post-Soviet scientists works of

A.A.Terekhov (Audit: Development Perspective, 2006), M. A. Azarskiya (Audit: Theory and Methodology, 2007), N.P.Baryshnikova (Organization and Methodology of Auditing, 2005), N.T.Belukha (Audit, 2007), S.M.Bychkova, S.M.Karzaeva (Audit, 2006), V.V.Skorba (Organization and Methodology of Audit, 2005), E.M. Gutsite (Audit, 2007), Y.T.Itkin (Problems of Audit Formation), N.V.Astarkhasev (Improving efficiency and quality of audit in Russia, 2007), V.R.Podolsky (Audit, 1997) and others should be specifically mentioned for their research and results in the field of audit services. Their research is of special importance both for the study of audit fundamentals in terms of up-to-date requirements, and for study of development problems of this service field.

Azerbaijani scholars V.T.Novruzov (Fundamentals of Auditing, 1997, Internal Audit, 2008), D.Bagirov (Audit, 1996), I.M.Abbasov (Audit, 2007), F.S.Hajiyev (Economic Analysis in Auditing, 2015), Q.R.Rzayev (International Accounting and Auditing, 2000), C.B.Namazova (Audit, 2012), R.S.Hajiyev, S.M.Sabzaliyev (Fundamentals of Auditing, 2003), A.S.Salahov (Some trends for improvement of accounting, auditing and statistics in the context of economic reforms, 2011) and others paid special attention to investigation of audit fundamentals and conducting methodology. These studies should be appreciated for their importance in terms of organization and development of the national audit system in Azerbaijan.

It is impossible to underestimate the role of all this research, contribution to the development of audit. However, significant issues such as significant global commotion in the field of socio-economic development at the end of the 20th century and at the beginning of the 21st century, crisis burn out, increased need of the state, society and other stakeholders for accurate, transparent and objective information in economic and financial activities, clearer definition of audit efficiency require new approaches to the organization and development of audit. In particular, significant issues such as development of this service field, establishment of a mechanism for its organization and regulation in terms of more flexible and

progressive requirements, continuous improvement of knowledge and professional level of auditors, determination of audit burden for the entity and economy, determination of this service field efficiency issues are becoming more relevant. The dissertation is based on the study of such important issues and organization and regulation of audit service in terms of up-to-date requirements, conducting its development related research in various directions, development of scientifically and practically sound proposals for development of this service.

Aims and objectives of the dissertation. The aims of the study include the following:

- To study theoretical and methodological bases and concepts of audit and put forward modern views in this field;
- To define the concept and basis of audit burden;
- To define the concept of audit economic efficiency and its calculation methodology;
- To assess the development trends of audit service in Azerbaijan, efficiency of existing market;
- To make scientifically and practically justified proposals on the development of audit service.

The following objectives have been identified to achieve the aims of the study:

- To study historical stages and features of audit formation;
- To identify the role and effect of audit as a field in social and economic life;
- To conduct a comparative analysis of conceptual views of audit;
- To evaluate up-to-date audit theories and its fundamentals;
- To identify the characteristics of audit burden, differences and similarities between it and tax burden;
- To analyze the level of organization and development of audit in international practice;
- To evaluate regulatory mechanisms and development features of audit service within post-Soviet countries;
- To determine audit burden on the economy and various entities;

- To determine economic efficiency of the audit service field;
- To assess current level of audit services market development.

Research methods. Methods such as analytical, statistical, comparative, systematic, retrospective analysis, logical research, survey and expert evaluation have been mainly used in the development of the thesis paper. Information background of the research is formed by statistical reviews, bulletins, reports and other materials of the State Statistics Committee of the Republic of Azerbaijan, the ANAS Institute of Economics, the Chamber of Auditors, the Ministries of Economy, Finance, Justice, the Chamber of Control over Financial Markets (former), the Central Bank, international organizations and related scientific research institutions.

The object of the research work is to establish and develop an independent audit system in the Republic of Azerbaijan. **The subject** of the study is to analyze the development problems of the audit Service Market in the country, to measure the audit burden on the economy, to assess the economic efficiency of the audit Service, to identify the areas of development of this service sector.

Scientific novelty of dissertation – is that the following has been introduced in the work for the first time: up-to-date views on the conceptual basis and nature of audit have been put forward, effect of this service field on socio-economic and management processes have been identified, international experience in the relevant service field have been systematized, audit burden and its efficiency bases have been identified, directions for development of audit service in the Republic of Azerbaijan and increasing its efficiency, improvement of existing regulatory mechanism in this field, increasing auditors level of professionalism in terms of up-to-date requirements have been identified. Scientific innovations of the dissertation work include the following:

- Considering audit an integral part of economy as an important field has been proved based on historical facts;
- Conceptual approaches to auditing have been removed from a narrow framework, substantiated on a broader basis (socio-economic, political and management) and the up-to-date conceptual nature and scope of audit services have been

identified;

- Views on formation of audit as a field with sufficient theoretical and practical characteristics, methodological basis and historical development have been substantiated;
- The concept of audit workload, its fundamentals and calculation methodology have been identified;
- The concept of audit economic efficiency, its fundamentals and evaluation methodology have been identified;
- Basis of up-to-date pricing policy for audit services and its improvement trends have been put forward;
- Ways to improve the effective communication mechanism between the auditor and the entity in the service market have been identified;
- Substantiated views on improving the regulatory mechanism of audit have been put forward;
- Up-to-date trends for improving the training mechanism of auditors have been identified;
- The trends of professional development of audit practitioners have been identified;
- The bases of audit application in the information technology system and trends of development have been identified.

Theoretical and practical significance of research.

Outcomes of the thesis research provide ample opportunities to determine the stages of audit service formation and development in the Republic of Azerbaijan, methods and trends of regular assessment of the service market, scientific and practical basis for the organization, regulation and development of audit in terms of up-to-date requirements. Also, the outcomes of the thesis research will contribute to assessment of audit burden on the economy and individual entities, to evaluation of its efficiency. Particularly in this context, the outcomes of the thesis research will have a practical effect on the organization of audit service in the country on a more sophisticated basis, application of advanced regulatory mechanisms in the service market, identification of up-to-date development trends of this service, training highly qualified and professional auditors. The thesis research and its outcomes are of special importance in

terms of conducting targeted research in the field of audit, training of highly qualified and professional auditors, as well as academic staff and experts.

Proof and application of the dissertation.

65 scientific articles and 4 theses related to the thesis research were published in the country and abroad. Also, in connection with the research topic, 2 training programs on auditors degree exam preparation courses and 2 training programs on auditors professional development courses conducted at the Chamber of Auditors, a sociological survey on “Problems of Audit Service”, “Audit” textbook (co-author-2001), “Audit from formation up to development” (initiated by the Chamber of Auditors, co-author-2002) analytical-research-oriented book, 4 monographs (Formation and development perspectives of audit service in the Republic of Azerbaijan, 2006. Opportunities for using audit to increase competitiveness of business entities, 2013 - collective monograph. Determining the effect of audit on competitive economy, 2014 - collective monograph. Development of audit services: theoretical fundamentals, 2019), a book (Effect of audit on formation of a competitive economy, 2011) were published.

The articles written by the author have been presented at many scientific-practical conferences, symposiums and seminars organized in the Republic of Azerbaijan and abroad. In accordance with the decision of the Board of the Chamber of Auditors on the practical application of the thesis paper, in 2003 on “Review of classification of independent auditors and audit firms”, “Analysis of audit services and development of relevant proposals”, “Development of proposals for perspective development and improvement of audit services” three scientific-research works were carried out. Relevant research works were accepted for application by the Chamber and a copy of these works was submitted to the State Registration Center of Scientific-Research, Experimental-Design Works and Dissertations of ANAS. Also, “Analytical analysis of situation in the field of formation and development of audit service in the Republic of Azerbaijan” developed by the Center for Economic Reforms of the Ministry of Economic Development was sent for practical

application to the Chamber of Auditors in 2006 and management of the Chamber taking into account the significance and outcomes of the submitted research work provided an official document to the author on its application. The author who is a developer of 2 training programs for auditors degree exam training courses and 2 training programs for auditors continuous development courses held at the Chamber of Auditors, was closely involved in development of theoretical-methodological and organizational basis of sociological surveys on “Problems of auditor service” (2003 and 2019) to ensure regular research of the service market, evaluation of its outcomes.

Host organization of the dissertation: ANAS Institute of Economics.

Rationale and structural bases of the dissertation. The rationale for the dissertation is determined by the subject matter, audited entity, aims and objectives of the research. The structure of the dissertation includes introduction, six chapters, twenty paragraphs, conclusions and suggestions, bibliography and a list of references. The dissertation work consists of 438000 marks (excluding images, tables, graphs, appendices and a list of literature). There are 280 pages in the dissertation while 5 schemes, 20 graphs, 17 diagrams, and 8 tables and 12 pictures are drawn based on the rationale and substance of the work.

Basic provisions subject to defense:

1. Conceptual approaches to auditing provide a broader justification for this service.

Views on up-to-date auditing also draw attention with their differences. As the main stage of improvement and development of the functional activity of audit coincides with the 20th century, the study and evaluation of its nature and concept in accordance with the nature of market relations caused extensive discussions among economists. We believe that disclosure of the nature of audit should reflect its important role in society and economy.

Analysis of theoretical views and concepts on audit shows that its significance in terms of modern age, its role in socio-economic processes should be determined with full depth and clarity. In our

opinion, given that in modern conditions audit has a more significant effect on socio-economic processes, actively participates in the assessment of the implementation of many laws and regulations, acts as a key assessment criterion for determining the compliance of financial and economic operations with the existing legal framework is more appropriate to express its nature as follows: “Audit is a form of civil market control that evaluates economic and financial processes in a broad sense and provides objective and transparent information about these processes to members of society and stakeholders.” As for the nature of audit as a market infrastructure, it is should be interpreted as follows: “audit is a field of market infrastructure that assesses the compliance of financial and economic and other operations carried out by business entities with existing legislation and legal framework, responds to it, identifies existing problems in economic activity, eliminates them, provides comprehensive consulting services for the improvement and expansion of operations.”

2. Study of modern audit theory provides a basis for new views in this field.

The view of characterizing modern audit as a developing field from theoretical and practical point of view is more justified. Such an approach can be put forward based on its close relationship with significant factors such as its long history of development, its close relationship with fields of economy, its important role in socio-economic life, formation of theoretical and methodological foundations in a specific direction. Based on the outcomes of recent research on various aspects of audit theory, reliability and risk assessment, it is necessary to define the subject in a clearer and more specific way, assessing audit as developing theoretical and practical field. The subject matter of up-to-date audit should be more referred to providing reasonable proposals related to assessment of macro and micro-level economic development processes in terms of neutrality and objectivity, assessment of financial and economic operations in various contexts, identification and elimination of problems in this field.

Methods and techniques that characterize audit methodology

are in the form of a complex system. We believe that it is reasonable to distinguish more significant approaches in the use and classification of methods applied in auditing: general theoretical and specific theoretical approaches. The first group includes generalization, systematization, analysis and synthesis, induction and deduction methods, while the second group includes physical and documentary inspection methods.

In our opinion, fundamental theoretical provisions should be taken as the basis of the audit concept and the elements of the audit concept should be distinguished within them. It is more appropriate to describe the elements of audit concept in a logical sequence and interrelationship as follows.

