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**“PERMISSION FOR  
DEFENCE”**

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## INTRODUCTION

**Actuality of the theme of the final qualifying work.** Providing economic development of business entities is considered one of the factors which support to advance the economy of the Republic of Uzbekistan. The economy of Uzbekistan will be stable if the development of private sector is guaranteed. This sector's characteristic features are represented by that it is rapidly shifting through market fluctuations and able for adaptations, availing employment by creating new job vacancies and generating income sources, forming a middle class of proprietors.

The transparency of financial statements and quality assurance of their audit are crucial because these assist to increase the amount of investments to our economy. To sustain growth, promote further economic development, and decrease the cost of capital, however, the country's accounting and auditing need to be strengthened to produce high-quality financial information.

Today, our country has been achieving a lot of progress in all branches of economy. The government pays a great attention to promote business entities which are exporting their products to foreign countries and training with entrepreneurship.

President of Uzbekistan Shavkat Mirziyoyev signed a decree "On Uzbekistan's Development Strategy ". The document has approved Uzbekistan's Five-Area Development Strategy for 2017-2021. In the third section of the decree is called as continuing of institutional and structural reforms aimed at reducing the state's presence in the economy, further strengthening the protection of rights and priority role for private property, encouraging the development of small business and private entrepreneurship. "649 investment projects, total sum of projects equal to 40 billion USD are planned to set up from 2017 to 2021. Therefore, it is essential improving the investment climate, active attraction to the economy and provinces of foreign investment, especially foreign direct investment and introducing modern international standards and corporate governance, international standards and corporate governance, strengthening the role of shareholders in the strategic

management of enterprises.”<sup>1</sup>As the results of reforms there are establishing a lot of firms, enterprises, and joint-stock companies. However, increasing of enterprises number will occur more competition that it requires analyzing deeply their accounting system and internal control of business entities, auditing as well.

The assessment focuses on the strengths and weaknesses of the accounting and auditing environment that influence the quality of financial reporting in the Republic of Uzbekistan, and includes a review of both statutory requirements and actual practice and draws on international experience and good practice in the field of accounting and auditing regulation. This is not the case development of business entities and their implementation in foreign economic activity is also directly related to the issue of improvement. It is necessary to learn deeply to implementing accounting system of business entities and auditing; hence theoretically based proposals and practical recommendations should be developed in terms of accounting and auditing of business entities. Based on the foregoing opinions, accounting and auditing in business entities and the process of further improvement of them demonstrates the importance of Final qualifying work.

**The subject** of research is accounting and auditing of business entities and analyzing their economic activity how they implement their business effectively.

**The object** of this final qualifying work is to study the order of accounting and auditing of business entities, as well as to identify ways to improve the accounting and auditing on the example of a particular company – «VENKON GROUP» LLC.

**The purpose and tasks of final qualifying work is**, in order to increase effectiveness of business entities, giving theoretically based recommendations in terms of accounting and auditing of business entities and, ultimately, enhancing information base, upgrading reliability and efficiency during the management of business entities. To achieve this goal, we have identified the following tasks:

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<sup>1</sup> O'zbekiston Respublikasi Prezidentining "O'zbekiston Respublikasini yanada rivojlantirish bo'yicha Harakatlar strategiyasi to'g'risida" gi qarori №4947, 7 Fevral 2017y.

- demonstrating the importance and necessity of business entities in the conditions of diversification of the economy;
- clarify the methodological basics of accounting and auditing of business entities;
- the procedures of forming accounting policy in the business entities;
- covering the issues of implementing of accounting system of business entities;
- illumination of the orders of preparing financial reports in business entities and auditing financial reports of them;
- demonstrating the planning process of auditing in business entities;
- presenting the procedures in terms of analytical actions in auditing of business entities;
- learning internal control system of business entities and assessing the quality of internal audit in business entities;
- analyzing the relationship between auditing and accounting of business entities;
- consider the methodology of analysis and analysis over accounting system and auditing.

The object of the work is «VENKON GROUP » LLC, the data is based on appendixes. In the process of completing the final qualifying work, to solve the tasks, will be used various methods and techniques of economic research: the study, collection, processing of scientific and educational literature on accounting and auditing.

**Theoretical and practical value of the final qualifying work.** This topic is not new, as it is studied and presented in scientific papers and in the economic literature of the economists. The scientific and practical significance of the study is that the solutions identified in this work problems, as well as the proposals developed by us can be used in specific economic conditions by specialists in the field of accounting and analysis, in specific enterprises; used in the educational process, in the study of this topic. At this stage of economic development, the importance of the

solvency of the enterprise, through which the formation of the optimal structure and increase of the production potential of the enterprise, as well as the financing of economic activities, is sharply increased. The financial well-being of the enterprises and the results of their activities depend on how accounting system and internal control works, trustworthiness of financial reports and auditing is organized.

The methodological and theoretical basis of the work is the works of researchers in the field of Economics, accounting and auditing, regulatory and methodological materials on this issue.

The following legal and regulatory framework of the Republic of Uzbekistan is used to consider this topic:

- Law of the Republic of Uzbekistan "On accounting" (13.04.2016, with subsequent amendments and additions);
- Law of the Republic of Uzbekistan "About enterprises" (with subsequent amendments and additions)
- Civil code of the Republic of Uzbekistan part 1-2;
- regulations on the composition of the costs of production and sale of products (works, services) and on the procedure for the formation of financial results (05.02.1999);
- the plan of accounts of accounting of financial and economic activity of economic activity of economic entities and the instruction on its application. NAS No. 21 and many other legal documents;
- collection of national accounting standards of the Republic of Uzbekistan; also accounting policy, primary and summary documentation of «VENKON GROUP» LLC. The latest economic literature and media information were used in the consideration of the topic.

This report describes the results of an assessment of the accounting and auditing requirements and practices of the Republic of Uzbekistan's enterprise and financial sectors. As well, further reform of the audit sector should include considering a more efficient approach to standard setting, strengthening the audit oversight system in place, and implementing a quality assurance.

The introduction of recommendations belong to accounting and auditing in business entities can be used to increase their effectiveness, and improve the quality of the auditors' work, reduce the risk they allows. The theoretical information provided ought to be used at the subject "Financial Accounting" and "Audit" in the process of studying and in the creation of new theses.

**The volume and structure of the final qualifying work.** Final qualifying work consists of: introduction, three chapters, conclusions and proposals, as well as a list of references. The paper presents tables, diagrams and drawings, from the latest scientific literature and the author's development on the basis of the practical material of the study.

## **CHAPTER 1. THEORETICAL BASICS OF ACCOUNTING AND AUDIT IN BUSINESS ENTITIES**

## **1.1. Functions, characteristics, essence and related legal documents of accounting**

Accounting is a system of representing information based on documents of enterprises regardless any form of property, providing comprehensively, continuously as well. Accounting – an ordered system of collecting, recording and summarizing information about this property in monetary terms, the obligations of the organization and their movement through solid, continuous and documentary account of all economic operations. Accounting is a system meant for measuring business activities, processing of information into reports and making the findings available to decision-makers. The documents, which communicate these findings about the performance of an organization in monetary terms, are called financial statements. Usually, accounting is understood as the Language of Business. However, a business may have a lot of aspects which may not be of financial nature. As such, a better way to understand accounting could be to call it The Language of Financial Decisions. The better the understanding of the language, the better is the management of financial aspects of living. Many aspects of our lives are based on accounting, personal financial planning, investments, income tax, loans, etc. We have different roles to perform in life-the role of a student, of a family head, of a manager, of an investor, etc. The knowledge of accounting is an added advantage in performing different roles. However, we shall limit our scope of discussion to a business organization and the various financial aspects of such an organization. When we focus our thoughts on a business organization, many questions (is our business profitable, should a new product line be introduced, are the sales sufficient, etc.) strike our mind. To answer questions of such nature, we need to have information generated through the accounting process. The people who take policy decisions and frame business plans use such information. This report describes the results of an assessment of the accounting, financial reporting and auditing requirements and practices of the Republic of Uzbekistan's enterprise and financial sectors. Despite what some people think, accounting is not a branch of mathematics, although the man credited with writing the first book on the subject, Father Luca



Pacioli (1445–1517), was a mathematician. He wrote on the topic ‘in order that the subjects of the most gracious Duke of Urbino [his sponsor or benefactor] may have complete instructions in the conduct of business, and to ‘give the trader without delay information as to his assets and liabilities’. (‘Assets’ are things that you own; ‘liabilities’ are things that you owe.)What Pacioli wrote is contained in a mathematics textbook (*Summa de arithmetica, geometria, proportioniet proportionalita* – Everything about Arithmetic, Geometry and Proportion) which was first published in Italy in 1494. It has been translated into many languages, including English. However, when people talk about accounting, they are normally referring to accounting as used by businesses and other organizations. The owners cannot remember all the details so they have to keep records of it. Organizations not only record cash received and paid out. They will also record goods bought and sold, items bought to use rather than to sell, and so on. This part of accounting is usually called the recording of data. One obvious fact is that without properly recorded accounting data a business would have many difficulties providing the information these various users (often referred to as ‘stakeholders’) require. However, the information produced by accounting needs to be a compromise – so many different groups of stakeholders make it impossible to produce accounting information at a reasonable cost in a form that suits them all. As a result, accounting focuses on producing information for owners. The other stakeholder groups often find the accounting information provided fails to tell them what they really want to know. However, if organizations made the effort to satisfy the information needs of all stakeholders, accounting would be a very costly exercise indeed! Each account should be shown on a separate page in the accounting books. The double entry system divides each page into two halves. The left-hand side of each page is called the debit side, while the right-hand side is called the credit side. The main purpose of accounting is to provide account information of its own and third-party users in accordance with the law, or information needs. Information provided by private users must be timely, accurate and sufficient for making decisions on the effective management of the enterprise, its analysis of the activities for planning, monitoring,

and others. The subject of accounting is a means of organizing, their condition and use, as well as the sources of their education.

