

## THE MODERN TRENDS OF THE AUDITING MARKET FORMATION IN THE REPUBLIC OF ARMENIA

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During Soviet times the audit, as an independent type of supervision or control, did not exist in a whole, though, certain elements of such activity have always existed. They existed separately from each other and were not presented systematically or together, which is currently very important integral part of market infrastructure.

Transition process to a market economy required a totally new accounting system, the fundamentals of which were established by Law on Accounting adopted by National Assembly on December 26, 2002, as well as by the Government decision N 740 on accounting system reforms, dated November 26, 1998. During the years 1998-2003 the following stages of the above mentioned decision 33 accounting standards of the Republic of Armenia were developed based on the International Accounting Standards and a number of legal acts were adopted.

Another step forward took place in 2008: the amendment of the Law on Accounting pointed that the International Financial Reporting Standards must be applied directly, rather than the accounting standards of the Republic of Armenia based on International accounting standards. During the year 2009-10 the new financial reporting standards were translated and adopted. The standards should be used by banks starting from January 1 2009. Credit institutions, payment organizations, issuers of securities in the market, all other investment companies and financial institutions were required to use new financial reporting standards starting from January 1, 2010. All other organizations, except those with less than 100 million turnovers, must apply financial reporting standards starting January 1, 2011<sup>1</sup>.

In recent years, the growth of the audit activity in the Republic of Armenia was mainly due to the banking system and, in general, economic development, as well as the result of special attention of RA government. The rapid development gives a good base for anticipation of significant changes in the Armenian market of the audit and consulting services. The pace of economic development increases demand for auditing and consulting services by business entities.

The growth in demand for auditing services was also a result of investments growth, implemented by private investors, international financial institutions and banking institutions. Modern banking system development trends give rise to great interest among foreign investors, who tend to invest money in banking system in case of auditors' positive conclusion. According to various estimations nowadays the foreign capital in the banking system is about 80 percent of total capital.

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<sup>1</sup> A. Harutyunyan, Transition to IFRS, practical issues, Association of Accountants and Auditors of Armenia, № 1, 2011, p. 7.

Since the independence of Armenia a number of legal acts, regulations and rules for financial statement transparency, effectiveness and legitimacy of rules for entities performing functions in private and public sectors of economy were adopted.

The significant step in auditing of private sector was done on December 26, 2002 when National Assembly of RA adopted the Law on Auditing. According to the law the auditing is the audit of financial statements and/or other information included in the documents containing financial statements and/or provision of audit-related services (audit review, agreed-upon procedures, compilation (collection of information)). Audit review of financial statements is the implementation of procedures enabling the auditor to detect the existence of facts, if any, which may witness those financial statements, in all essential terms, are not prepared in accordance with the legislation of the Republic of Armenia<sup>2</sup>. Audit and audit review shall enable the audit entity to provide a level of assurance on the reliability of information, whereas agreed-upon procedures and compilation do not envisage such assurance. Audit is an independent verification of information contained in the financial statements of an audited entity, resulting in an audit conclusion. Agreed-upon procedures are procedures of auditing nature, which the person carrying out the procedure, the legal entity (institution or individual entrepreneur) and the relevant third party or parties agree upon, and as a result of which - based on the report submitted by the person carrying out the procedures - the users may draw their conclusions. The objective of the audit of financial statements is to enable the auditor to express an opinion on whether the financial statements, in all essential terms, are prepared in accordance with the legislation of the Republic of Armenia. It was stated in the law that auditing standards are regulatory legal acts complying with the international auditing standards, regulating the methods of and the procedure for carrying out audit and providing audit-related services. Auditing standards, as well as rules of conduct for an auditor shall be defined by the Government of the Republic of Armenia on the basis of international auditing standards and code of ethics.

The further adoption of international auditing standards formed and introduced modern auditing system in the Republic of Armenia. The RA Ministry of Finance was stated by the RA Government an authorized body responsible for the implementation of law on auditing in the Republic of Armenia<sup>3</sup>.

Many authors mentioned that the system of modern auditing of financial statements of RA was developed during recent 20 years though the law was adopted only in the year 2002. The reforms in the field of auditing are interconnected with the reforms in accounting systems. They must create a system that should provide interested users (investors, the management staff, partners, banks, government agencies, etc.) unbiased information on financial condition of enterprises. The development of auditing can assist in the development of the whole economy.