Audit theory and its distinction as a field of specific knowledge is expressed by the system of views and attitudes that interpret this service and form its basis. Significance of this theory is that it is based on principles that do not depend on evidence and events it explains. We believe that audit theory should help to understand the nature and characteristics of audit activity, its implementation tools and principles of forming auditor's objective opinion on financial statements of the business entity.

Audit uses information developed in tax, financial-credit and accounting, implements application of similar methods and techniques for data collection and processing. According to the specific subject and purpose of the audit, the auditor interacts with other sectors of economy and conducts audits in these fields, based on specifics of their activities, theoretical and methodological basis. In all cases, the aims and objectives of audit are fundamentally different from the aims and objectives of the fields with which it is in close contact. It can be assumed that audit is aimed at obtaining sufficient and appropriate audit evidence to assess the accuracy and efficiency of information, transactions and economic business activities in accordance with its subject matter, assessing their reliability, and providing a reasonable response to the entity's future activities.

3. Audit has a positive effect on the development of market relations.

Up-to-date audit is valuable in itself as a necessary element of business management and regulatory mechanism. Unlike other types of control system, it occurs in all spheres of social reproduction and plays an important role in the regulation of economic processes, consistent movement of financial resources. In production process, audit evaluates the efficiency and appropriateness of use of labor and production tools, raw materials and resources. In the distribution process, audit is actively involved in determining the status of the public product to meet the needs of community, assessing the existing potential of funds and resources required for ensuring large-scale reproduction, checking and evaluating the use of newly developed products for distribution and redistribution in accordance with market requirements. Audit draws attention by affecting and controlling the following important fields of activity in up-to-date market economy:

- budget establishment, and correctness and appropriateness of its uses;
- collection of social insurance funds and correctness and appropriateness of their uses;
- restoration and expansion of public savings and consumer funds;
- evaluation of labor in accordance with its quantity and quality.

Fields covered by audit in the process of public product exchange include the following:

- to assist in regulation of contractual relations;
- to influence establishment of a fertile ground for providing economy with raw materials, resources, technical means and providing population with consumer goods;
- to be involved closely in implementation of appropriate activities aimed to effective functioning of market principles of supply and demand, elimination of economic crisis, recession.

In the final consumption process of recycling, the audit controls transactions related to the consumption of production, more

precisely, restoration and expansion of production assets, satisfaction of public demand. In private consumption, it assesses consistency in meeting material and cultural needs of members of society and level of compliance of the whole process with the requirements of existing legislation and regulatory framework. In our opinion, resulting from these approaches, the following conclusion can be made: subject matter of audit, in a broad sense, covers all stages of recycling process and all levels of management system, actively involving it in these processes. Audit forms a broad and clear opinion on the level of development of economic processes, relationships in accordance with the requirements of market economy at both macroeconomic and microeconomic levels, and transparency, correctness and appropriateness of financial and economic processes in business entities.

Efficiency of economic activity depends largely on the level of organization of audit system and mechanism. It is this important factor that makes the high role of audit in the system of production, management and general control an undeniable fact. Information provided by audit is of particular importance to government agencies, those interested in the source of information, as well as members of society, public institutions and foundations. Significant role and importance of audit as a field for the state-economy-society is clearly demonstrated in terms of its activities and the specific outcome of this activity. Determining the position of audit in a broad sense is closely related to organization of the service in the business entity and assessment of the targeting of its outcome. In the development of up-to-date audit system, special attention should be paid to the following two main fields:

- Assessment of current condition, financial and economic activity, and financial outcome of business entity by audit and information formed in this direction;
- Services provided by audit to improve and expand the activities of the business entity and its outcome.

In the first direction, audit performs the function of financial control, acting as a provider of objective, transparent, complete and substantial information for specific users. In the second direction,

audit serves to improve and expand the activities of the business entity, performing advisory and consulting function.

According to research in any country with a developed market economy, it is impossible to go without organized audit service, to fully assess the development and progress in the country. The significant role of audit as a service field is characterized by the fact that it has a practical effect on the improvement of the information system, as well as on improving its quality. Audit acts as the most important body establishing public opinion on the formation and proper use of the state budget and social protection funds. International and national experience proves that a final opinion on the accuracy of revenues and expenditures of state, social and other large funds is provided only after a professional auditor's opinion. Experience of developed countries, auditing not only completes its functional activities by providing traditional services, but also penetrates other fields of activity that will contribute to the growth of economic development. Contemporary auditor or audit firm should not be engaged in the analysis and evaluation of only one problem area of the entity, but should be able to provide comprehensive services to organize its activities on a completely sound basis. Also, as a "doctor-professional" who provides treatment and advice on a healthy lifestyle, the auditor must provide similar services to the entities, ensuring confidentiality of their information, in full compliance with its principles. The auditor's model of interaction with the business entity, which is the mainstay of economy, also proves to be acting mechanism of the "family doctor, lawyer or consultant".

The characteristics of audit theory result from the nature and operational characteristics of this service. Audit is an emerging sector of economy that is increasingly proving itself as a market infrastructure. As the demand for its services as an important part of economy and market infrastructure increases, the scope of this service users also expands. This factor is also manifested in the organic connection with the regularity of supply and demand in a market economy. Auditing market environment is important in terms of both economic theory and economic development. The main audit

activity in a market economy is directly related to a thorough study of the state of this market and positions available there.

4. Although the concept of audit burden is proposed for the first time, its measurement can be justified theoretically and methodologically.

Determining audit burden in different fields is of particular importance in terms of assessing both the level of efficiency of this workload and the possibility of influencing the performance of the fields in which it is applied. Sufficient tax burden in economic sources - determines total burden and costs of legal entities and individuals in connection with payment of taxes. Thus, in the micro context, it reflects transfer of debtors income, and in the macro context, society income from private sector to public sector. As for audit burden, although it does not have such a conceptual meaning as the tax burden, there are similarities between the two concepts:

- ✓ in most cases, audit burden, like tax burden, is established on a mandatory basis;
- ✓ audit burden is based on economic activity like tax burden;
- ✓ audit burden is aimed at reducing the entity's income like tax burden;
- ✓ audit burden serves to clarification of the targeted level of collection and increase of tax burden transparency.

In addition to all these factors, there are significant differences between these two burdens and audit burden can be directed at the following:

- expansion of economic activity of the entity;
- identification and use of new financial and economic potentials;
- proper organization of financial and economic activities and operations;
- protection of business reputation in the market environment;
- improvement and substantiation of organizational-management and decision-making system;
- regulation of relations with various public and private institutions (tax, customs, banking, etc.)

Based on existing concepts, the views on the audit burden can be evaluated from in the following contexts:

- audit burden also serves the state, economic and public purposes in the context of its nature;
- although audit burden is established by agreement between the parties, it is sometimes quite high;
- poor quality audit and burden it creates are directly “robbery”;
- audit burden is also focused on improving business and investment environment.

Audit burden or indicator can also be in some sense related to the tax burden and other such concepts. In this context, the concept of audit burden is put forward by us for the first time based on a number of concepts and views. Based on our research, it would be appropriate to express audit burden indicator as follows: “Audit burden” indicator expresses effect of total auditing expenses (quantitative and qualitative and otherwise measurable) on the country’s economy or individual entities (individuals, legal entities) and an attitude. The scope of audit is marked by a wide range of fields and entities to which it relates. The concept of acceptance of audit burden both in the relevant fields and entities, as well as from in a single economic context is considered to be more appropriate.

When determining audit burden, it is not satisfactory to express the service cost as the contracted value between the parties as auditing expenses cover a number of costs that are not included in the contract value of the service, and it may be appropriate to differentiate between quantitative and qualitative components. Thus, consultation of the entity with specialists before and during audit; preparation for audit or maintenance of the relevant full-time employee related to audit; cost elements such as involvement of various audit staff in this process should also be considered necessary to include here. Although such costs serve the purpose of audit, they are also a kind of invisible expense and are not directly included in the audit contract. These costs relate to the costs that the entity uses to carry out the audit obligation but remain directly with the entity. Based on existing experience and legal-methodological documentation, costs that make up audit burden can be classified as

follows:

- auditing (contract) costs in accordance with legislation;
- maintenance of professional staff in the entity in connection with audit or preparation for it;
- expenses incurred for use of the entity's responsible employees labor (accountant, economist, lawyer, etc.) in connection with auditing and the process during this period;
- mandatory payments (fines) arising after audit (by tax and other authorities);
- expenses incurred by the entity after audit (at the request of shareholders, banks, tax and other parties) in connection with the court proceedings;
- material and moral damage to the business reputation of the entity after audit (not identified and eliminated during audit), etc.

Although it is quite difficult to quantify clearly audit burden (in the form of a financial payment), there are a number of methods that can be used to determine costs of such burden (for direct audit and various costs associated with indirect audit). It is especially important to use author's approach, research, expert evaluation, and survey for specific purposes, such as measurement methods. It is more appropriate to measure audit burden at the micro level, to express it as a quantitative indicator of the entity or an employee of the entity (relationship of audit value and the entity or its employee). Quantitative indicator of audit burden accrued to economy (including its level, etc.) will be more different. Thus, relation of audit burden to economy in itself will be considered conceptually more appropriate if expressed by comparison of the whole audit indicator (cost of audits during the year they had been conducted) with GDP, budget, industry, legal entities and per capita. Further, identification of a number of important audit indicators in terms of this methodological approach is of particular importance in terms of evaluating not only quantitative but also qualitative aspects of this service. From a conceptual point of view, audit burden accrued to economy can be expressed as follows:

$$A(ec) = A(\text{pay}) / \text{GDP}$$

Where $A(ec)$ – indicator of audit burden accrued to economy, $A(\text{pay})$ – auditing expenses incurred during the year, GDP – Gross domestic product (annual).

The methodology for calculating a number of indicators of burden accrued to population (capitated), in particular tax burden, plays an important role in the development of relevant audit indicator. Thus, it is possible to determine audit “burden indicator” accrued to population (capitated). Ratio of audit-related quantity (total annual auditing expenses) to population would be more appropriate in this regard.

In our opinion, it is possible to measure and calculate the audit burden accrued to business entities or enterprises. This indicator can be defined as the ratio of total auditing expenses to income of business entities in the country:

$$Ae = Ae/Mi$$

where Ae – audit burden accrued to entities, Ae – audit related expenditures, Mi – income of entities. The same method of determination can be applied to the profit of an entity.

The audit burden itself should be taken as one of the concepts of market economy. Application of this concept will also reflect level of audit potential application of market participants, including enterprises of various organizational and legal forms. It would be more appropriate to classify the outcomes and benefits of application of audit burden concept as follows: strengthening financial discipline in the country; improving level of financial markets use by individuals and legal entities; establishing a favorable, fertile information environment in the country; increasing access of business entities to foreign markets; improving investment climate and activity; improving corporate governance system.

Audit burden can be systematized as both administrative and redundant. Audit burden defined by law is administrative in nature, but, unlike tax burden, it is not determined by specific indicators, but arises under the terms and conditions of the contract. Administrative audit burden has some similarities in nature with administrative tax burden. Although surplus burden is not included in auditing expenses (contractual amount), these costs remain as the entity’s own surplus

burden. Thus, mobilization of time and labor of the entity's employees in connection with audit research and inspections, involvement of specialists in audit development or retention of additional staff, documentation, cost of a number of technical measures become surplus burden on the entity. When approaching audit burden in the context of legislation, it is clear that this burden applies to all enterprises, organizations and departments operating in the country, regardless of the form of ownership and organizational and legal accountability.