The main problem solved in the process of accounting, include the following:

- formation of complete and accurate information on the activities of the organization and its property status;
- providing users with information to monitor compliance with the law in carrying out economic operations and their expediency, availability and movement of property and obligations, use of material, labor and financial resources in accordance with approved standards, regulations and estimates;
- prevention of negative results of operations and identify internal reserves to maintain its financial stability.

Accounting contains two components:

1. Financial Accounting – Accounting, aimed at the formation of the accounting information for the user.
2. Management Accounting – Accounting, which establishes the organization for its own internal purposes, to generate accounting information required in management decisions.

As mentioned earlier, financial accounting deals with the preparation of financial statements for the basic purpose of providing information to various interested groups like creditors, banks, shareholders, financial institutions, government, consumers, etc. Financial statements, i.e. the income statement and the balance sheet indicate the way in which the activities of the business have been conducted during a given period of time.

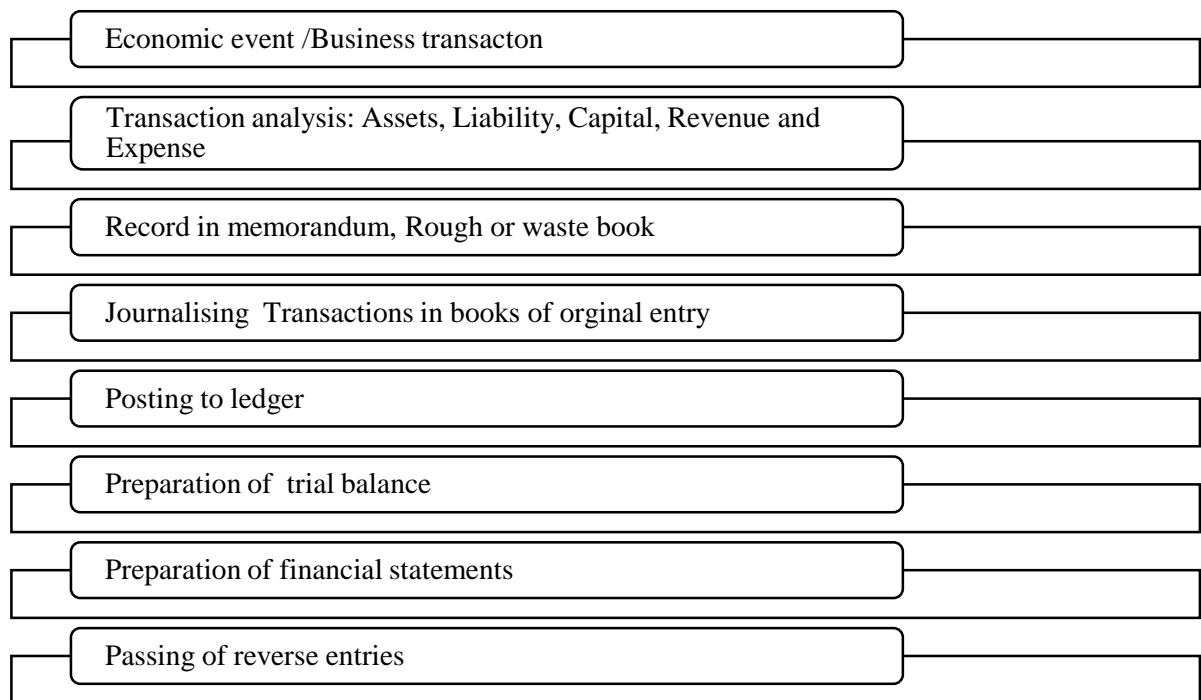
Management accounting is ‘tailor-made’ accounting. It facilitates the management by providing accounting information in such a way so that it is conducive for policy making and running the day-to-day operations of the business. Its basic purpose is to communicate the facts according to the specific needs of decision-makers by presenting the information in a systematic and meaningful manner.

Accounting (financial) statements of introducing a system of indicators that characterize the property and financial position of the company on a certain date and its financial performance over a certain period, methodologically and organizationally is an integral part of the entire accounting system. It performs the final stage of registration process that determines the organic unity formed in its performance with primary documents and accounting records.

An accountant is a person who does the basic job of maintaining accounts as he is the man who is engaged in book keeping. Since the managers would always want to know the financial performance of the business. An accountant prepares profit and loss account which reports the profits/losses of the business during the accounting period, Balance Sheet, which is a statement of assets and liabilities of the business at a point of time, is also proposed by all accountants. Since both statements are called financial statements, the person who prepares them is called a financial accountant.

Financial statements are compilation of financial data, collected and classified in a systematic manner according to the accounting principles, to assess the financial position of an enterprise as regards to its profitability, operational efficiency, long and short – term solvency and growth potential. Financial statements are basic and formal means through which management of an enterprise make public communication of financial information along with select quantitative details. They are structured financial representation of the financial position, performance and cash flows of an enterprise. Many users are rely on the general purpose financial statements as the major source of financial information and therefore, financial statements should be prepared and presented in accordance with their requirement. Of course, some of the users may have the power to obtain, information in addition to that contained in the financial statements. That does not undermine the dependence of the general users on the information contents of the financial statements. Financial statements provide information about the financial position, performance and cash flows of an enterprise that is useful to wide range of users in making economic decisions. It means to show the results of the stewardship of

management, or accountability of management, or the accountability of management for the resources entrusted to it. In fact, the term ‘double entry’ book keeping has come into vogue and in this system the total amount debited always equals the total amount credited. It follows from ‘dual aspect concept’ that at any point of time owners’ equity and liabilities for any accounting entity will be equal to assets by that entity. This idea is fundamental to accounting and could be expressed as the following equalities: the sum of liabilities and owners equity equals to assets.



### **Drawing 1. Accounting process<sup>2</sup>**

An accounting process is a complete sequence of accounting procedures which are repeated in the same order during each accounting period. Accounting process involves six steps or stages identification of transactions, recording the transaction, classifying, summarizing, analysis and interpretation and reporting of financial information. In accounting, all the transactions are recorded on the basis of evidence/document which are mainly three– (1) payment voucher; (2) receipt voucher; and (3) transfer voucher. Recording the transaction is the first step in the

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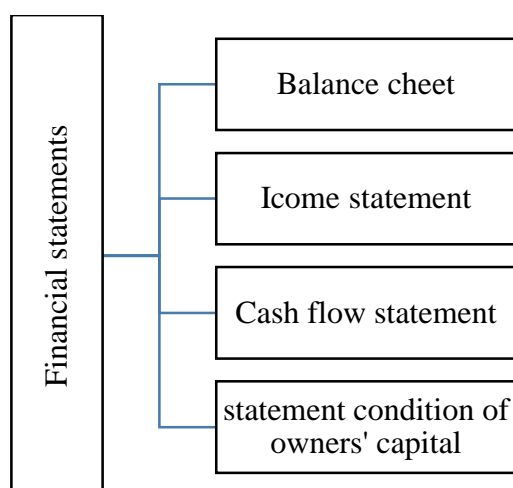
<sup>2</sup> Dr. Chandra Shekhar. Introduction to accounting. Handbook - Kalyani Publishers, New Delhi; 2010 - 44p.

process of accounting which is performed in the book called 'Journal'. Journal is a primary book for recording the day to day transactions in a chronological order, i.e., the order in which they occur. The process of recording journal entries in the journal is called journalizing. For the journalizing, all the accounts are classified into three categories namely personal account; real account; and nominal account.

As indicated above, Trial Balance helps in knowing the arithmetical accuracy of the accounting entries. This is because according to the dual aspect concept for every debit, there must be an equivalent credit.

Balance Sheet is a statement of financial position of a business concern at a given date. It is called a Balance Sheet because it is a sheet of balances of those ledger accounts which have not been closed till the preparation of Trading and Profit and Loss Account. After the preparation of Trading and Profit and Loss Account the balances left in the trial balance represent either personal or real accounts. In other words, they either represent assets or liabilities existing on a particular date. Excess of assets over liabilities represent the capital and is indicative of the financial soundness of a company. Types of the balance sheet:

The opening balance-is understood as the balance made at date of the state registration of the enterprise, that is at date of its basis. Usually in an active of the given balance debts of founders against the new enterprise are displayed only, and in a balance passive the quantity of the declared authorized capital stock is underlined. The annual balance - the balance made up for the completion date of the company. The consolidate the balance - the balance made up for a date to combine two or more businesses. The dividing the balance - the balance made up for date of separation from the company of other enterprises. The gross balance - the balance made up of collected amount of depreciation of assets, as well as the overhead of sales, bad debts are not deducted the mandatory reserve. The net balance is the balance made up of collected amount of depreciation of assets, as well as the overhead of sales for bad debts deducted mandatory reserve.