It should be stated that the introduction of the audit system of private sector in the Republic of Armenia has helped to overcome the difficult stage of its creation and is still developing currently.

Nowadays the companies involved in auditing services also provide other services to such clients as:

- Business consultation,
- Legal consultation,
- Accounting.

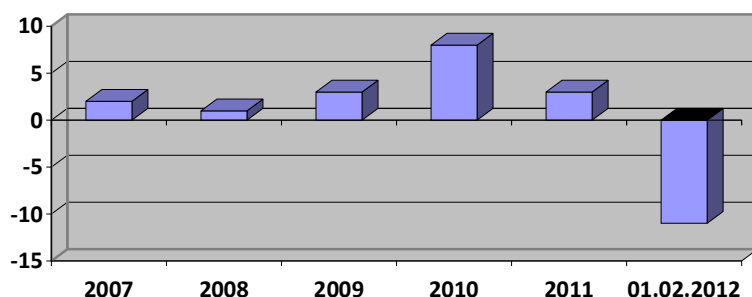
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<sup>2</sup> The Law on Auditing of RA, 2002.

<sup>3</sup> The decision of RA Government n 318, dated 31.03.2001 on authorized body according to the Law on Auditing of RA.

At the beginning of the year 2012 the number of licensed audit companies in the Republic of Armenia was 32<sup>4</sup>.

**Figure 1: The growth dynamics of the number of audit organizations and individual auditors , 2006-01.02.2012**



In Figure 1, it becomes clear that audit companies registered a significant growth in the year 2010, due to the increased demand for auditing services.

The significant reduction in the year 2012 is the result of amendments to the Law for Auditing. According to those amendments the audit company should have minimum number of qualified auditors to keep the right for functioning in the field of audit. .

The audit market of RA is divided into the following poles: audit, accounting, business and legal consulting. The companies, which have a high competitive market position, offer a set of all services. The primary services that are provided by the audit companies are accounting and auditing. At the same time, customers who apply for auditing and accounting services may also order other services, such as business consultation, which is a much demanded service. There are 32 auditing companies in RA at the beginning of the year 2012.

At present there are several major international auditing companies in the auditing market of the Republic of Armenia. The companies are Grant Thornton, KPMG Armenia, PriceWaterhouseCoopers Armenia and Ernst & Young. They are usually called “Big Four” companies. The main competitors of the local audit organizations are KPMG Armenia, Grant Thornton and PriceWaterhouseCoopers Armenia companies.

Out of 1000 large taxpayers presented by tax authorities on 28.02.2011, only Grant Thornton and KPMG Armenia companies were included into the list and accordingly numbered 236 and 399<sup>5</sup>.

**Table 1: The position of international audit companies in the list of 1000 large taxpayers of the Republic of Armenia**

No	Company	The amount of paid taxes /thousand drams/
236	Grant Thornton	170 808
399	KPMG Armenia	95 861

<sup>4</sup> The official internet web page of Ministry of Finance of RA, [www.minfin.am](http://www.minfin.am)

<sup>5</sup> The official internet page of Tax Service of RA, [www.taxservice.am](http://www.taxservice.am)

The number of employees in companies providing consulting services is surprisingly low. The largest number of employees has Grant Thornton. According to the information received from the audit organization their customers are mainly large organizations and open joint-stock companies.