5. Concept of audit economic efficiency should be related to the interests of both the service and stakeholders.

Up-to-date economic development, like other fields, highlights the concept of audit efficiency, and such an approach is considered even more important in two main aspects.

The first one is determining the efficiency of organization and development of audit activity as a field.

The second one is specifying efficiency of audit for the fields and parties it serves.

The approach to efficiency of audit activities has so far been expressed in a kind of narrow sense, with a more polar assessment. Thus, audit efficiency is associated with the level of its ability to solve the problem in a given situation, ability to perform its duties. However, the demands of modern economy and society on auditing do not coincide with such an approach. This is because there is a need to pay attention to another important pole of audit efficiency, i.e. the concept of expecting the benefits and efficiency of the parties involved in audit is already in the spotlight. Acceptance of audit efficiency in a broad sense allows to justify such a concept: audit efficiency should be related to the expectation of both its own activities and benefits and efficiency of the fields it serves. The benefit of this activity to the users of the service, regardless of their ownership and organizational-legal form, should coincide with the efficiency of some kind of audit. More specifically, the auditor's level of adherence to his/her duties and professional responsibilities should establish just such an efficiency.

It would be more appropriate to assess audit efficiency s from

three levels: efficiency of audit as a field; efficiency at the micro level (for users); efficiency at the macro level (economy, society).

Positive and negative outcomes of audit in the context of audit subject matter, field, etc. should also be considered in assessing the level of efficiency established by this service. It is important to use the required system of indicators to assess efficiency of audit, and indicators may differ depending on the scope of the service and its objectives. When developing such indicators, special attention should be paid to the following methodological features:

- indicators should be able to analyze and evaluate indicators;
- indicators should adequately cover both audit and entity's operational processes;
- indicators should be selected in in the context of aims and outcomes;
- indicators should be related and complementary to create a unified picture of efficiency.

In order to ensure audit efficiency, it is important to consider relevant assessment principles: cost effectiveness, efficiency, profitability, earning power and self-sufficiency. The approach to audit efficiency may differ because of voluntary and mandatory audits. Experience has proved that in most cases, the entities subject to mandatory audit do not set efficiency requirements, but only initiate a positive or satisfactory opinion on the audit of their financial and economic activities. As opposed to international practice, auditor-customer relationship in Azerbaijan has not yet been established at a high level.

Based on up-to-date experience, the following view can be advanced: finding out the ways of generalization and finding solutions to problems in economic and business activities, evaluating the efficiency of resource use, ensuring transparency and reliability of the information environment related to the use of all types of funds should be the basic principles of audit efficiency.

In contemporary practice, audit efficiency also applies to related services, which are a branch of unified audit services, and this represents more voluntary audit services than mandatory audit. As a voluntary audit service, performance audit has a wider field of

activity and includes both effective control and a wide range of advisory and consulting services. In the context of theory and practice, efficiency of any activity or process must have a certain conceptual, measurable conceptual basis. Given the nature of this service, it should be considered more accurate to determine both its own efficiency and the efficiency it establishes for the areas in which it operates.

Experience has proven that ensuring audit efficiency is closely linked to the human - professional and highly qualified personnel factor. Another factor affecting audit efficiency should be organizational and governance factor. Another factor in improving audit efficiency is closely related to appropriate analysis and evaluation of internal reserves and resources (economic, labor, financial, etc.). Based on our research and studies, we believe that it is reasonable to distinguish the concept of audit efficiency in the following two aspects:

- general conceptual approach to audit efficiency;
- the concept of audit economic efficiency;

The first approach is important because it covers a broader concept. Such a conceptual approach should include important aspects of efficiency field of audit, such as public, economic, social, governance, environmental. When approaching economic efficiency of audit in terms of both legislation and the scope of economic activities, it will cover a wider range: business entities of different organizational and legal forms, economic sectors, investment activities, securities market, special economic zones. We believe that it is more appropriate to express the concept of up-to-date audit efficiency as follows: Audit efficiency should include improving financial and economic performance of public and private sectors, assessing economic efficiency of socio-economic development programs and projects in the country, and making necessary proposals and recommendations. Also, one of the main tasks of audit should be to provide all this information to stakeholders in terms of complete, substantial and objective requirements. The main purpose of audit efficiency is to determine economic efficiency of governance system, increasing its efficiency and appropriateness.

6. Economic efficiency of audit should be evaluated on various aspects based on quantitative and qualitative characteristics.

Availability of necessary basis and sources of information to assess economic efficiency of audit is considered necessary. However, in both domestic and international practice, such a database is unsystematic and limited compared to other areas. It may be appropriate to use the following indicators to assess audit efficiency:

- profitability ratio of transaction or audit (ratio of relationship between financial performance and overall costs);
- labor productivity indicator of employees (ratio of contract value to salary expenses);
- labor capacity indicator of transaction or audit (ratio of salary costs to contract value);
- an indicator of transaction or audit cost.

Evaluation of economic efficiency of audit should include a combination of three key aspects:

- Analysis and evaluation of the prior periods;
- Evaluation of current situation;
- Determination of development trends for future periods.

When assessing audit and economic efficiency of an entity, it would be more appropriate to take into account their main characteristics and use such indicators in this context: indicators assessing market rating level of the entity (profitability, stock value, etc.); indicators assessing financial and economic status of the entity (profit, production capacity, credit attraction, debt, etc.); other indicators (innovation activity, capital investment, level of organization of management system, etc.); expenses.

Assessment of audit services market efficiency allows to determine distribution of shares between the participants of audit services market (auditor, audit firm, local and foreign audit firms, etc.), level of market development (range, forms of services, etc.) and characteristics. In order to carry out assessment, it is reasonable to study the revenues obtained from the service and their structural composition.

In the context of determining participation level of audit in the establishment of key macroeconomic indicators, it is important to assess the level of participation of the audit in GDP, non-oil GDP and to assess the development trends in this area over the years. Total scope of audit services over years can be taken together with the relevant macro indicators, as an assessment ratio. It is reasonable to use relevant indicators to assess the level of market activity of auditors and audit firms providing various services and having various positions in the audit services market: overall development dynamics of the service; development trends of the service by industries (industries, tax, state, bank, producer and consumer); development dynamics of audit services provided in the market: value of awarded contracts; market value (scope) of real service performed; development level of audit types.

Assessment of economic efficiency of audit necessitates evaluation of rating indicators of the following audit institutions operating in the form of individuals and legal entities in the existing service market (audit service rating indicators): national audit firms; external audit firms; independent auditors.

Assessment of economic efficiency of audit should reflect the relationship between the cost of service and the costs incurred, depending on the nature of the activity. Such an approach can be systematized as follows, expressing the cost of service, the costs incurred, service indicators in terms of time and currency:

- cost of audit service;
- costs incurred by audit service;
- cost of service per 1 manat.

Assessment of economic efficiency of audit, highlighting extensive analysis of the service market, identifies the following indicators and necessitates its assessment:

- revenues per auditor and audit firm;
- revenue receipts from services (profitability) and their profitability;
- average annual earning power and profitability level;
- rate of return;
- costs incurred by audit and its efficiency;

- efficiency (usefulness) of audit activity by economy sectors;
- level of audit regulation (in the context of state, audit institution and market regulation).

Income and expenses of the audit service vary by industry and are closely related to the scope of this service, timing, level of complexity of audits. This factor is of particular significance in assessment of economic efficiency of an audit, and the following two key areas should be considered in assessment of economic efficiency of a service:

- ✓ audit efficiency by entities where it was conducted (public, private, tax, bank, etc.);
- ✓ its own efficiency as audit scope.

In addition to quantitative indicators, the use of qualitative indicators in assessing audit efficiency is intensified by a special need. As opposed to quantitative indicators of audit, development of quality indicators requires a special approach, and methodological basis of such approaches should ensure quality aspects of the scope of service and measurement of their efficiency. Indicates the importance of developing quality indicators of audit efficiency in the following areas:

- ✓ country and macro level indicators;
- ✓ indicators by areas and various services;
- ✓ indicators on the effect of audit on the performance of audited areas and entities;
- ✓ community and social based efficiency indicators (producer, consumer satisfaction, community, citizen, economic crime, corruption, etc.);
- ✓ quality and efficiency indicators at the micro level;
- ✓ indicators by various markets and business environment (country-level economic, business environment, taxes).

It is also necessary to use special quality indicators to assess current level of development and efficiency of audit, and it is reasonable to have an individual approach to the development of such methodological frameworks (expert assessment, surveys and monitorings, etc.). Although different indicators are used to assess

economic efficiency, it would be more appropriate to distinguish the following economic indicators close to the topic of the dissertation:

- Sectoral structure of the national economy (audit service) and its efficiency;
- Profitability;
- Level of competitiveness in the service market;
- Earning power of audit service (operations of audit firms and independent auditors);
- Labor, capital and material capacity.

We believe that methodology for assessing economic efficiency can be summarized as follows, and such an approach also provides ample opportunities to assess audit efficiency from various aspects:

$$\text{Economic efficiency} = \text{Outcome/Expenses}$$

The concept of economic efficiency also reflects criteria and methods of accurate assessment based on the comparison of costs and savings. Cost-benefit ratio for expenses incurred for obtaining certain outcome can also be considered as cost-performance ratio of audit. From this point of view, it would be more appropriate to express the previous formula as follows:

$$Ee=C/E$$

where EE – economic efficiency, C – cost-effectiveness or profit, E – expenses incurred for obtaining profit. It would be more appropriate to take the annual profit as audit outcome. It should be noted that the economic efficiency ratio is considered satisfactory when it is greater than one. Another form of economic efficiency is the ratio of earning power, and it is necessary to assess earning power of audit service in this regard. Measurement of earning power should also be considered in determining economic efficiency of audit, and it is more appropriate to calculate this indicator as follows:

$$\text{Earning power (audit)} = \text{Profit (audit)/Costs (audit)}$$

Formula of earning power of the audit service can also be provided in the following form

$$Es =P/C*100$$

where Es – earning power of audit service, P – profit gained from the service and C – total costs incurred for service. It also should be

noted that the level of earning power above 100% (1) is considered satisfactory. At the same time, Expenditures / Outcome ratio shows the amount of costs incurred per unit of audit service outcome. And this is close to the cost per unit of service, manat, which is widely used in practice in terms of content.

The necessary legal and regulatory framework for the organization and regulation of audit service has been established in the Republic of Azerbaijan, and this process continues. Efficiency of audit service is closely related to the level of organization and regulation of this area. Thus, efficiency of audit organization and regulation and its compliance with contemporary requirements also affects increasing economic efficiency of this service. The regulatory mechanism should act not as a burden accrued to the development of the audit, but as a stimulus to its development. We believe that such an approach should be considered important in assessing economic efficiency of audit. Contemporary audit practice and development trends in this area show that it is more appropriate to systematize regulatory mechanism of audit service in three directions. These regulatory mechanisms include mainly legal, institutional and economic market mechanisms. The level of organization and regulation of relations between auditors and audit firms and market participants should be one of the main indicators of audit efficiency. Such an approach not only reflects quality of audit and attractiveness of the services provided to the entity, but also plays an important role in assessing the efficiency of the service from various aspects.