**Drawing 2. Financial statements<sup>3</sup>**

Users of financial statements and their information needs:

- investors: Information need of the group primarily relates to decision making of buy, hold or sale of the entity's share. Also dividend paying ability of the entity is a matter of interest;
- employees: Need to know about the stability and continued profit-ability of the employer which would ensure payment of remuneration, employee opportunities and retirement benefits;
- lenders: Interested in debt servicing capability;
- suppliers and other trade creditors: Interested in information about the entity's ability in the short run to pay their dues. Of course, they are interested in long run viability of the entity, if it is their major customer;
- customers: Seek information about the continuation of the entity in particular if the entity is their major supplier;
- government and their agencies: They have manifold interests like taxation; contribution of the entity in employment generation and economic activities of the nation and also the infrastructural facilities to be provided to subserve the need of the entity commensurate with its contribution to the society;
- public: Mostly interested in employment generation and societal contribution.

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<sup>3</sup>Developed by the author in accordance with the contents of this section.

In one of our legal document called “Law on Accounting” it is stated that accounting is kept by method of double record by the simultaneous and interconnected reflection of economic activity in money value on at least two accounts of financial accounting.<sup>4</sup> Objects of accounting are the assets, obligations, equity, reserves, the income, expenses, profit, losses and economic activities connected with their movement<sup>5</sup>. Synthetic accounting is performed by generalization of data on objects of accounting on certain economic signs according to the procedure, determined by the legislation. Analytics are kept for the purpose of forming of detailed accounting information on objects of accounting according to the procedure, determined by the subject of financial accounting independently.

According to the Law on Accounting, a company’s CEO or the board of directors is responsible for “complete and true” accounting records and the preparation of financial statements. The legislation further imposes on the CEO the responsibility for “internal” accounting and reporting, internal controls, maintaining up-to-date accounting documents, and financial and tax reporting. Financial statements are prepared using prescribed forms and must be signed by a company’s CEO and a second person nominated by the CEO, usually the chief accountant.

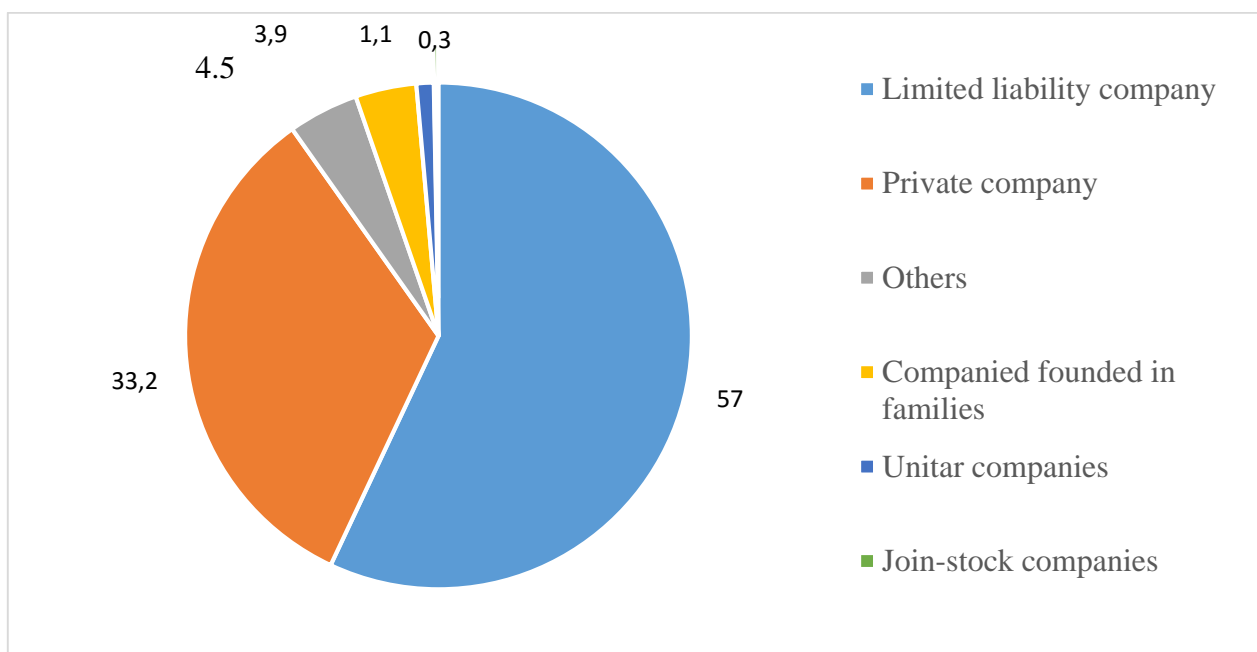
The National Account Standards (NSA) interpreted the Law on Accounting which regulates the financial statement preparation and publication of all public interest entities including joint-stock companies. The government has been implementing changes to its statutory framework with the objective to strengthen the creditability of its accounting system. The NSA was developed based on the International Accounting Standards (IAS) and the International Financial Reporting Standard (IFRS). However, there still remain significant differences between the NSA and IFRS as the government has undertaken a conservative approach in introducing changes to the system in order to ensure better compatibility and smooth

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<sup>4</sup>Article 4. The Republic of Uzbekistan “Law on Accounting” on August 30, 1996 No. 279-.The last edition from 13-04-2016)

<sup>5</sup>Article 7. The Republic of Uzbekistan “Law on Accounting” on August 30, 1996 No. 279-.The last edition from 13-04-2016)

transition. All of the country's laws flow from the centerpiece of the legal system, the Constitution of the Republic Uzbekistan. Constitutionally, the Republic Uzbekistan is set up as a democracy, based on the principle of separation of powers into executive, legislative and judicial branches. The following are the various types of companies permitted by Uzbek law and the number of companies in each category:



**Chart 1. Proportion of companies in Uzbekistan in terms of formation in 2017<sup>6</sup>**

Accounting and financial reporting in the Uzbek enterprises sector are primarily regulated by the Law on Accounting and the Law on Auditing Activity. When addressing issues of accounting and auditing, other company legislation is typically cross-referenced to these two laws. Although the two laws spell out most of the country's financial reporting obligations, certain institutions, primarily those in the financial sector, are subject to some additional requirements. The law of Accounting sets out the main principles and regulations governing accounting and financial reporting in the Republic of Uzbekistan, including the basis for that accounting and reporting, the responsibilities of the regulators, and the

<sup>6</sup><https://www.stat.uz/uz/432-analitichiskie-materialy-uz/2032-korxonalar-va-tashkilotlarning-demografiyasi>



responsibilities of those involved in the financial reporting process. The Law on Accounting is applicable to all legal entities in both the private and public sectors. The law defines financial statements as including a balance sheet, statement of financial results, cash-flow statement, statement of changes in capital and notes to the financial statements. The law also designates the Ministry of Finance to be the standard setter and says the reporting period must be the calendar year. Companies that have subsidiary branches must prepare consolidated financial statements. Additional prescribed reports must be submitted to the tax authorities, shareholder(s), the state statistics department and other authorities as required by other laws ( prudential reporting by banks and insurance companies). The reporting period is one quarter, on accumulative basis. The Law on Accounting effectively, although implicitly, defines what a public interest entity (PIE) is. PIEs include open joint-stock companies, insurance companies, banks, security and commodity exchanges, investment funds and other financial institutions. These entities are required to publish their audited financial statements by May 1 of the year following the year end. The law does not, however, say how financial statements are to be released to the public. Ordinarily, for PIEs, the domestic print media will publish a summarized balance sheet and income statement; the Tashkent Stock Exchange publishes its own summarized balance sheet and income statement on its website.

The law specifies that all accounting entries should be backed by source documents confirming specific transactions. The law also defines mandatory “attributes” of a source document, including name of the company issuing the document, nature of the document, its number and the location of its issuance, description and quantity of goods/services delivered/provided, and the signature of person who is responsible for completeness and veracity of the document. The Law on Accounting also mandates an annual assets and liabilities inventory. NSA 19 “Organization and Undertaking of Inventory Counts” provides further guidance on this top. This standard also requires an annual count of inventory, biannual count of property, plant and equipment, and a regular count of cash and fuel inventories. The Law on Accounting also prescribes the use of evaluation methods, as well as certain

accounting treatments, such as accounting for subscribed, surplus and “reserve” capital. The content of accounting ledgers, internal reports, and other documentation is confidential. The Law on Accounting is further interpreted in national accounting standards (NSA) and regulations issued by the Ministry of Finance. Most NSA were issued in 1998, and some were updated in the period from 2003 to 2005. These were developed based on IAS/IFRS, but significant differences between NSA and IFRS remain. Regulations supporting NSA were issued during the same period to provide additional guidance, reporting formats and details on how to apply the reporting requirements, as well as guidelines on the accounting treatment of specific transactions. Both the Center on Coordination and Control Over Functioning of the Securities Market and the tax authorities are entitled to monitor compliance with legislation on financial reporting, although the tax authorities look at compliance only from the perspective of tax collection. In reality, however, it does not appear that these institutions have the resources and capacity to effectively monitor compliance with financial reporting requirements, particularly compliance with the disclosure requirements. Small and medium-sized enterprises (SMEs) follow the requirements of the Law on Accounting and apply NSA 20 Accounting and Financial Reporting by Small Business. SME financial reporting is much simpler than that of PIEs or financial institutions. The annual financial statements of micro entities and small enterprises comprise only a balance sheet, are port on financial results and a report on accounts payable (debts and credits. Under the current legislation, the Ministry of Finance has the responsibility for setting Uzbek accounting and auditing standards. The Law on Accounting and the Law on Auditing Activity refer to “standards,” and that reference is interpreted NSA. The government of Uzbekistan decided to develop National Accounting Standards inspired by IAS/IFRS. The Ministry of Finance also releases supporting regulations and guidelines that elaborate on the standards or provide detailed procedures for accounting and documentation.