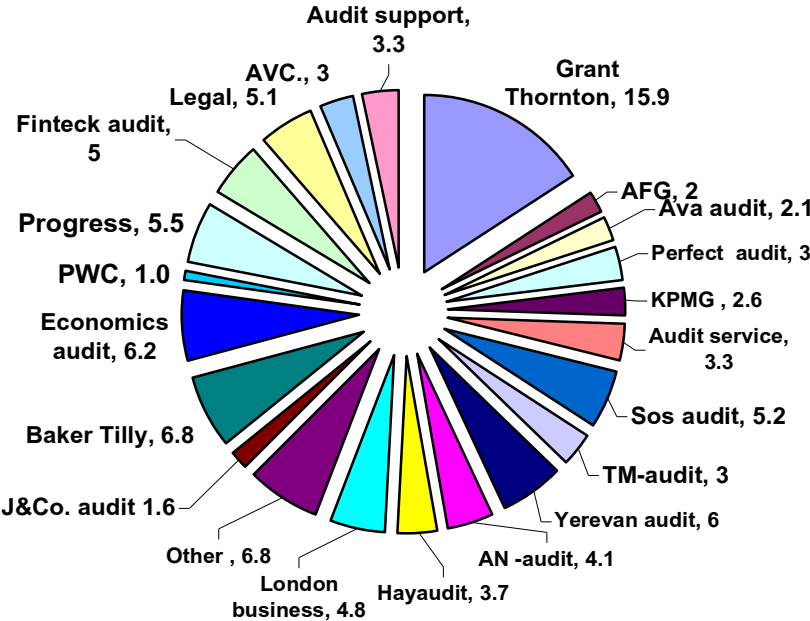
Prior to the year 2010 a huge number of very large companies remained out of the audit field because of their legal status. Most of them were limited liabilities companies and closed joint-stock companies. In the year 2009 the Law on Accounting was amended and according to that amendment starting from the year 2010 the financial statement of large organizations became subject to mandatory audit and must be published after audit.

According to the RA Tax legislation large organization is the organization the annual activity turnover of which exceeds one billion drams or book value of assets exceeds one billion drams. This organization's financial statements may be published in press, on the Internet or in the form of booklets.

Annual financial statements may be published together with auditors' opinion only after being audited. In the year 2011 about 1000 organizations should be audited. Particularly, 617 companies exceed one billion dram book value of assets, and 314 of them did not exceed 1 billion annual turnover revenue<sup>6</sup>.

The published data of auditing companies in the year 2011 for audited companies give us opportunity to find out the share of each in auditing market of Republic of Armenia (Figure 2).

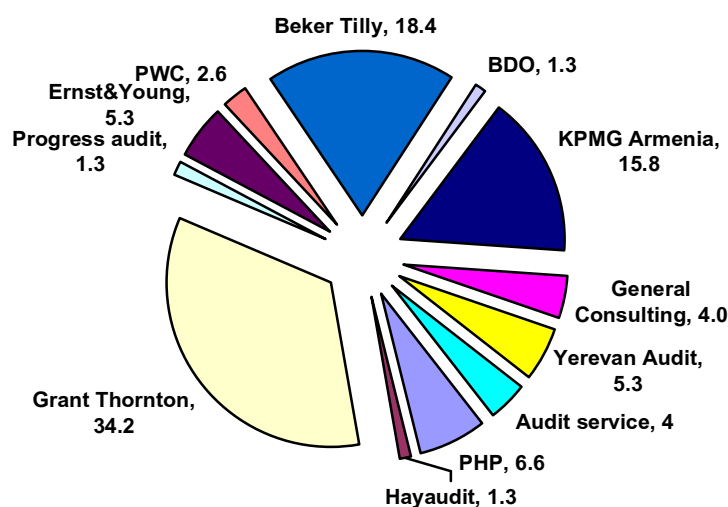
**Figure 2: The share of auditing companies in the audit market of RA by the number of audited organizations(%)**



<sup>6</sup> A. Hovhannisyan, E. Vasilyan, Mandatory audit does not give the desired result, www.banks.am, 2011.

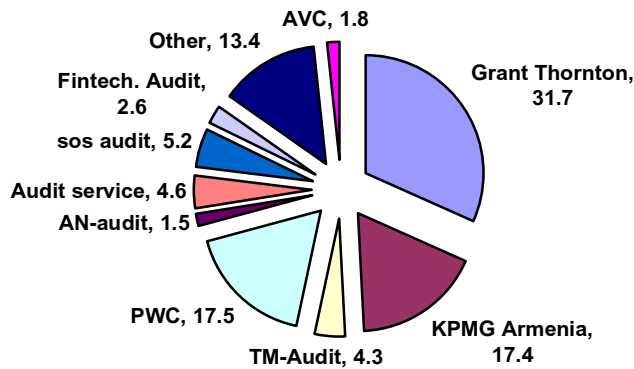
It is obvious that the leader in the RA auditing market is Grant Thornton that served nearly 2.5 times more clients than the other organizations. The rest of the auditing companies can be divided into two groups. Some of these companies (about 21) create a competitive market, each occupying from 1.5 to 7% of market clients. Other auditing organizations serve up to 1.5% of organizations that are subject to audit. But at the same time, the interesting fact is that only three auditing companies, such as Grant Thornton, KPMG Armenia and Baker Tilly Armenia, are mainly involved in financial sector audit, which is financial guarantor of economic stability. We should note that the market share of the above mentioned three companies for financial sector audit for the year 2011 was about 70%.