7. International auditing practice necessitates improved development of this service market.

Prior to the crisis at the beginning of the 21st century, the world audit practice was characterized by establishment of two classical conceptual models of regulation of audit activities: state; public-state model. The first model was related to organization and development of audit in the European Union (Germany, Austria, France, Spain). The second model of audit regulation was developed in English-speaking countries and is better known for its liberal orientation. As in other areas, dirigiste or liberal approach to regulation in the audit services market does not testify a high level of

development in this area. Such an approach is more clearly felt on the basis of research conducted at ANAS Institute of Economics. The Law on Auditing, adopted among CIS countries in the Russian Federation, in fact establishes a mixed regulatory model in the country. In fact, Russia may be the first CIS country to officially adopt a mixed regulation model of auditing.

World practice proves that radical changes in the field of audit services, as a rule, occur as a result of economic crises or corporate scandals. The global financial crisis and later economic crisis, which occurred at the beginning of the 21st century and effects are not mitigated yet, has become turning point in the history of audit development. The G20 meetings held in Washington on November 15-16, 2008 and in London on April 2, 2009 adopted a number of documents covering action plan for overcoming the global financial crisis and measures to strengthen financial system. At this important event, it was acknowledged that the main causes of the crisis are serious failures in the financial sector, financial regulation and control design.

In international practice, similar unpleasant situations have been observed in other countries in the last fifteen years, when entity-audit scandals have occurred and its serious consequences have arisen. The activity of foreign audit firms in the audit service market in the Republic of Azerbaijan is distinguished by its high advantage, which makes up 85-90% of the service market. Most of the leading companies, banks and insurance companies in the country are audited by well-known and transnational foreign audit firms. The recent problems faced by banks have created many serious problems for the country's economy and community, and the number of bankruptcies and closures of organizations in this sector has increased. It should be noted that audit firms also played a so-called "role" in creating such an unpleasant situation. Thus, International Bank of Azerbaijan was also audited by well-known audit firms such as Deloitte & Touche, KPMG Azerbaijan LTD, PricewaterhouseCoopers Audit Azerbaijan in different periods of the last decade. Based on the global experience and current situation in the country, it would be appropriate to put forward the following view: there is a special need to organize and

regulate the national audit market in accordance with up-to-date requirements and take more drastic measures to create a healthy competitive environment in this market.

The practice of organizing and developing audits is based on global experience and has its own characteristics in different countries, including Azerbaijan. It also takes into account the specifics of the state structure of each country and national traditions of the level of economic development. Establishment of a legislative and regulatory framework has played a key role in the development of the audit service in the post-Soviet states. It is reasonable to evaluate the legal framework for regulation of audit services in the CIS countries by four-stage level.

The first stage of legal framework of audit consists of various legislative acts aimed at regulating audit service, including the law on the regulation of audit service, including the Civil and Tax Code, sectoral laws. The Law on Services, being the main sectoral legislative document, contains the procedures for audits organization and regulation, the mechanism of state (central) control in this area, the main requirements and responsibilities for auditing.

The second stage of legal framework for audit regulation is characterized by legal and regulatory documents adopted by the central executive body, the Cabinet of Ministers, which defines specific areas of audit regulation, identifies legal and regulatory documents adopted by the Cabinet of Ministers (licensing, identification of entities subjects to compulsory audit and other relevant regulatory documents). Legal and regulatory documents in this direction define specific points and rules of proceedings for organization of audit service, regulation of relations between the parties in the service market.

The third stage of legal framework of service regulation is formed by existing regulatory-methodological framework, standards, decisions made by responsible executive body, regulatory documents in this field. The main purpose of the relevant methodological framework and standards is to determine the norms and rules of audit procedure, to clarify the quality criteria for the organization of control over the service, to ensure regulation of relations between

audit entities and audited entities.

The fourth stage of legal framework of audit includes regulatory documents and internal standards adopted by audit firms in connection with organization of their activities and improving the quality of their audits. According to characteristics of audit organization and development, it is more appropriate to systematize the legal and regulatory framework for regulation of auditing in the CIS countries according to the following scheme.

Current situation existing in the development of audit services in post-Soviet countries is characterized by its distinctive features. For the purpose of study, it was appropriate to study audit experience of Russia, Ukraine, Kazakhstan, Lithuania, Georgia, Kyrgyzstan, Uzbekistan. Taking into account development level of legal and regulatory framework of audit and improvement of regulatory mechanism (state, public), it is reasonable to systematize these countries into the following groups:

- Group I - Republic of Lithuania (distinguished by a high level of development)
- Group II - Russian Federation, Ukraine and the Republic of Kazakhstan (has an average level of development)
- Group III - Republics of Georgia and Kyrgyzstan (distinguished by sufficient level of development)
- Group IV - Republics of Uzbekistan and Belarus (characterized by low level of development)

There are fundamental differences in the audit practice of the CIS and developed countries, and these differences appear in many criteria. In these countries, audit has been established over the last 30 years and the cause of its establishment is observed from top to bottom (based on legal and regulatory documents adopted by state and government bodies). It is in this process of establishment that the nature and significance of this service is not sufficiently valued in society, as the necessary market requirements for the full development of audit are not sufficiently taken into account.

8. Audit service market is being developed in Azerbaijan by foreign audit firms.

Like in many areas over the past decade there have been

positive development trends in the audit services market in Azerbaijan. Compared to 2010, the scope of audit services in 2018 increased by 2.3 times and amounted to 59 million manat. There was also an increase in the average cost of contractual services performed in the service market, average contract value increased from 9028 manat to 15062 manat (1.7 times) during the comparison period. The number of practicing audit firms increased 2.5 times in 2018 compared to 2010, and the number of independent auditors increased 1.5 times. The share of voluntary audit in this service market is still low. Thus, the share of mandatory audit within provided audit services is higher - 71%, while the share of voluntary audit is 29%.

Research suggests that activity of domestic audit firms and independent auditors in the country's service market is not sufficiently developed. Thus, while there was 10-15% (domestic audit firms - 10%, independent auditors - 5%) in the share of domestic audit firms and independent auditors in total volume of contracts awarded in 2012-2018, this indicator for foreign audit firms was 85-90%. It was observed at the level of 90%.

The scope of services provided to auditors (per auditor) differs significantly in terms of organizational and legal form of organization of their activities. Compared to 2010, scope of services per auditor in branches and representative offices of foreign audit firms in 2018 increased by 3.8 times and comprised 4345 manats, and scope of services per auditor in audit firms using the trademark of foreign legal entities decreased by almost 2 times and comprised 324 manats. However, during the relevant period, scope of services per auditor in domestic audit firms increased by 9 manats and comprised 79 manats, and in independent auditors increased by only 1 manat and comprised 41 manats.

Although mandatory audit, which is the main and leading type of audit service in the country, is quite developed, organization and coverage of this service area is still unsatisfactory. This is because there are many cases of avoidance of this service by many enterprises, organizations and business entities that are subject to mandatory audit by law. In 2010, 50% of 2679 municipal bodies, 18% of 1570 joint-stock companies, 2% of 23298 Limited Liability

Companies, 26% of 1609 foreign-invested enterprises, their branch offices, 47 insurance companies, 62%, 13% of 234 joint ventures, 54% of 192 banks and credit organizations which were subject to audit by current legislation avoided this service. Thus, only 7% of the entities subject to mandatory audit in the relevant period used this service. During that period there were certain changes in situation in this area. Thus, in 2017, 2134 (3.2%) out of 67507 entities in the country subject to mandatory audit, and in 2018 3142 (6.6%) out of 47286 entities subject to mandatory audit were audited. While comparing 2017-2018, there was 3.5% increase in the number of business entities subject to mandatory audit. Audit avoidance of entities subject to mandatory audit differ by economic region. As most of the entities subject to mandatory audit are registered in Baku and operate here. However, a number of cases of avoidance mandatory audit remains high in the capital, and this view is reflected in our research. The following diagram shows clearly auditing of entities subject to mandatory audit in the country regions.

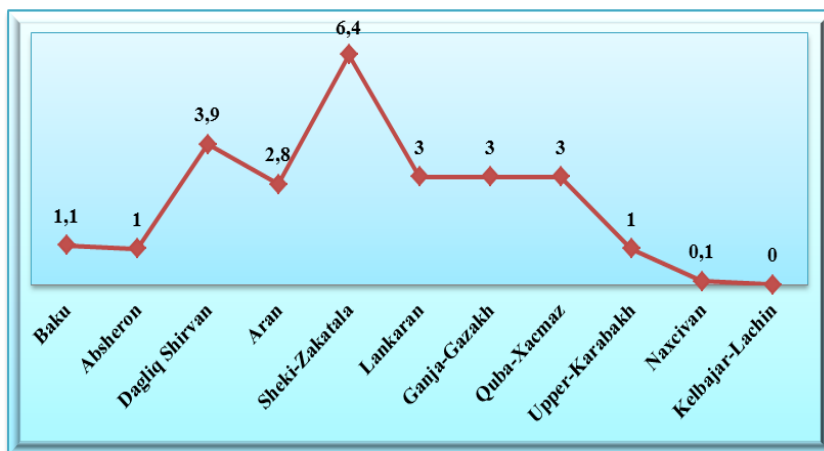


Chart 1. Rate of entities subjected to mandatory audit by regions (%).

9. Research shows that there is a need for higher audit development in the country.

Outcomes of the joint survey conducted by the Chamber of Auditors of the Republic of Azerbaijan and the ANAS Institute of

Economics (01 August – 01 October 2018) played an important role in identifying important areas for the development of audit services market. Results of the survey and research related to organization and development of audit services market in the Republic of Azerbaijan provide basis for the following opinions:

- ✓ In the development of the audit service, as it was in previous periods, mandatory audit prevailed.
- ✓ There is still a need for improvement of the quality of audit services.
- ✓ Increasing attention to obtaining practical bearing of auditors' recommendations to stakeholders is particularly relevant.
- ✓ There is a serious need to increase the level of auditors' professionalism and improve their qualification.
- ✓ The scope of consulting services (voluntary audit) in the service market should be increased. In particular, audit expenses have been identified as a key efficiency indicator and should be a key tool for assessing the efficiency of both the audit and those using this service.

10. Level of audit burden accrued to economy and business entities in Azerbaijan is low.

Based on our methodological research, it is possible to determine audit burden in the Republic of Azerbaijan. An initial macroeconomic assessment of audit burden should be considered appropriate. The weight of audit burden on GDP for the relevant years can be determined as in the diagram below. As can be seen from the diagram, the weight of audit burden accrued to GDP is negligible. While this load was 0.0005% of GDP in 2012, it increased to 0.0007% in 2018, i.e. there was a very small increase of 0.0002%. This situation occurred against a backdrop of a 1.4-fold increase in GDP and a 2-fold increase in the scope of audit services during relevant periods.