Table 1

## Corporate financial reporting requirements<sup>7</sup>

<b>Financial statements</b> <b>Entities</b>	<b>Legal Entity and Consolidated Financial Statements</b>	<b>Audit</b>	<b>Public Disclosure</b>
<b>Open joint-stock Companies</b>	NAS	Required	Must publish annual financial statements in the print media; however, the law does not specifically require publishing or making publicly available a “full set of financial statements” together with the notes to the financial statements, as required by NAS.
<b>Closed joint-stock companies</b>	NAS	Required	None
<b>Large Private Limited Liability Companies</b>	NAS	Not Required	None
<b>Small Private Limited Liability Companies</b>	NAS and NAS 20	Not Required	None
<b>Unincorporated Businesses</b>	NAS 20	Not Required	None

The Ministry of Finance develops NSA gradually, and the focus is on those that best correspond to the needs of Uzbek market. Furthermore, the Ministry of Finance adopts only the standards that do not contradict Uzbek civil, companies or tax legislation. As a result, there are significant differences between NSA and IFRS, leading to a standards gap. A comparative analysis of NSA and IFRS demonstrates that there are significant differences between the two sets of standards, so that financial statements prepared under NSA would be materially different from those prepared under IFS, and include the following:

- some IFRS/IAS have no NSA equivalents, for example, IAS 39, IAS 40, IAS 41, IFRS 4;
- existing NSAs are not always up to date because IAS/IFRS have changed significantly during the last decade;
- several NSAs contain more detail than their IAS/IFRS equivalents and are also supplemented by the standard chart of accounts (NSA 21), standard financial reporting formats with additional forms, such as the report on fixed assets and

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<sup>7</sup>Report on the observance of standards and code (ROCS) of The Republic of Uzbekistan December, 2008

debtors and creditors, and additional regulations and guidelines (for example, IAS 1 has several NSA equivalents for each of the prescribed financial statements; this is, to some extent, due to traditions that exist in Uzbek environment, including the history of rules-based standards).

The main regulatory documents that regulate the accounting of business entities are:

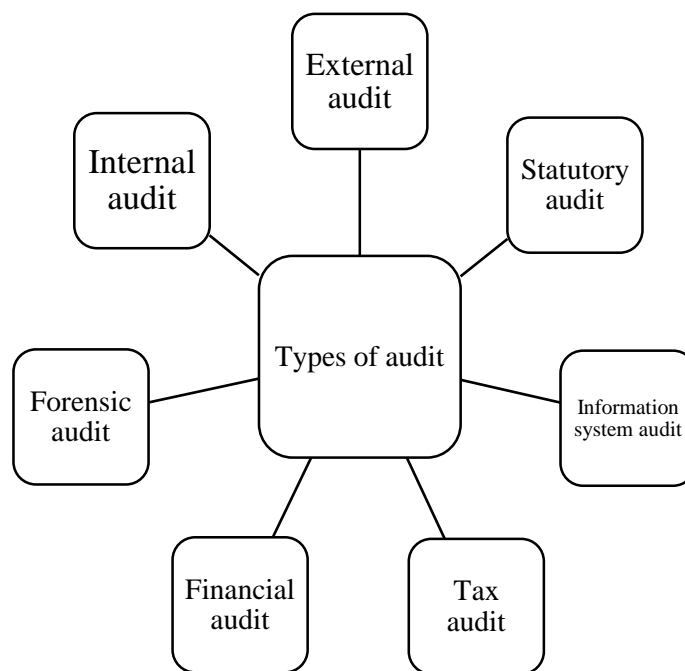
- National Accounting Standard of the Republic of Uzbekistan (NSA);
- Law of the Republic of Uzbekistan "On Accounting" (13.04.2016, with subsequent amendments and additions);
- Law of the Republic of Uzbekistan "About enterprises" (with subsequent amendments and additions);
- Tax code of the Republic of Uzbekistan;
- Civil code of the Republic of Uzbekistan part 1-2;
- Regulations on the composition of the costs of production and sale of products (works, services) and on the procedure for the formation of financial results (05.02.1999);
- The plan of accounts of accounting of financial and economic activity of economic activity of economic entities and the instruction on its application. NSA No. 21 and many other legal documents;
- Chart of accounts of financial and economic activities of economic entities and instructions for its use, approved by the Order of the Ministry of Finance of the Republic of Uzbekistan dated 30.03. 2000. №37.

## **1.2. Importance, characteristics, types and related legal documents of audit**

The capital markets depend on accurate, reliable, and objective (neutral) data that portray the economic nature of an entity's business and in turn provide a base to judge current progress toward long-term objectives. If the market does not receive reliable data, investors lose confidence in the system, make poor decisions, may lose a great deal of money, and ultimately, the system may fail. It is a complex process. The National Accounting Standards Board define accounting principles;

management applies the accounting principles and develops systems of internal control; and the auditing profession independently tests management's reports to ensure reliable reporting of financial information. Auditing is mutually interrelated with accounting activity and it may increase the effectiveness and efficiency of economic activity of company. From the point of view of the investigators, the following types separated:

1. External audit (assurance services, consultant services, financial advisory, tax services, legal service, risk management advisory)
2. Internal audit.



**Drawing 3. Types of audit<sup>8</sup>**

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes. The internal audit activity must assess and make appropriate recommendations for improving the governance process in its accomplishment of the following objectives:

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<sup>8</sup>Developed by the author in accordance with the contents of this section.

- promoting appropriate ethics and values within the organization; ensuring effective organizational performance management and accountability;
- communicating risk and control information to appropriate areas of the organization;
- coordinating the activities of and communicating information among the board, external and internal auditors, and management;

The internal audit activity must evaluate risk exposures relating to the organization's governance, operations, and information systems regarding the:

- reliability and integrity of financial and operational information;
- effectiveness and efficiency of operations;
- safeguarding of assets; and
- compliance with laws, regulations, and contracts.

Operational audits are audits of the operational processes of the organization. They are also known as management or efficiency audits. Their prime objective is the monitoring of management's performance, ensuring that company policy is adhered.

An external audit is a type of assurance engagement that is carried out by an auditor to give an independent opinion on a set of financial statements. The objective of an audit of financial statements is to enable the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. An audit of financial statements is an example of an assurance engagement. An audit provides assurance to the shareholders and other stakeholders of a company on the financial statements because it is independent and impartial. Misstatements which are significant to readers may exist in financial statements and auditors will plan their work on this basis; that is, with professional scepticism. The concept of 'significance to readers' is the concept of materiality. Materiality is an expression of the relative significance or importance of a particular matter in the context of the financial statements as a whole. A matter is material if its omission or misstatement would reasonably be expected to influence the economic decisions of users taken on the basis of the

financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement.

The accounting and auditing profession varies in structure from country to country. In some countries accountants and auditors are subject to strict legislative regulation, while in others the profession is allowed to regulate itself. We cannot look at every country, but some of the examples below will be shown the divergence of structure and we can make some general points:

1. United Kingdom: In the UK there are a number of different accountancy, or accountancy-related, institutes and associations, such as the Association of Chartered Certified Accountants (ACCA), the Institute of Chartered Accountants in England and Wales (ICAEW) and the Institute of Chartered Accountants of Scotland (ICAS). All these bodies vary from each other but they are all characterized by various attributes:

- stringent entrance requirements (examinations and practical experience);
- strict code of ethics;
- technical updating of members.

2. In France, the accounting profession is split into two distinct organizations:

- Accountants (Ordre des Experts Comptables et des Comptables Agréés)
- Auditors (Compagnie Nationale des Commissaires aux Comptes)

Most members of the auditors' organization are also members of the more important accountants' organization. Examinations, work experience and articles are similar to those of the UK accountancy bodies. The profession's main influence is through the issue of non-mandatory opinions and recommendations of accounting principles relevant to the implementation of the National Plan.

3. Germany: The main professional body in Germany is the Institute of Certified Public Accountants (Institut der Wirtschaftsprüfer). Members of this institute carry out all the statutory audits, and are required to have very high educational qualifications and experience. The Institute issues a form of auditing standard but this is tied very closely to legislation. As well as auditing, members are mainly involved in tax and business management, with no obvious significant role in

establishing financial accounting principles and practices. There is no independence accounting standard-setting body.

5. US: In the US, accountants are members of the American Institute of Certified Public Accountants (AICPA), a private sector body. Although the Securities and Exchange Commission in the US can prescribe accounting standards for listed companies, it relies on the Financial Accounting Standards Board (FASB), an independent body, to set such standards. In turn, FASB keeps in close contact with the AICPA, which issues guidance on US standards and is closely involved in their development.

National Standards on Auditing serve as the auditing standards applicable in Uzbekistan. Similar to the NSA, the National Standards on Auditing was established based on the International Standards on Auditing (ISA) however it is not fully aligned with the ISA. The main issue of the practice of the auditing standards is the weak institutional audit function both at the regulator's monitoring level, as well as at the corporate level. It is still the case that the level of detail included in external auditor's reports under National Standards on Auditing remains insufficient comparing to international reporting standards. The Audit Law of Uzbekistan enacted that stipulates that all audit firms must be registered with the Ministry of Justice and licensed by the Ministry of Finance. Audit in Uzbekistan is performed in accordance with the Law of the Republic of Uzbekistan "On Audit Activity" and National Standards on Auditing. The Law "On Audit Activity" requires auditors to follow Uzbek National Standards of Auditing. Law of the Republic of Uzbekistan "On Auditing Activity" allows the existence of several professional accounting organizations. Currently there are three professional organizations in Uzbekistan: National Association of Accountants and Auditors, Chamber of Auditors and Federation of Accountants, Auditors and Consultants.