**Figure 3: The share of auditing companies in the audit market of RA by the number of audited financial organizations (%)**



In general, only 12 auditing companies out of 32 were involved in the auditing of financial sector organizations of the Republic of Armenia. It can be assumed that on the one hand the quality of auditing services is higher in the above mentioned auditing companies than in others and therefore they are more attractive for financial sector organizations. But on the other hand the 3 audit companies have become dominant in the field of financial sector auditing, which means we deal with a dangerous market trend of establishing dominant position in the financial sector auditing. The analyses of audit market services shows that mainly the companies involved in financial sector auditing have the opportunity to receive a large amount of revenue. But at the same time we should note that in the year 2012 the unexpected growth of revenue registered PWC which was received from non financial sector. According to the observation of the published financial statements of the RA auditing companies we can distinguish several organizations that in the year 2011 were able to obtain large revenue from the services provided.

**Figure 4: The share of auditing companies in the audit market of RA by the amount of received revenue (%)**



The above mentioned organizations are the main participants in the audit market, according to revenue size standard. Three of the mentioned companies – Grant Thornton, KPMG-Armenia and PWC owned 67% of the income received in the audit system. The big trio was formed in the RA audit market that was obviously strengthening its position in the market. In the figure above 6 more companies having their own stable share in the audit market in recent years are distinguished though their income is much less than the income of the big trio.

**Table 2: First 10 auditing companies of RA by the amount of received revenue in the year 2010-2011.**

2011			2010		
No	Company	Revenue (Thous. drams)	No	Company	Revenue (Thous. drams)
1	Grant Thornton	1329407	1	Grant Thornton	1284298
2	PWC	732552	2	KPMG	876636
3	KPMG	730164	3	TM audit	206671
4	Sos audit	217414	4	Sos audit	171621
5	Audit service	192333	5	PWC	164494
6	TM audit	181582	6	BDO Armenia	93916
7	Fintech audit	110520	7	N-audit	83379
8	AN audit	84830	8	AVC	77743
9	AVC	75625	9	AN audit	69048
10	Hayaudit	64773	10	Hayaudit	64883

It is clear that the main participants of the audit market remained the same during the years 2010 and 2011. Only PWC increased its annual revenue for almost 5 times during the year 2011. Taking into account the fact that PWC did not have significant increase in client number, we can assume that maybe auditing price was increased.

It is obvious that in future the number of organizations subject to auditing will increase along with economic growth. We also believe that auditing will increase the transparency of large companies' financial results.

**ՀԱՅԿ ՄՆԱՑԱԿԱԼՅԱՆ – ՀՀ աուդիտորական ծառայությունների շուկայի ձևավորման ժամանակակից միտումները** – Վերջին տարիներին ՀՀ աուդիտորական գործունեության ոլորտում աշխուժության աճը հիմնականում պայմանավորված է բանկային համակարգի և, ընդհանուր առմամբ, տնտեսության զարգացման տեմպերով, ինչպես նաև կառավարության կողմից այդ ոլորտին հատուկ ուշադրություն դարձնելու շնորհիվ: Ոլորտի զարգացման տեմպերը հիմք են տալիս կանխատեսելու զգալի փոփոխություններ աուդիտի և խորհրդատվական ծառայությունների հայաստանյան շուկայում: Սույն հոդվածում վերլուծվել է ՀՀ աուդիտորական շուկայի ներկա վիճակը, աուդիտորական կազմակերպությունների դիրքը շուկայում՝ ըստ տարբեր հայտանիշների, վեր են հանվել զարգացման միտումներն ու հնարավոր խոչընդոտները:

**АЙК МНАЦАКАНЯН – Современные тенденции формирования рынка аудиторских услуг в РА.** – В последние годы рынок в области аудита развивался главным образом за счёт роста банковской системы, национальной экономики и особого внимания правительства к данной сфере. Темпы развития сектора дают основание прогнозировать значительные изменения в сфере аудиторских и консалтинговых услуг. В статье проанализирована нынешняя ситуация на рынке аудита и тенденции его развития, а также препятствия, могущие возникнуть в Армении на этом пути.