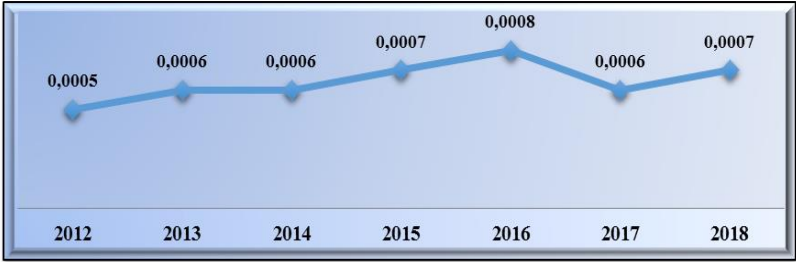


Chart 2. The weight of audit burden accrued to GDP (%)

Based on our methodological research, the audit burden on non-oil GDP can be estimated as follows. As can be seen from the diagram below, the weight of audit burden accrued to non-GDP is relatively high compared to GDP, but it is still impossible to evaluate this burden satisfactorily. Thus, while the share of audit burden accrued to non-oil GDP in 2012 was 0.001%, in 2018 this figure increased slightly to 0.002%.

We believe that calculation of audit burden accrued to the industries and entities to be audited is also of particular significance. The audit burden accrued to the gross profit of industry is also very small. As can be seen from the diagram below, the audit burden accrued to gross industrial output in 2012 was 0.001%, but in subsequent periods this figure changed slightly and finally reached 0.002% in 2018.



Chart 3. The weight of audit burden accrued to gross profit of industry (%)

The same situation is observed in the audit burden accrued to net profit of industries. That is, this did not happen when this figure had to be relatively high in net profit. Thus, while the share of audit burden accrued to net profit of industries in 2012 was 0.001%, it

increased slightly in subsequent years, and in 2018 this figure reached 0.002%.

The weight of audit burden accrued to gross profit of the mining industry does not differ significantly from the weight of audit burden accrued to overall industry. While in 2012 the share of audit burden accrued to gross profit of this industry was 0.002%, in 2018 this figure increased by only 0.001% and reached 0.003%.



Chart 4. The weight of audit burden accrued to net profit of industries (%)

A similar situation is observed in the weight of audit burden accrued to net profit of mining industry. In other words, audit burden accrued to net profit of mining industry can be assessed as low. It should be noted that while the share of audit burden accrued to net profit of this industry in 2012 was 0.002%, in 2018 this figure increased by only 0.001% and reached 0.003%.

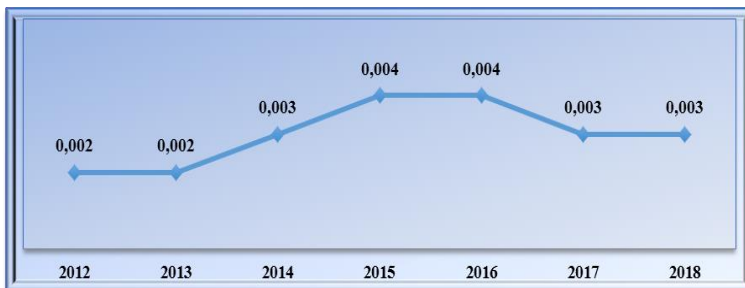


Chart 5. The weight of audit burden accrued to net profit of mining industry (%)

Manufacturing industries and enterprises operating in this sector are more subject to independent audit. However, unfortunately, the weight of audit burden is very low, not only in the

revenues, but also in the profits of this sector. Thus, while in 2012 audit burden accrued to gross and net profit of the processing industry was 0.005%, in 2018 this figure increased by only about 50% (0.004%) and reached 0.009%. Of course, this change can be viewed favourably, but given the need for voluntary audit services in the processing industry, this figure cannot be considered satisfactory.

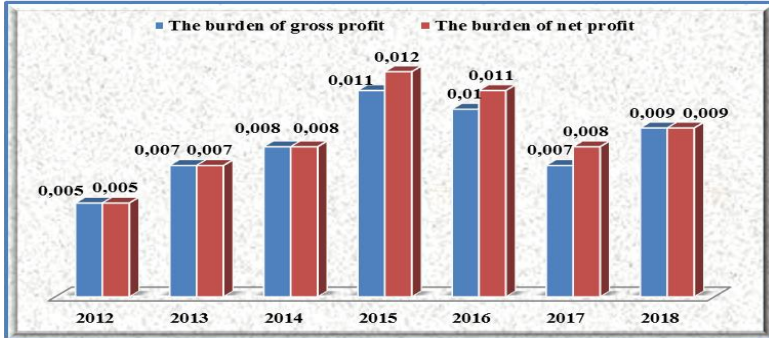


Diagram1. The weight of audit burden on the profits of processing industry (%)

It is still not possible to evaluate the level of use of audit services by small and medium-sized businesses as satisfactory. The weight of audit burden accrued to small and medium-sized businesses, which are the audit practitioners, was not high in recent years as well as in previous periods. Thus, while audit burden accrued to small businesses was 0.012%, audit burden accrued to medium-sized businesses was relatively high - 0.043%.

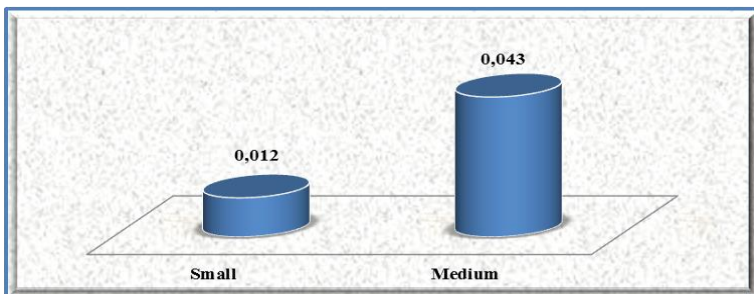


Diagram 2. Audit burden accrued to small and medium-sized businesses (%)

The weight of audit burden can also be calculated for various

profitable business entities operating in the country that are subject to audit. Let's randomly choose five business entities with different levels of annual profitability, i.e.: 10,000,000 manats, 1,000,000 manats, 500,000 manats, 200,000 manats and 100,000 manats, and set their annual audit expenses at 5,000 manats (such audit expenses are taken as the average for audit services market). The results of our calculations are provided in the diagram below. As can be seen from the diagram, audit burden: for a business entity with an annual income of 100,000 manats will be 0.1%; for 200,000 manats - 0.03%; for 500,000 manats - 0.01%; for 1,000,000 manats - 0.005%; for 10,000,000 manats - 0.0005%. Such a situation is almost common in the service market, and, as can be seen, as the annual income of business entities increases, the weight of their audit burden goes own.

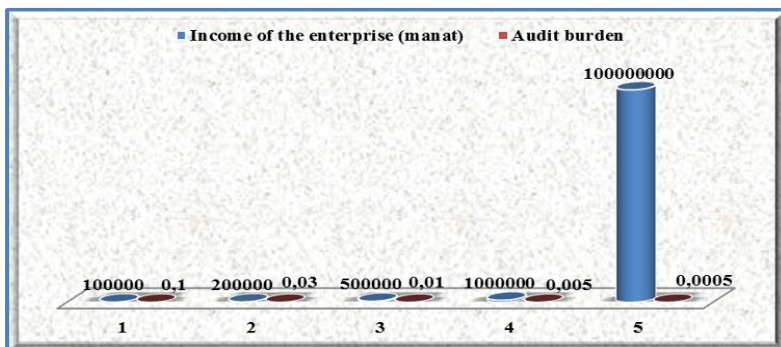


Diagram 3. Differences between audit burden accrued to economic entities by annual income (%)

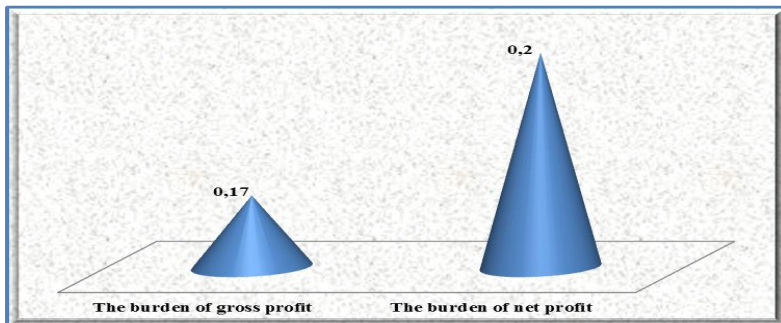


Diagram 4. Audit burden accrued to bank profits (%)

Banks are also considered to be subject to audit by law, and their level of audit is almost 100%. However, in contrast to the international practice in the country, more foreign audit organizations are involved in the audit of banks. The audit burden of banks in the country does not differ in its height. Thus, research over the past decade shows that while the share of the audit burden on the total profit of banks is 0.17%, this burden on their net profit is slightly different - 0.2%.

The situation is similar in other sectors of financial markets, such as insurance and stock markets. Our research has found out that the share of audit burden accrued to insurance and stock markets is lower than in the banking sector. Thus, while the share of audit burden accrued to insurance market is 0.081%, this figure is lower for stock market (0.002%).

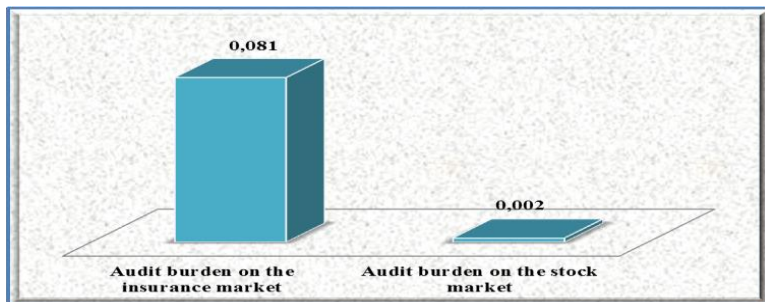


Diagram 5. The weight of audit burden accrued to insurance and stock markets (%)

Existing research has also revealed a number of important aspects. Our research shows that audit burden for all enterprises operating in the country, regardless of sectoral affiliation, was 0.001-0.002% in the last five years. The main part of audits conducted in the country (88%) accrues to the share of foreign audit firms, and this situation has been changed slightly during a long period. The fact that 80-88% of the scope of audit services accrued to the share of foreign audit firms for over 25 years of formation and development of national audit service market shows that the main creator of audit burden in Azerbaijan is foreign audit firms.

11. Economic efficiency of audit in Azerbaijan is not high.

It is reasonable to use the methodological approach we have established to evaluate economic efficiency of audit from a practical point of view. However, it is known that there is a need for development of a broader and more specific database in this case. Surveys and expert assessments conducted jointly with the Chamber of Auditors of the Republic of Azerbaijan facilitated developing such a database. Although initial database of 15 audit firms and 10 independent auditors was used for the survey, later an extensive database that is important for research was established using various methods. Economic efficiency of audit was measured against four key indicators (by audit firms and independent auditors): profit; economic efficiency ratio; level of profitableness; cost per unit of service.

Profit margin in audit firms is characterized by its variability. Thus, there are three main levels of this indicator: minimum limit - 40, 150 and 187 manats; average limit - 4558 and 9219 manats; the best limit - 10000-60000 manats; the highest limit is 267,267 manats. According to research, the profit of 20% of audit firms does not exceed 200 manats, and the profit of 74% of these firms fluctuates between 10,000 and 60,000 manats, with only one firms having a higher profit (267,267 manats).