National Standards on Auditing consist of 21 auditing standards. Because of the delay in adopting revised ISA, some National Standards on Auditing do not have an ISA counterpart. Audit risk standard (National Standards on Auditing 9 Materiality and Audit Risk) has not been updated since its adoption, the National



Standards on Auditing audit approach is not a risk-based approach. Similarly, all performance and reporting standards are based on older audit standards clarity and redrafting project ( National Standards on Auditing 3 “Audit Planning”, National Standards on Auditing 4 “Requirements Relating to Internal Standards of Audit Firm”, National Standards on Auditing 5 “Quality Control over an Auditor’s Work”, National Standards on Auditing 6 “Audit Documentation”, National Standards on Auditing 10 “Audit of Other Information”, National Standards on Auditing 11 “Audit in a Computerized Environment”, National Standards on Auditing 12 “Evaluation of the Systems of Accounting and Internal Control”, National Standards on Auditing 13 “Analytical Procedures”, National Standards on Auditing 14 “Sampling”, National Standards on Auditing 16 “Use of the Work of an Expert”, National Standards on Auditing 24 “Auditing Procedures when Financial Statements are Materially Misstated”, National Standards on Auditing 25 “Compliance with Laws and Regulations”, National Standards on Auditing 31 “Knowledge of the Business”, National Standards on Auditing 50 “Audit Evidence”, National Standards on Auditing 55 “Obtaining Audit Evidence for Related Party Transactions”, National Standards on Auditing 56 “Subsequent Events”, National Standards on Auditing 60 “Use of the Work of An Other Auditor”, National Standards on Auditing 70 “Auditor’s Report and Conclusion”, National Standards on Auditing 80 “Agreed Upon Audit Procedures” and National Standards on Auditing 90 “Professional Services of Audit Firms”). An annual audit is mandatory for both open (shares are issued to the public) and closed (shares are restricted to certain classes of shareholders only) joint-stock companies, banks and other credit institutions, insurance institutions, investment funds, charities, and entities with state participation. The law states that the auditor is appointed by “the entity” and confirmed by the shareholder(s) or, where applicable, by a shareholders’ meeting. The Law on Auditing Activity similarly to equivalent laws in peer countries, does not define “audit” but, rather, “auditing activity” (regulating both audit and non-audit services). The difference, while subtle in wording, results in significant consequences for auditors as it in fact regulates any activity performed

by auditors and audit firms as opposed to regulating statutory audits only, auditors that perform audits required by law and only these audits. The law defines auditing activity as “for-profit (entrepreneurial) activity by audit firms when performing auditor’s review and other professional service.” These other services are then defined as establishment and maintenance of accounting, preparation of financial statements, conversion of national financial statements to statements in accordance with international standards, analysis of financial and economic activities of the company, consulting on matters of accounting, tax, planning, management and other matters of financial and economic activity, and preparation of tax returns. Audit firms may provide other professional services envisaged by National Standards on Auditing.

The Ministry of Finance Licensing Authority is responsible for examining, certifying and licensing auditors. The examination consist of written and verbal parts. The Law on Audit Activity requires that all candidates have a university degree. They also have to meet certain experience requirements. Candidates with a university degree in economics must acquire three years of relevant work experience, while candidates holding non-economics degrees must have five years of relevant experience. Relevant experience is defined as the work of chief accountant, financial and/or analytical work (there is no requirement for mandatory audit work under a licensed auditor). Other requirements include integrity, no prior court convictions, and the ability to enter into legal transactions. The certification process includes 200 hours of training provided by one of the approved providers and one exam administered by The Ministry of Finance examination committee (the committee includes representatives from The Ministry of Finance, Ministry of Justice, tax authorities, the securities exchange commission and professional associations). The two part exam contains five subjects (financial accounting, management accounting, taxation, business law and audit). As in some other peer countries, there is some confusion in the Republic of Uzbekistan about the relationship between internal and external audit, and the role of internal audit in a company. According to the regulation on internal audit issued by the Cabinet of

Ministers, all entities with assets exceeding USD 1 million must have an internal audit department led by an auditor holding an external audit certificate. Internal auditors are responsible for internal controls, assessing the work of executive bodies and other corporate functions, compliance with legislation, accuracy of accounting records, safeguarding of assets and implementation of corporate governance principles. Often, the work of internal auditors is perceived as a supplement to the work of external auditors.

In addition, entities not subject to mandatory audit may choose to arrange a voluntary audit of their financial statements. For statutory audits, there is a mandatory auditor rotation after three years on the engagement. Auditing standards applicable in Uzbekistan are National Standards on Auditing, which are theoretically based on ISA. However, it would be misleading to contend that National Standards on Auditing are fully aligned with ISA. Further, the “auditor’s report” is defined as a long form report that includes prescribed analytical information, as well as discussion of internal control issues and compliance with taxation and other legislation, etc. The “auditor’s conclusion” contains information resembling that in the audit report prescribed by ISA 700. In addition, because the Uzbek accounting framework is based on attesting to compliance, Uzbek audit conclusions require wording that fits that framework. The Audit Licensing Authority, with the assistance of both the National Association of Accountants and Auditors and the Chamber of Auditors, has promulgated 21 National Standards on Auditing. The standards, inspired by the “old” (pre-risk-based) ISA approach, get their legal authority from the Ministry of Justice registering the standards. The Law on Auditing Activity requirements for statutory audits appear to be broader than, and different from, those in many other countries in that small companies are subject to mandatory audit if they are joint-stock companies. For example, the EU Fourth Company Law Directive sets maximum limits on the exemption criteria, but Member States are permitted to set lower size criteria, thereby exempting fewer companies. In this context a question arises whether any public benefit is derived from the audit of a small or inactive joint-stock company. The Law on Auditing Activity also regulates

the conduct of the statutory audit of commercial enterprises. Only licensed audit firms employing licensed auditors are allowed to perform such audits. There are three types of Uzbek audit licenses:

- first level license: Audit firms with these licenses may provide only voluntary audits, must employ at least two certified auditors and have statutory capital of at least 1,500 times the minimum wage (approximately USD 30,000).

- second level license: Firms with these licenses may perform voluntary and mandatory audits except for banks and open joint-stock companies with authorized/statutory capital exceeding 500,000,000 sum (USD 300,000), must employ at least four certified auditors, including one auditor with an international designation (CAP, CIPA, ACCA), and have statutory capital of at least 3,000 times the minimum wage (approx. USD 60,000).

- third level license: Firms with these licenses may perform any audit with the exception of banks (additional license needed), must employ at least six certified auditors and two international accountants (CAP, CIPA, ACCA), and have statutory capital of at least 5,000 times the minimum wage (approx. USD 100,000).

Law on Auditing Activity independence requirements for auditors include the following: Auditors or audit firms are prohibited from auditing entities where they, or close relatives (parents, spouses, brothers, sisters, children; brothers, sisters, parents and children in law), are founders (participants), shareholders or employees. Further, they cannot audit entities in which they have any interest other than that resulting from conducting the audit and providing accompanying services. Statutory auditors are appointed by shareholders of the company:

- The Law On Joint-Stock Companies (Art.65) stipulates that the general shareholders' meeting appoints the external auditors for JSCs. The licensing authority employs seven staff to perform inspections to ensure compliance with the requirements. The inspectors visit each audit firm at least once in three years. Where transgression is suspected, the licensing authority forwards the case to the court. The court may order the suspension or withdrawal of a firm's audit license of firms, and revoked licenses can never be retrieved. If individual auditors breach the laws and

regulations applying to them, the court can also suspend or withdraw their certificates. An auditor is permitted, however, to reapply for the revoked certificate after three years. The law also establishes the extent of information to be included in the registry of auditors.

### **Conclusion for the first chapter**

It would also be helpful if the national standard-setting process were to be continued; the last national accounting standard (NSA 23 “Accounting During Reorganization”) was issued in June 2005. Finally, there is a need for greater public availability of financial information, particularly information on companies likely to be of public interest, whether due to size or significance (financial institutions and major private sector entities). Without such information, even if accounting and auditing reforms achieve their objectives, existing and potential users will not be able to access this information, reducing the overall benefits to society and the potential for corporate-sector-led economic growth. Uzbek accounting and auditing legislation does not formally recognize the accounting profession. While it spells out detailed information on education requirements for auditors, no requirements or criteria have been established for the certification and competence of accountants.

We recommend that the Uzbek statutory and legal framework be amended to- Define criteria for distinguishing between public interest entities (PIEs), small and medium sized enterprises (SMEs), and micro entities for tailoring proportionate financial reporting requirements appropriate to the needs of the market and the entities’ own information needs. Strengthen the oversight system of the audit profession and create a robust audit quality assurance review program.

All regulators and other institutions with responsibilities in the field of financial reporting face increasing challenges as the changing business environment creates demand for an updated accounting and auditing infrastructure.

Although the cautious approach to accounting reform did not result in a critical need for institutional strengthening, there is a need for increased capacity, as evidenced by, for example, the fact that the disclosure requirements listed in National Standards on Auditing 1 are not enforced and that the absence of these

disclosures does not always result in a modified audit opinion. This indicates a need to strengthen the capacity of both auditors and the audit quality control function. Accordingly, it is recommended that the regulators receive support, including from international peer institutions, to build their capacity in terms of the number, qualification levels, and training of their staff. Many individuals are involved in accounting functions, educating the accountants who work at the majority of Uzbek companies is key to improving the practical application of National Standards on Auditing and principles-based accounting.

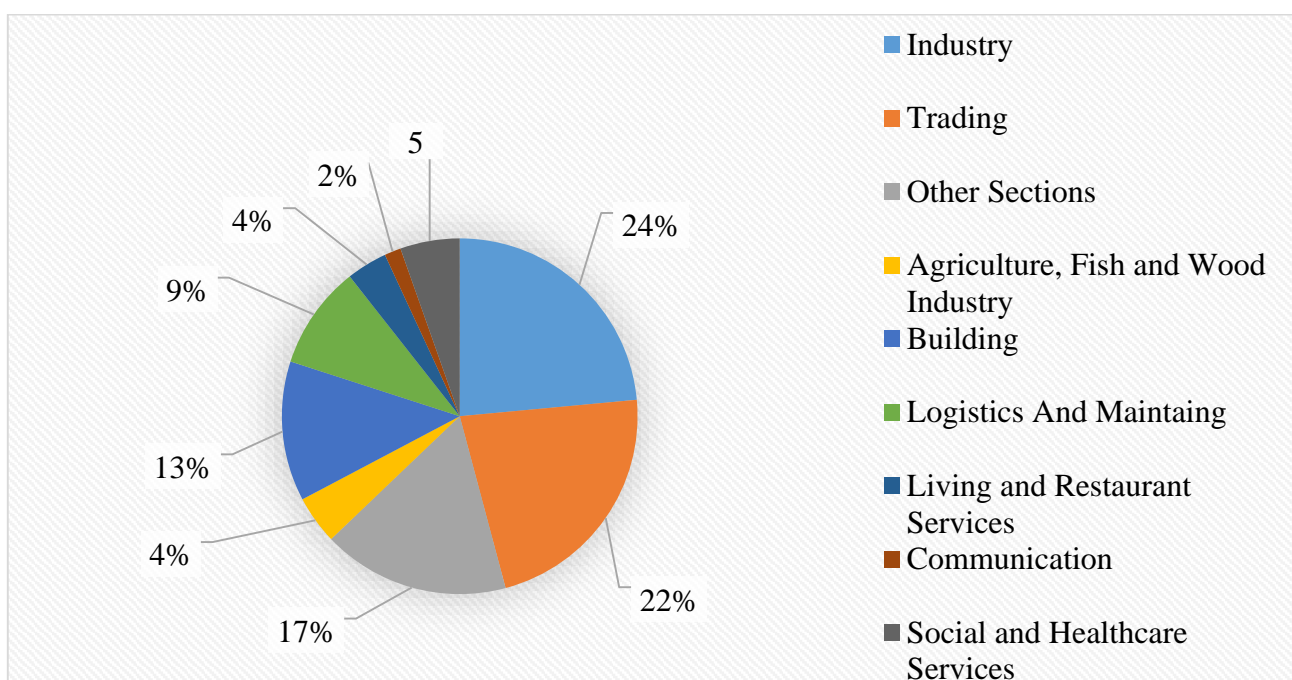
## **CHAPTER 2. THE ROLE, VALID PROCEDURES AND UTILIZATION OF ACCOUNTING AND AUDIT IN BUSINESS ENTITIES**

### **2.1. Organizing, implementation, the process of fulfilling and the effectiveness of accounting**

The majority of businesses in Uzbekistan are organized as limited liability companies, open and closed joint stock companies, partnerships, sole

proprietorships, and representative offices of foreign companies. Companies may limit their presence to a permanent establishment (not a legal form and only for tax purposes). The most common types of business presence in Uzbekistan for foreign companies are:

- limited liability companies;
- joint stock companies;
- representative offices;
- private companies and other forms.

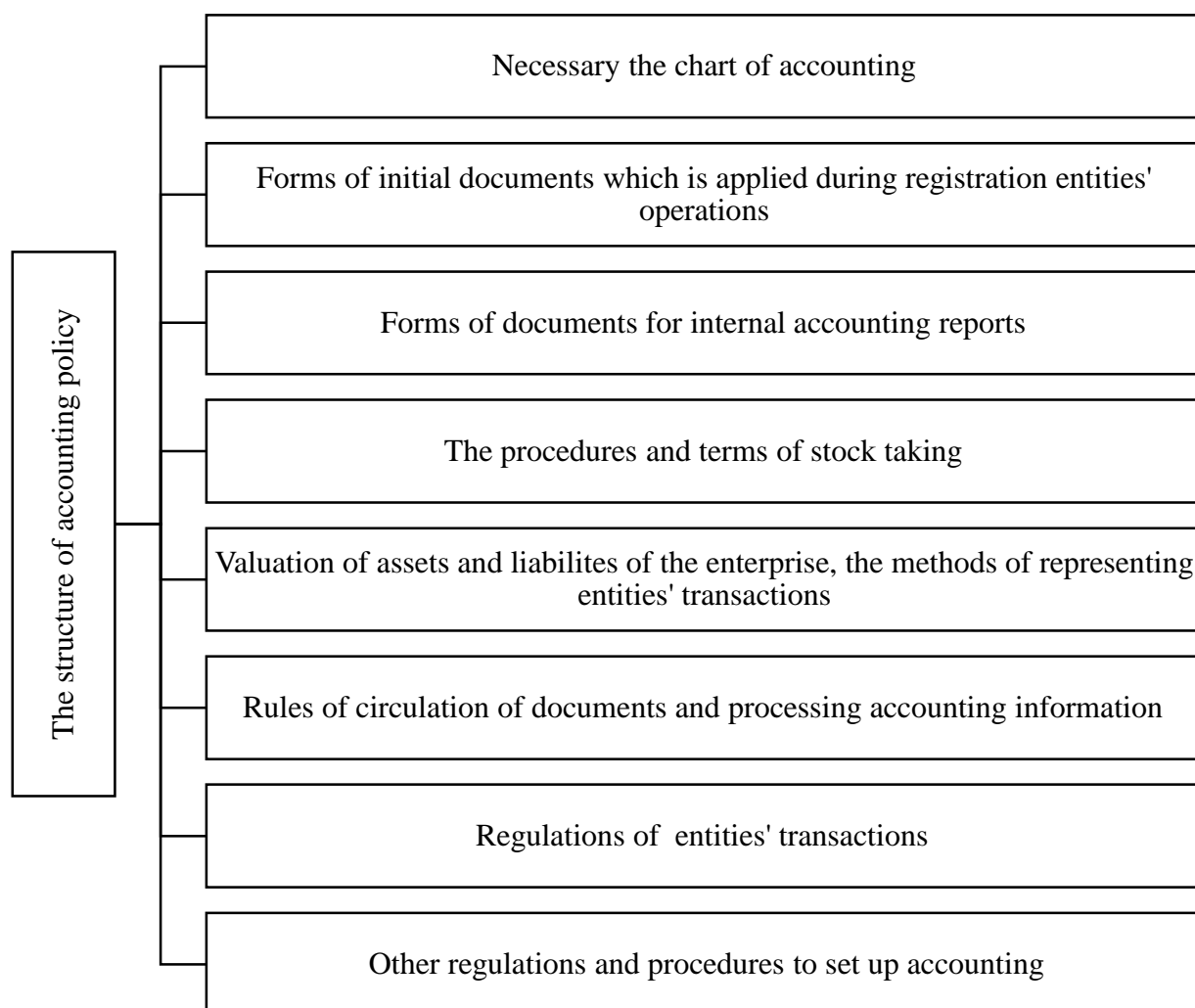


**Chart 2. The shares of large companies works variety sectors of economy in Uzbekistan according to 01.01.2017<sup>9</sup>**

As mentioned above enterprises do their business in diverse sectors of economy. Therefore, they need to implement their own accounting policy. Limited liability status means that the businesses' debts and the personal debts of the business's owners (shareholders) are legally separate. The shareholders cannot be sued for the debts of the business unless they have given some personal guarantee. This is called limited liability. Therefore, each business entity has its own accounting

<sup>9</sup> <https://www.stat.uz/uz/432-analitichiskie-materialy-uz/2032-korxonalar-va-tashkilotlarning-demografiyasi>

system and varies from one to another depending of the legal documents of Uzbekistan.



**Drawing 4. The structure of accounting policy<sup>10</sup>**

That's why business entities create their accounting policy and it is considered the trading secret. Also, they have the right to make the list of reduced the chart of accounts to provide controlling over economic activity of enterprises.

Initial stage of accounting is recording all documents belong to the economic activity of business entities. Succeeding stages of doing accounting in companies are followings:

- recording the information in the initial accounting documents which is used in the accounting registers;
- preparing financial statements;

<sup>10</sup> Developed by the author in accordance with the contents of this section.



- using from the accounting registers so that other business entities can get the necessary data.

Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements. It is composed by chief accountant and confirmed by the director of the business entity. All business entities must implement own accounting policies. The procedures of preparing accounting policy and financial statements is followed by the NSA №1 “Accounting policy and financial statement” of the Republic of Uzbekistan and other standards. Accounting policy will be implemented in the next year’s 1<sup>st</sup> January after confirming decree. To form accounting policy other National Accounting Standards are also applied. For instance, accounting policy in terms of fixed assets is formulated the following national standards in business entities over Uzbekistan:

- NSA № 5 “Fixed assets”;
- NSA № 24 “Accounting of expenses regarding obligations”;
- NSA № 19 “Organizing and doing stock taking” and others.