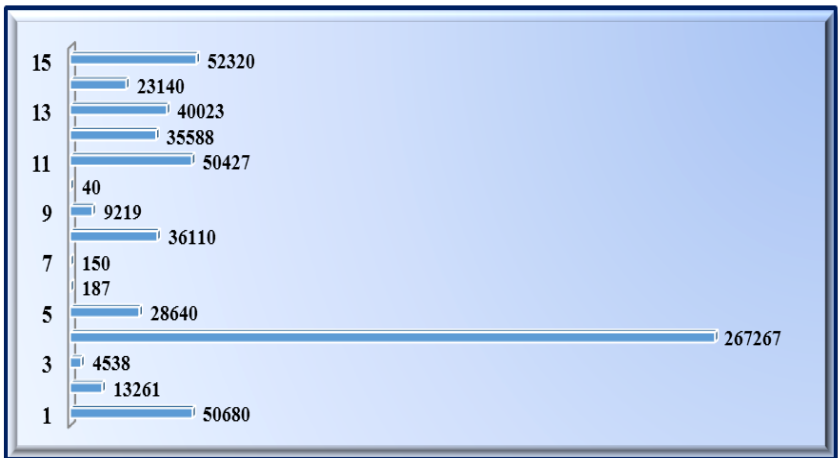


Diagram 6. Profit of audit firms (manat)

Economic efficiency of audit firms cannot be evaluated in the same context. In general, level and ratio of economic efficiency of audit firms can be considered satisfactory as compared with enterprises and business entities operating in industry and a number of service sectors. However, the highest efficiency ratio of audit firms in the field of our research varies from 0.36 to 0.49 (for audit firms 1, 4, 5, 8, 9, 11, 12, 13, 14 and 15). In the 2nd audit firm, this indicator is 0.28, which is considered an average. And just in three audit firms (audit firms 3, 6, 7, 10) this indicator is low, in the range of 0.15, 0.01, 0.02 and 0.1.

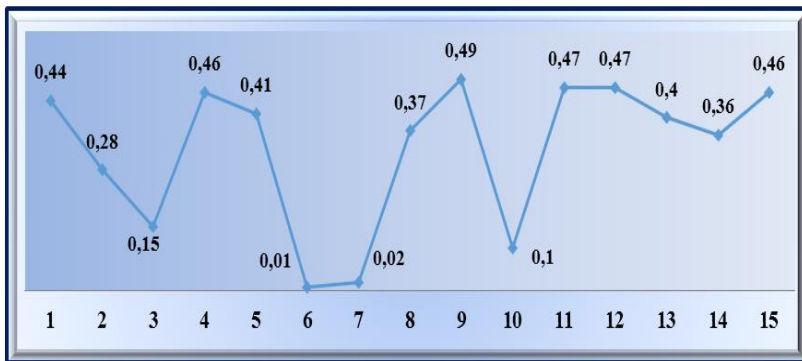


Chart 6. Economic efficiency ratio of audit firms

Level of profitableness of audit firms also varies, ranging from 1% to 49% (Figure 4.4.2). That is, the existence of audit organizations with the lowest, average and highest profitableness levels manifests itself in the service market. It should be noted that the 6th (1%), 7th (2%) and 10th (1%) audit firms have the lowest level of profitableness. Profitableness of the 2nd (28%) and 3rd (15%) audit firms can be evaluated as average, which is close to the existing profitableness of the country's economy sectors (10-28%). However, the profitableness of the remaining 10 audit firms varies from 36% to 49%, which is higher than corresponding indicators of other audit firms.

According to cost per manat of service in audit firms can be considered high for such a service. Thus, unlike other sectors of the economy (industry, agriculture, tourism, financial markets, etc.),

these firms do not have large capital investments, fixed assets and working capital. That is, material and intangible costs that will increase audit expenses are not basically high in Azerbaijan. However, despite all these factors, cost per manat of service in audit firms varies from 0.67 to 0.99 manat (Figure 4.4.3). Our research suggests that audit firms spend an average of 0.83 manat (83 qepiks) to provide 1 manat of services. The current situation is mainly affected by wages and social payments (50%). Of course, the share of services such as taxes, rent, transport, utilities and communications in this cost structure is not small.

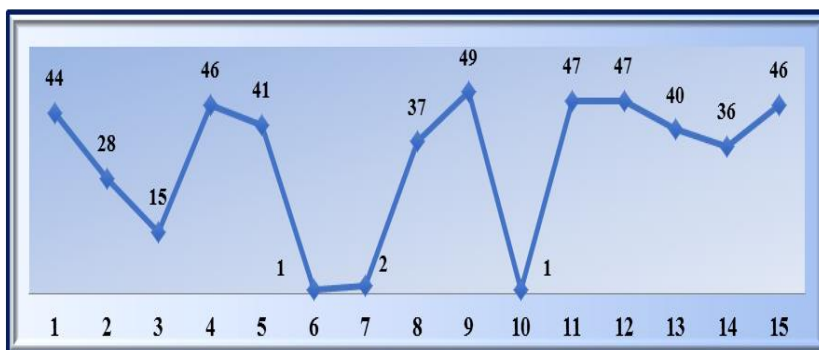


Chart 7. Level of profitability audit firms (%)

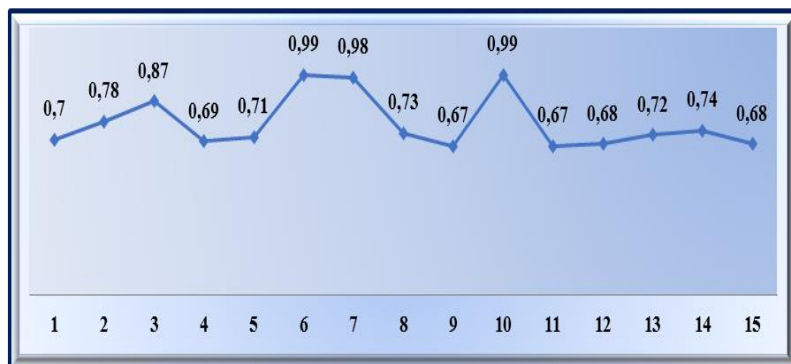


Chart 8. Cost per manat of service in audit firms (manat).

Most indicators of economic efficiency of independent auditors are higher than those of audit firms (Figure 4.4.2). Thus, the lowest

level of profitableness is observed in the 4th (2343 manats) and 8th (8093 manats) independent auditors. Profitability of the 1st (17386 manats), 2nd (23207 manats) and 6th (33929 manats) independent auditors can me evaluated by average level in terms of their nature. 3rd (55411 manats), 5th (68190 manats), 7th (52820 manats), 9th (90527 manats) and 10th (74046 manats) independent auditors have the highest profitability indicator. In general, 50% of independent auditor's profitability is high, 30% is average and 20% is low. For audit firms, this figure is 20% (low), 13% (average) and 67% (high). In general, the lowest average profit for independent auditors is 41 times higher than that for audit firms.

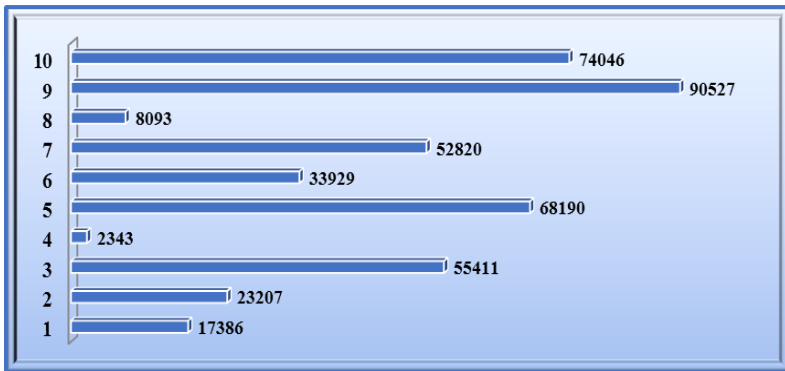


Diagram 7. Profit of independent auditors (manat)

According to our research economic efficiency ratio of independent auditors can be overestimated compared to both audit firms and economic sectors. An interesting aspect is that only two independent auditors (4th - 0.36 and 8th - 0.29) have a low economic efficiency indicator, but this is not a very low figure compared to audit organizations. 1st (0.89), 2nd (0.97), 3rd (1.1), 5th (1.4), 6th (1.2), 7th (0.99), 9th (1,5) and 10th (1,4) independent audit firms have high economic efficiency ratios [13; 14; 245]. Thus, most of the relevant indicators of these auditors are close to 1, and some exceed 1. For comparison, the average economic efficiency of independent auditors is 1.3 times higher than that of audit firms.

The level of profitableness of independent auditors is also high

compared to audit firms and many sectors of economy (Figure 4.4.5). Thus, only two independent auditors - 4th (36%) and 8th (29%) - have a low level of profitableness, but this figure cannot be considered too low as compared with the corresponding indicator for both audit firms and economy. According to research 1st (89%), 2nd (97%), 3rd (110%), 5th (140%), 6th (120%), 7th (99%), 9th (150%) and 10th (140%) independent auditors have a high level of profitableness [13; 14; 245]. In other words, the lowest level of profitableness of 80% of independent auditors, which a subject matter of research, is 89%, and the highest is 150%. Of course, this indicator can be evaluated favourably by independent auditors in general. The average level of profitableness of independent auditors is 5 times higher than the corresponding indicator of audit firms.

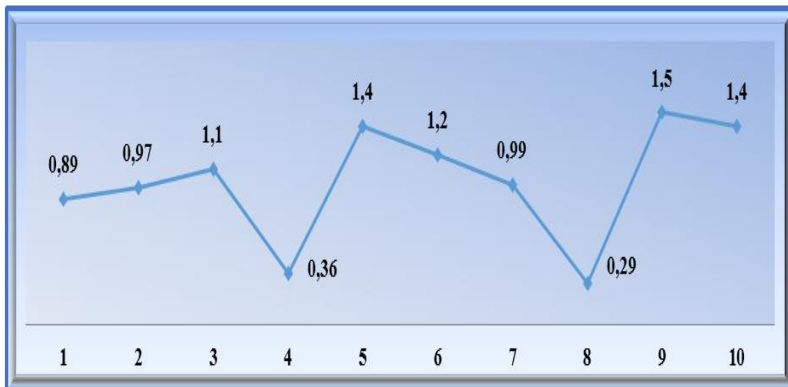


Chart 9. Economic efficiency ratio of independent auditors

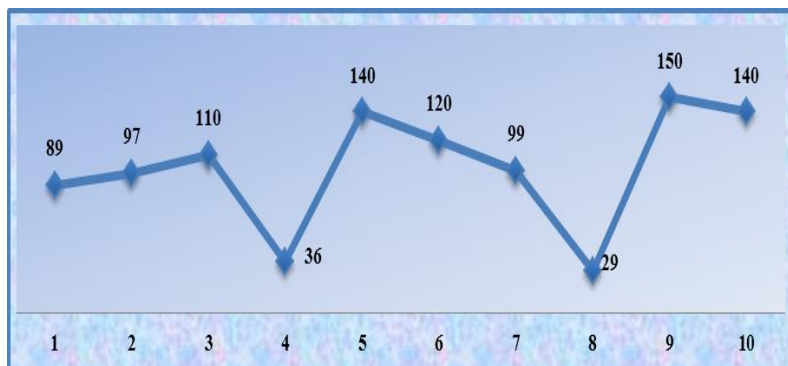


Chart 10. Level of profitableness of independent auditors (%)

Cost per manat of independent auditors' services can also be evaluated favourably. Thus, this indicator is higher than corresponding indicator in both audit firms and in many sectors of economy. It should be noted that only in the 4th (0.74 manat) and 8th (0.78 manat) independent auditor, cost per manat of service is considered high. In other independent auditors, this figure varies between 0.41 manat and 0.52 manat. Average cost per manat of independent auditors service is 1.5 times higher than the corresponding figure of audit organizations.