There are four types of depreciation of fixed assets: the straight line method, the double declining balance method, the units-of-production method and cumulative method. Revaluation of fixed assets is carried out one of two methods (directly re-valuation and indexing initial value method ).

Accounting policy in terms of intangible assets is compiled the following standards:

- NSA № 7 “Intangible assets”;
- NSA № 24 “Accounting of expenses regarding obligations”;
- NSA № 19 “Organizing and doing stock taking” and others.

Accounting policy in terms of inventories is prepared the following standards:

- NSA № 4 “Inventories”;
- NSA № 24 “Accounting of expenses regarding obligations”;
- NSA № 19 “Organizing and doing stock taking” and others.

The purchase order authorizes the purchase of the inventory from an approved vendor. As soon as the inventory is received, a receiving report is completed. The

receiving report establishes an initial record of the receipt of the inventory. To make sure the inventory received is what was ordered, the receiving report is compared with the company's purchase order. The price, quantity, and description of the item on the purchase order and receiving report are then compared to the vendor's invoice. If the receiving report, purchase order, and vendor's invoice agree, the inventory is recorded in the accounting records. If any differences exist, they should be investigated and reconciled. The specific identification method is not practical unless each inventory unit can be separately identified. For example, an automobile dealer may use the specific identification method since each automobile has a unique serial number. However, most businesses cannot identify each inventory unit separately. In such cases, one of the following three inventory cost flow methods is used. Under the first-in, first-out (FIFO) inventory cost flow method, the first units purchased are assumed to be sold and the ending inventory is made up of the most recent purchases. Under the last-in, first-out (LIFO) inventory cost flow method, the last units purchased are assumed to be sold and the ending inventory is made up of the first purchases. Under the average inventory cost flow method, the cost of the units sold and in ending inventory is an average of the purchase costs. The system of recording inventories is stated in the NSA № 4 that there are two types: continuous and periodical. To determine the cost of inventories these methods is recommended: simple method, marked method, booking method and succeeding method.

Whenever a business transaction takes place, involving sales or purchases, receiving or paying money, or owing or being owed money, it is usual for the transaction to be recorded on a document. These documents are the source of all the information recorded by a business. Documents used to record the business transactions in the 'books of account' of the business include the following:

- quotation: A document sent to a customer by a company stating the fixed price that would be charged to produce or deliver goods or services.
- purchase order: A document of the company that details goods or services which the company wishes to purchase from another company. Two copies of a purchase order are often made, one is sent to the company from which the goods or services

will be purchased, and the other is kept internally so the company can keep track of its orders. Purchase orders are often sequentially numbered.

- sales order: A document of the company that details an order placed by a customer for goods or services. The customer may have sent a purchase order to the company from which the company will then generate a sales order. Sales orders are usually sequentially numbered so that the company can keep track of orders placed by customers.

- goods received note: A document of the company that lists the goods that a business has received from a supplier.

- goods dispatched note: A document of the company that lists the goods that the company has sent out to a customer. The company will keep a record of goods despatched notes in case of any queries by customers about the goods sent. The customer will compare the goods dispatched note to what they receive to make sure all the items listed have been delivered and are the rights pecification.

- invoice: When a business sells goods or services on credit to a customer, it sends out an invoice. When a business buys goods or services on credit it receives an invoice from the supplier.

- statement: A document sent out by a supplier to a customer listing the transactions on the customer's account, including all invoices and credit notes issued and all payments received from the customer.

- remittance advice. A document sent to a supplier with a payment, detailing which invoices are being paid and which credit notes offset.

- receipt. A document confirming confirmation that a payment has been received. This is usually in respect of cash sales, a till receipt from a cash register. Invoices should be numbered, so that the business can keep track of all the invoices it sends out. Information usually shown on an invoice includes the following:

- name and address of the seller and the purchaser;
- date of the sale;
- description of what is being sold;
- quantity and unit price of what has been sold.

In the course of business, source documents are created. The details on these source documents need to be summarized, as otherwise the business might forget to ask for some money, or forget to pay some, or even accidentally pay something twice. It needs to keep records of source documents of transactions so that it knows what is going on. Such records are made in books of prime entry. The main books of prime entry are as follows:

- sales day book, purchase day book, sales returns day book, purchase returns day book, journal, cash book.

Ledger accounts summarize all the individual transactions listed in the books of prime entry. We have already seen the first step in this process, which is to list all the transactions in various books of prime entry. Now we will look at the method used to summarize these records: ledger accounting and double entry. The principal accounts are contained in a ledger called the general or nominal ledger.

When it comes to drawing up the financial statements, the revenue and expense accounts will help to form the statement of profit or loss, while the asset and liability accounts go into the statement of financial position. The journal is the record of prime entry for transactions which are not recorded in any of the other books of prime entry. At suitable intervals, the entries in each ledger account are summed and a balance is struck. Balances are usually collected in a trial balance which is then used as a basis for preparing a statement of profit or loss and a statement of financial position. The first step in the process of preparing the financial statements is to open up another ledger account, called the profit or loss account. In it a business summarizes its results for the period by gathering together all the ledger account balances relating to the statement of profit or loss. This account is still part of the double entry system, so the basic rule of double entry still applies: every debit must have an equal and opposite credit entry.

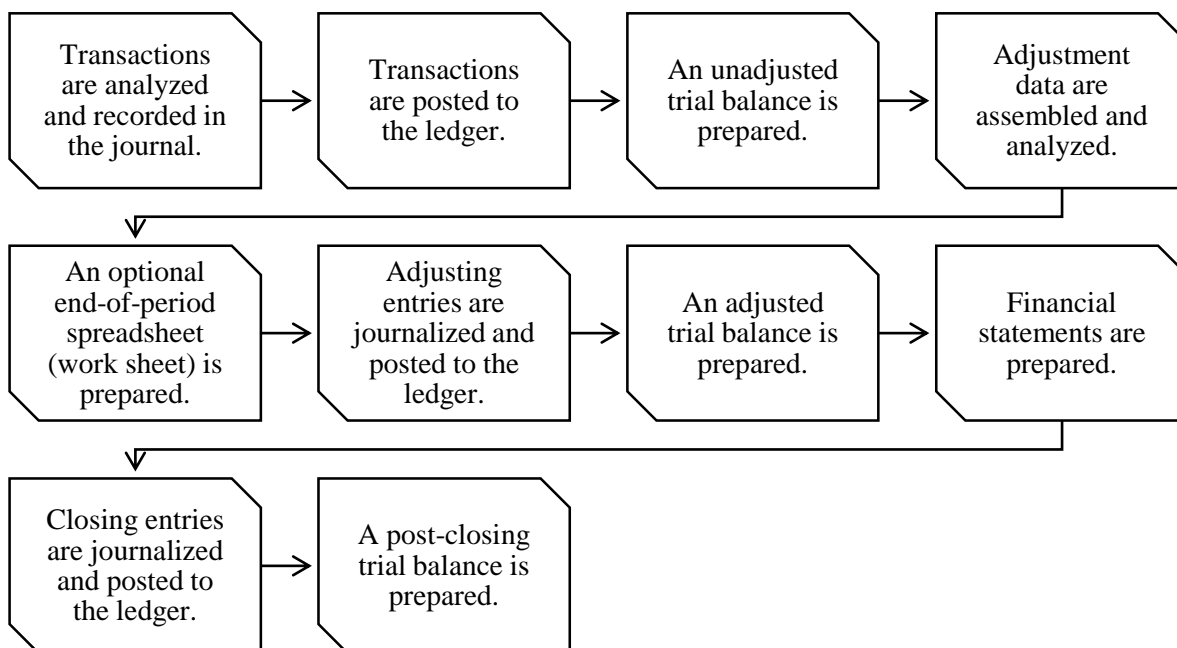
Companies are normally required by law to keep accounting records which are sufficient to show and explain the company's transactions. High quality financial reporting contributes to promoting private sector growth and reducing volatility, through: (a) strengthening countries' financial architecture and reducing the risk of

financial market crises, together with their associated negative economic impacts; (b) contributing to foreign direct and portfolio investment; (c) helping to mobilize domestic savings; (d) facilitating the access of smaller-scale corporate borrowers to credit from the formal financial sector by lowering the barrier of high information and borrowing costs; (e) allowing investors to evaluate corporate prospects and make informed investment and voting decisions, resulting in a lower cost of capital and a better allocation of resources; and (f) facilitating integration into global financial and capital markets.

Fundamental to the implementation of international accounting and auditing standards is a clear understanding of what these standards are, what they require, and what it means to adopt them. Failing this, countries are unable to set concrete implementation targets or to measure progress in reaching those targets. Statutory accounting reports are still essentially produced to enable the authorities to assess the tax liability of an enterprise, and accounting is primarily a matter for the legal classification of transactions and provision of supporting documentary evidence. Accountants are not expected to exercise the degree of professional judgment that is a feature of western accounting practice. Most potential investors restate the accounts of the enterprises in which they are considering investing in accordance with IFRS or another national or group standard so as to portray an understandable and meaningful financial position of an enterprise.

Business entities are required to prepare its accounting and financial reporting in accordance with the NSA of Uzbekistan. Financial statements are prepared on a quarterly and annual basis, consistent with NSA. Quarterly financial statements are required by tax authorities. The effects of transactions and other events recognized when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate. Moreover, the correctness of circulation of documents in business entities is important. The circulation of documents is provided with amount information to carrying out three functions: planning, controlling and

valuation. The simplified form of accounting in Uzbekistan is these: simple form of accounting and combined form of accounting.