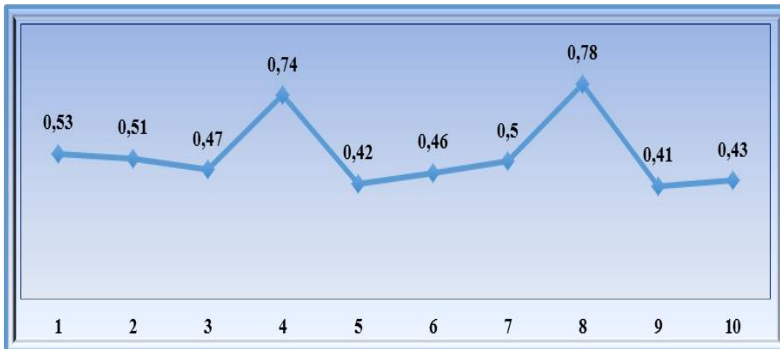


Chart 11. Cost per manat of service of independent auditors (manat)

Research suggests that there is some closeness between independent auditors and audit firms in terms of most costs (rent, transportation, utilities, communications, etc.). The main factor affecting the high economic efficiency of independent auditors is their lack of salaries and social benefits. Thus, when the scope of services is large, independent auditors hire other specialists (individuals) on a contract basis, the amount of payments to them is not high (between 500-1000 manats), and taxes and social payments are paid by those specialists.

Increased economic efficiency of audit is also associated with a reduction in tax crimes. According to official statistics, the fact that country-level tax crime figure within economic crime is still high should be considered a matter of concern. This approach also proves the serious need to increase the efficiency of audit services (compulsory and voluntary). Although the level of tax evasion in economic crimes registered in 2017 decreased by 1.3 times compared

to 2010, as shown in the graph below, their level is still close to 50%.

Evaluation of economic efficiency of audit service should also be related to determining its participation rate in creation of GDP, one of the main country-level macroeconomic indicators. Thus, the share of the service sector in creation of GDP is not insignificant. The share of trade in GDP is 10%, transportation - 6.7%, tourism and catering - 2.4%, information and communication services - 1.8%, financial and insurance activities - 2.6%, services provided to population - 2.7%, while this figure for audit services has not exceeded the level of 0.001% for about 25 years.

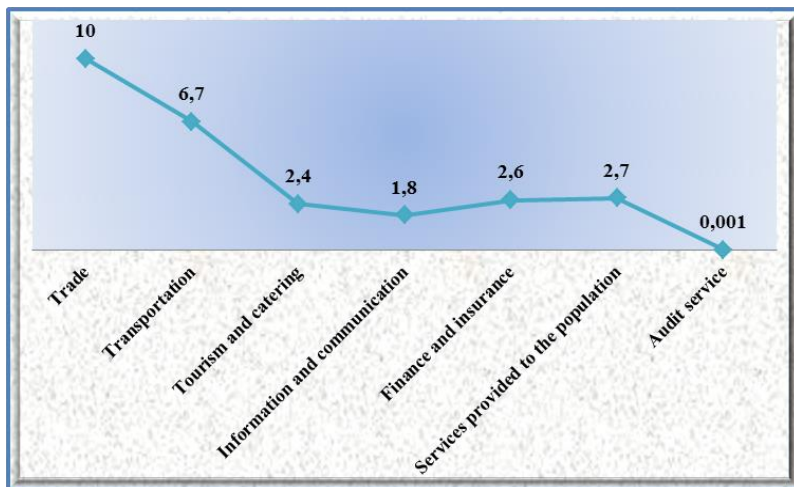


Chart 12. Participation share of service sectors in GDP (%)

Audit service has the lowest share of paid services in the country. Thus, the share of audit services in the structure of paid services is 0.01%, and the audit service is in the last place in the structure of these services.

According to research audit service is distinguished with its weak position in terms of the scope of paid services per capita. Thus, the scope of audit services per capita is 5.9 manats, and it should be noted that the volume of sports and physical education services is 1.4 times higher than such audit services. The knowledge of the population about audit services and their appeals to this field cannot

be assessed favourably. This is because the share of audit services in the income of population during the period of operation of this field is less than 0.001%.

Current situation suggests that audit service is not only the most underdeveloped in the country, but also fails to have a significant role in the country's economic development. As another important economic indicator, evaluation of the participation rate in the audit of capital investments in the country does not provide a favourable opinion. According to our research the share of audit services in fixed capital investments does not exceed 0.002% during the long period of audit development in the country. Such a situation casts a shadow over the objectivity of opinions on the transparency and accuracy of indicators in the existing industry. The low level of coverage of enterprises and business entities with audit services in Azerbaijan can be proved by another fact. Thus, the scope of audit services per private enterprise is 393 manats, while this figure is 434 manats for a small enterprise, 4163 manats for a state entity and 54 manats for an individual entrepreneur. While the audit coverage of a private enterprise operating in Azerbaijan is 0.001%, this figure is 0.001% for a small enterprise, 0.012% for a state enterprise, and 0.0001% for an individual engaged in entrepreneurial activity.

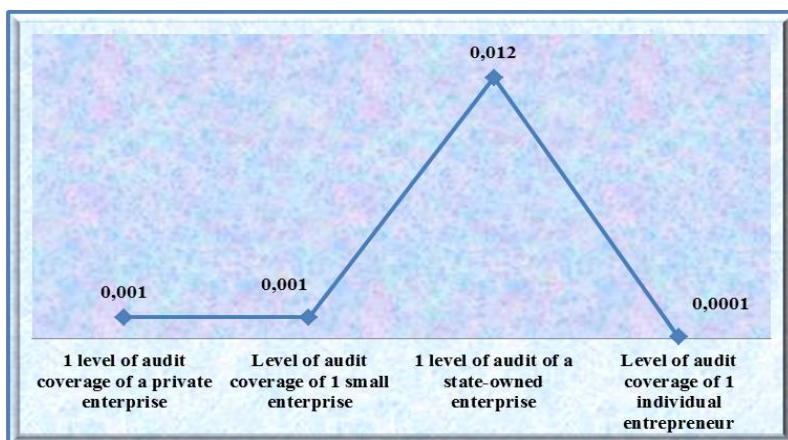


Chart 13. Level of audit coverage of individuals and legal entities (number of audit bodies per entity)

During the period of audit development in the country, the situation in the field of competition in the service market cannot be assessed favourably. Thus, external audit firms (85-90%) mainly have been prevailing in this market for a long time. Indicators of domestic audit firms and independent auditors in the service market are not yet observed with high results. Thus, compared to other markets and services (finance, a number of service markets, etc.), the development of audit services is characterized by very low indicators.

12. Improving the pricing policy in the field of audit will ensure the maintenance of a healthy competitive environment in the service market.

The role of the price factor in the organization and development of audit services market is of particular significance. The following should be considered in the pricing process in the audit services market:

- ⇒ Importance and cost of service provided to the customer entity.
- ⇒ Provision of audit service self-repayment costs.
- ⇒ The price level of the competitive environment, effect of contract value, wages and service fees on the service market.
- ⇒ Relationship between the operations of audit firm (independent auditor) and the services paid.
- ⇒ Relevancy of factors that shape the value of audit service.
- ⇒ Evaluation of the solvency of the customer business entity.

In auditing practice, it should be considered appropriate to use three main methods of valuation in the development of audit and consulting services:

- ⇒ Method of accounting for service costs (use of time and other resources).
- ⇒ Accounting method for assessing the current condition of the consulting service facility.
- ⇒ Combined method.

It is more appropriate to investigate the composition of individual elements of the salary system in the audit market and consulting services in terms of regulating the service market. In the world practice, salary based system in the market of audit and

consulting services is being used. Special attention should be paid to the justified procedure for wage payment system.

It is also advisable to prepare sample tables of budget projects for audit and consulting firms on the payment system. The basis of the registered payment system should be the full scope of work performed and services provided by auditors and specialists of different levels and degrees. Depending on the outcomes of audit and consulting service, application of a payroll system is rarely used. Such a case may be taken on the basis of the auditor involvement (specialist-consultant) in connection with a more advanced and large-scale assessment and clarification of the results of the business entity's activities. Depending on the outcomes of audit-consulting service, when payroll system is applied, the awarded contract should specify the scope of the service, the scope of work, its specific results and the direction of the amount to be paid in connection with these results.

The combined payroll system includes the above-mentioned payment systems, and this payment system is distinguished by its universality and the possibility of application in different conditions. In particular, in the service market, such a payroll system can sometimes be commonly applied to specific types of services. It is reasonable to include services such as legal and economic services, various analyzes, assessments and other such services. Payroll system for specialists involved in the provision of audit and consulting services may be selected specifically depending on the type or range of services.

The contact value paid by the customer business entity for the provision of audit and consulting services cannot be defined completely as auditor's salary. According to research in a healthy competition and market environment, the remuneration of an independent auditor is 30-40% of the total service fee received. In an audit firm or organization acting as a legal entity, the weight of the relevant cost elements often remains unchanged.

13. Improving the relationship between audit entities and audit firms (independent auditors) will lead to organization of the service market in terms of up-to-date requirements.

One of the significant issues for development of the audit service is to improve the relationship between the auditor and the business entity in terms of up-to-date requirements, to determine the criteria that form the choice of auditors of business entities. It is necessary for business entities to give preference to two main aspects in choosing an independent auditor or audit firm:

- ✓ technical proposals;
- ✓ financial proposals.

Technical justification and evaluation of proposals should be measured on a score scale. Thus, a firm can be selected based on a 100-point criterion. In the relevant system, the maximum score of 60 can be used for initial evaluation criterion, which can be taken as a score of outcome of previous high-quality audit conducted by the audit firm in the business entity and opinion on which was provided. The next evaluation criterion can be scored 20 points, which should include the stages of evaluating the audit methodology, developing audit plan and program, conducting audit within a specified period and forming the audit outcome, preparing proposals on the audit outcome. The next evaluation criterion of 20 points, may include the following stages:

- Level of knowledge and proficiency of auditors, specialists and assistants;
- Ability of this audit staff to conduct the audit according to the defined plan-program;
- Diplomas, licenses and certificates of auditors;
- Evaluation level of at least 5 audits conducted by the auditor and the specialist in the relevant field and reference provided about them by these audited entities.

All these 100-point selection criteria shall constitute only technical selection criteria of audit firm and form a set of their technical proposals. The next criterion for selecting an independent auditor or audit firm should be aimed at evaluating financial proposals they offer. The main focus at this stage is the cost of auditing stage, and it is reasonable to evaluate the relevant stage on a 100-point scale. If the lowest and most advantageous value for the enterprise is equal to 100 points in this process, the highest value can

be taken by lowering comparatively to this value.

The tender commission (in joint-stock companies, banks and financial-credit organizations, holdings, etc.) established after the evaluation of technical and financial proposals of audit firm may summarize both proposals and outcomes according to the following factors:

- Evaluation factor of technical proposals;
- Evaluation factor of financial proposals.

The customer may also request the audit organization (independent auditor) to submit any necessary information prior to the audit. The customer may also require the audit firm (independent auditor) to provide the following additional information prior to the audit.

14. Improvement of audit service regulation mechanism should be required in Azerbaijan.

It is reasonable to distinguish the following main directions of audit service regulation:

- form of state-administrative regulation;
- form of market-economic regulation;
- form of socio-ethical regulation.

We believe that the state regulation mechanism in the audit services market should affect the efficient and reasonable development of administrative and economic regulatory functions, and existing legislation should reflect the basis for the joint application of these mechanisms.

Social regulation mechanism is a new field for the Azerbaijani service market. Implementation of social regulation mechanism in different directions - ethical, economic and administrative – is reasonable.

Since public associations of auditors are organized from below, they should be inclined to gain a high reputation and build their activities on a voluntary basis and through mutual cooperation. Such a formation process has closely assisted the Chamber of Auditors in regulating the service market, relieved it from administrative and regulatory problems, and can play a key role in the professional protection of a healthy competitive environment in the service

market. The activity of the Professional Public Union of Auditors, which is considered necessary to establish with the Chamber of Auditors, can have a positive effect on the purposeful and effective application of administrative, economic and ethical regulatory mechanisms required for regulation of the service. On the other hand, improper functioning of these institutions could create a basis for development of an abnormal environment in the service market.

Public associations of auditors can play an important role in strengthening a healthy competitive environment in the audit services market. Thus, by regularly monitoring the service market, public association can help to improve the quality of audits conducted by member organizations and independent auditors, assess their rankings and position in the service market. It is necessary for the auditors to develop and adopt internal regulatory documents and rules of Professional Public Associations in consultation with the members. Such regulatory documents should mainly be aimed at improving the regulation of the members activities, organization of their activities within the framework of sound and civilized legal rules.

Preference for ethical methods in the regulation of the service market stems from the nature of up-to-date market relations. The mechanism of ethical regulation is required for development of business environment in the country in general in accordance with civil requirements and standards, and provides for the implementation of extensive measures in this field. There is a special need for strengthening the culture of entrepreneurship in the measures taken to develop entrepreneurship in the country, taking extensive awareness-raising measures in this direction. It is the application of such high ethical norms and rules in the audit services market, raising awareness of auditor to include latest updates, will definitely play an important role in establishing healthy competition and business environment in the service market.

The role of market-economic regulation mechanism in the regulation of audit service is increasing. Methods of economic regulation should have a greater weight in the development perspective of the service. It is such a development trend that will get

auditors more interested (in the context of economy) in the outcome of audit, as well as their responsibility for service activities (compensation for losses, protection of the image in the service market, etc.) will increase. The operation of the economic mechanism in itself cannot provide the expected outcome, for this purpose, it is necessary to add the following methods of economic regulation in the legal and regulatory documentation:

- coordination of possible application of economic regulatory instruments (fines, specification of property and material liability, etc.) with the contractual terms of the customer;
- creating opportunities for the wide application of economic regulation methods in the service market, taking urgent measures in this area, improving economic legislation for this purpose.

15. Directions for improving the training mechanism for auditors should be identified.

One of the most important issues facing contemporary audit is the process of training highly qualified, professional and competent auditors. The problem of assessing the level of knowledge and proficiency of those who want to become a certified auditor is becoming more relevant in up-to-date conditions. It is especially important to consider the following necessary factors in the training of auditors:

- the purpose of the training process and practice to be organized to be engaged in audit activities;
- knowledge, professional skills and professional qualities required to achieve this goal;
- elements on which the professional auditor's education and professional experience are based

Based on all these factors, it is necessary to determine the purpose and structure of the organization of the process of pre-professional education (before obtaining a license) education and practical training of persons wishing to be engaged in auditing activities. In this important process, the adoption of the following necessary elements of education and practice in the field of auditing as a basis can create a favorable basis for improving the quality of

the training process.

One of the necessary factors for a professional auditor possessing high professional qualities, especially in the field of professional ethics of auditors. The aim of education and practical training in auditing is to train high-level, competent and professional auditors and to ensure a high-profile role that the society sets for auditors. Education and experience acquired by those wishing to become auditors should be organized in such a way as to create a fertile ground for them to improve and expand their professional level in accordance with modern requirements during their professional activity. Those who aspire to become certified auditors must always be distinguished by their abilities to learn and desire to apply what they have learned. It is necessary to use such training methods (programs, etc.) in the pre-license education stage that it creates favorable incentives and opportunities for those who want to acquire a specialty to improve their skills even after obtaining a license.

Improving the process of organizing training courses makes it important to improve training methods along with curricula. Knowledge, skills and professional qualities, which are the main components of success in education and practical work organized in the profession of auditor, must be taught and studied in a wide range. To this end, in order to achieve positive results the following factors should be considered:

- assessment of training process;
- experience requirements.

Vocational education in auditing should be based at least on the level of higher education, the educational process should be linked to the intellectual, social and communication skills in the industry, and opportunities and guidelines should be developed for the acquisition of these skills. Audit training should include the following elements:

- basic knowledge in the field of organization and economics;
- basic knowledge on information technologies;
- basic knowledge of audit and related fields.

Basic knowledge in the field of organization and economics in the specialty of auditing should be mastered based on the study of the

following subjects: economics; statistics and economic analysis; behavioral models in organizations; management of economic operations (management); marketing; international economic relations and operations. The organizational and economic education process should provide future auditors with a broad knowledge of the environment in which they will operate. Basic knowledge of information technology - covers the basic knowledge of information technology required for professional auditors.

Those who want to become a certified and professional auditor and practice after that, have to be able to compile relevant texts, prepare spreadsheets, work with audit, accounting, and analysis programs at a high and professional level. The program of basic knowledge in audit and related fields should be more comprehensive and cover the following theoretical and practical knowledge: audit; accounting (national and international); account management; tax accounting; economic legislation; financial analysis; professional ethics in the field of audit.

Knowledge of auditing and related fields should be comprehensively linked when teaching necessary topics on the auditing profession. In the process of training future auditors in Azerbaijan, it is necessary to consider the development of two important areas: training of auditors based on higher education institutions and their professionalism in training courses organized on the basis of the audit institute (Chamber of Auditors) to ensure their subsequent professional auditing activities, improving as a true experienced auditor by increasing practical work experience. The widespread development of such an effective and improved teaching practice in Azerbaijan, as in modern practice, could have had a positive impact on the training national auditors known for their high prestige and professionalism in society.

16. Modern methods should be used to improve the professionalism of practicing auditors.

Improving knowledge in the field of auditor psychology plays an important role in increasing professional image of the auditor. When preparing auditors, in addition to specialty subjects, it is more expedient to add sections and questions directly related to auditor

psychology to the examination programs. When developing training programs for auditors, it is advisable to add the following sections to these programs, which are closely related to auditor psychology: anticipation of the public interest; objectivity and independence of auditor; organization of professional relations with employees; auditors' relationship with customers; tax relations; actions incompatible with audit activities. Special attention should be paid to in-depth study of national and international auditing and accounting standards during the professional development of auditors. Measures to improve the skills of auditors should be implemented in a planned manner, and existing programs should be constantly improved during the organization of relevant courses.

Professional development can be carried out in two directions: general voluntariness, and, if required, on the basis of the principle of compulsion. The principle of compulsion should define the involvement of auditors in serious and compulsory professional development. Auditors to be involved in these courses can only be identified based on their annual performance

It is reasonable to use the experience of International Audit Institutions when organizing professional development trainings, as well as to involve in this process representatives of foreign audit firms operating in the country. When professional training is provided, the following directions should be given priority:

- General professional development courses.
- Practical development courses.
- Targeted courses.

The role of experienced specialists in teaching theoretical and practical issues is of particular importance in the organization of professional development courses. It is advisable to invite experts from Supreme Audit Institutions of other countries, as well as International Audit Institutions to give lectures at professional development courses. Target-oriented reforms in the political and economic life of the country once again require auditors to increase their knowledge and experience in many areas. Thus, for this purpose, special attention should be paid to the organization and development of audit in economy. It is the development of sectoral

auditing that should be given priority in raising the auditors proficiency level, and if required, professional training courses should be organized in this direction.

17. Application of audit in the information technology system should also be preferred subject to considering up-to-date development trend.

Audit of information technology systems (ITS) should be considered a new field for Azerbaijan. Although this area is related to auditing to some extent, it is often not directly related to the audit of financial and economic processes alone. There may be some similarities between ITS audit responsibilities and traditional audit responsibilities. Existence of different aspects of the audit of ITS is a must.

In the course of their professional activities, auditors are required to perform various mathematical and other calculations, analyze balances on synthetic and analytical accounts, calculate ratios and perform estimates, compile complex tables and diagrams on the accuracy of individual operations and financial indicators. It is in this context that the auditor needs to use more complex programs than simple computer programs. The programming of accounting and auditing in terms of up-to-date requirements has a significant impact on the application of ITS as a new field.

The use of special software in the audit, as a rule, leads to the solution of certain issues. Such issues should include factors such as training of software staff, development of application rules, instructions, establishment of automated network systems for audit and accounting, staff training, formation of material and technical base of ITS. We consider it reasonable to define the objectives of the audit of the forthcoming ITS as follows:

- Assess the organization and use of ITS;
- To determine the appropriateness of the level of staff provision with computer technology;
- Assess the ITS and regulatory structure of this area in relation to the level of achievement of the tasks set for business development;
- To determine the ability of ITS to use a wide range of internal

and external sources of information.

Development and improvement of knowledge and practical-professional level in conducting of ITS audit in two directions is due to a special need:

- The first direction should combine the level of knowledge and professionalism in economics, auditing, financial and accounting;
- The second direction should stipulate technical knowledge, wealth of knowledge and experience in the field of information and communication.

ITS audit can be performed by internal and external audit institutions. Thus, when the audit of ITS is carried out by internal audit body, internal audit structure, internal audit system is both its developer and evaluator of the operation process. The main task of ITS audit should be more focused on improving corporate activities, expanding business, increasing the productivity of staff.

One of the most important steps in the audit of the ITS operations and its structural unit in the enterprise is to survey the employees on the operations of the system, and its current state. As a result of such a survey, the required information on the operation of the system, the problems encountered and their causes could be obtained. It should also be called a kind of audit (ITS audit) survey. At the same time, the auditor can gain the opportunity to achieve a more reasonable auditing, the correct preparation of the audit program by collecting the required information on the operations of information technology unit, the system organization. The role of technological audit in ITS audit is a particularly important direction. Analysis and evaluation of more technical processes should be preferred in such audit. It is necessary to include the following directions and aspects in the technological audit of ITS:

- ⇒ analysis of technical operation system and organization of servers;
- ⇒ monitoring the security level of the network;
- ⇒ determining the efficiency and coordination capabilities of the system, and studying and evaluating other issues in this direction.

Final results of ITS audit should be reflected in the auditor's final report or opinion. Training should be provided to the personnel in ITS system, as well as to auditors who will operate on these systems.

The main scientific articles and monographs published on the dissertation work are as follows.

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