**Drawing 5. Accounting cycle<sup>11</sup>**

The accounting process that begins with analyzing and journalizing transactions and ends with the post-closing trial balance is called the accounting cycle. The steps in the accounting cycle are given above. Data and information come from sources both inside and outside an organization. An organization's information systems should be designed so as to obtain – or capture – all the relevant data and information required.

## **2.2. Link between accounting and audit. Auditing and its influence on the activity of business entities**

The audited information is used in the decision making process on the assumption that it is reasonably complete, accurate and unbiased. Auditing is a systematic and scientific examination of the books of accounts and records of business to enable the auditor to satisfy himself that the profit and loss account and the balance sheet are properly drawn up so as to exhibit a true and fair view of the

<sup>11</sup>Developed by the author in accordance with the contents of this section.

financial state of affairs of the business and profit or loss for the financial period. Therefore, accounting and audit are mutually interrelated, at the same distinguishes each other.

Table 2

**Distinction between accounting and audit<sup>12</sup>**

Points of difference	Accounting	Auditing
Meaning	It is recording of all the day to day transactions in the books of accounts leading to preparation of financial statements.	It is the critical examination of the transactions recorded in the book of accounts.
Nature	It is concerned with finalization of accounts.	It is concerned with establishment of reliability of financial statements.
Commencement	Accounting commences when bookkeeping ends.	Auditing begins when accounting ends.
Objects	The object is to ascertain the trading results.	The object is to certify the correctness of financial statements.
Scope	It involves various financial statements. It involves maintenance of books of accounts. It does not go beyond books of accounts.	It depends upon the agreement or upon the provisions of law. It goes beyond books of accounts.

Besides being a Chartered Accountant an auditor should possess certain other qualities, such as knowledge of relevant laws, intelligence, tactfulness, vigilance, honesty and integrity courage, impartiality, broad-mindedness, patience, perseverance, maintaining secrecy of his client, commonsense.

Table 3

**The relationship between accounting and audit<sup>13</sup>**

Accounting	Audit
Analyze events and transactions	Review client's internal control system
Record and summarize data in accounting records	Obtain and evaluate evidence on statement assertions

<sup>12</sup>Developed by the author in accordance with the contents of this section.

<sup>13</sup>Developed by the author in accordance with the contents of this section.

Make financial statement assertions	Determine fairness of statements in conformity with recognized accounting principles
Prepare financial statements as per recognized accounting principles	Prepare audit report on finding
Distribute Financial statements and Auditor's report to shareholders	Deliver audit report to client

Functionally, an audit can be classified into external audit and internal audit. The major points of distinction between the two are as follows:

1. The external auditors are appointed by the owners of the organization, shareholders in case of a company. When external auditors are appointed under a particular statute, they are called as statutory auditors. But internal auditors are appointed by the management of the organization. The internal auditors may be appointed on contractual basis or they may be appointed as employees of the organization.

2. The scope of work of an external auditor is determined by the particular statute under which they are appointed but the internal auditors have to work within the scope defined by the management which generally includes review and appraisal of accounting, financial and administrative controls.

3. The main concern for an external auditor is to collect the adequate and reliable evidence to support his opinion as to the truth and fairness of the representations made in the financial statements. The internal auditors, on the other hand, are concerned with the compliance of various policies, rules and procedures of the enterprise, compliance with applicable laws and generally accepted accounting principles.

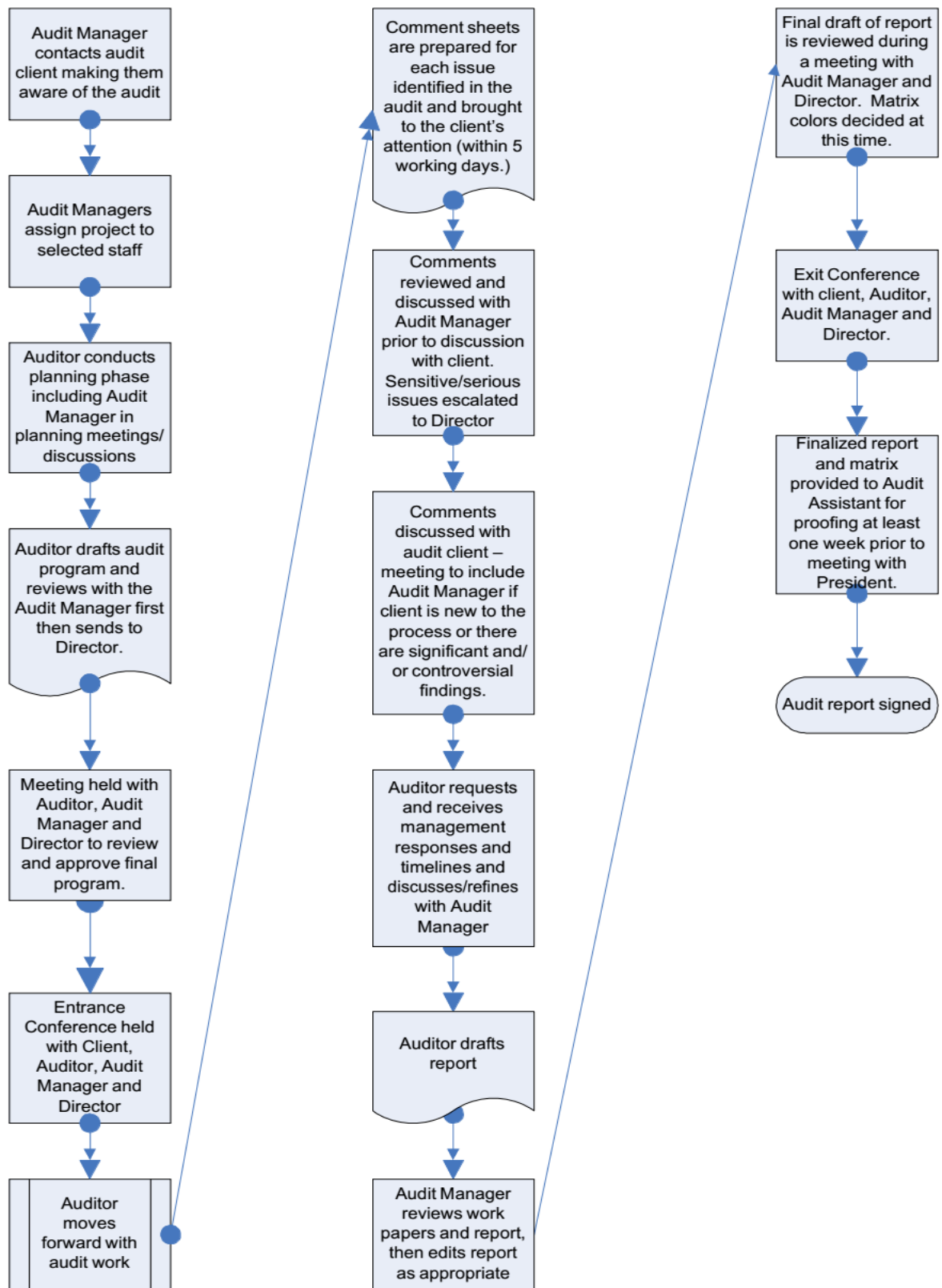
4. The external auditors are directly responsible to the owners and in some cases to the third parties but the internal auditors do not have any freedom to report to the outsiders. It may be noted that unlike external auditors, internal auditors are generally not considered as independent of the management. But one of the basic philosophies of audit is that the auditor must be independent. Thus, in order to derive



benefit from audit in its right earnest even internal auditor must be independent to the extent practicable.

It is required by the government that an internal audit unit be established in each of the joint stock companies of total asset valued in excess of SUM 1 billion in Uzbekistan.. Such internal audit unit should report to the company council (supervisory board) and not to the company's board of management. The transformation of the economy of our country to market economy system requires running businesses with up-to date technologies, implementing modern ways and experiences of controlling business in our entities. In such circumstances the role of auditing especially internal audit increases significantly.

In the market economy intensified the task of improving profitability and monitoring of enterprises. Many companies suffer from inefficient use of human, financial, material, from a lack of necessary to make the right decisions information of unintentional and intentional misreporting, it reduce distortion by staff and managers. Such problems can be solved through proper organization of internal audit. Internal audit - independent evaluation of produced within the company as the provision of audit services, and it is an integral part of the administrative control of the enterprise.



**Drawing 6. Internal audit process flow chart<sup>14</sup>**

<sup>14</sup>K. H. Spencer Pickett. The internal auditing. Handbook. – UK. The Atrium, Southern Gate, Chichester, West Sussex, PO19 8SQ , -3<sup>rd</sup> edition 2002y. – 260p

The problem of determining the effectiveness of the internal audit is non-trivial, because:

- a) the results are not always quantified;
- b) effectiveness depends not only on the auditors themselves, but to a large extent, on the follow-up audit client;
- c) playing the role of subjective evaluations.

For a more effective functioning of the internal audit in the enterprise it is necessary to regulate the position of the department (Service, or one full-time units). It will determine the place of internal audit in the enterprise management system, its goals and objectives, independence, responsibility and relationships with other functional units of the enterprise, duties and powers, restrictions and regulation activities.

The following aspects are required to be covered by an auditor while doing audit of any organization:

- review system and procedures;
- review the internal control system;
- routing checking/arithmetical accuracy;
- accounting principles;
- books and statements;
- verification of assets;
- verification of liabilities;
- true and fair value;
- statutory compliance;
- reporting.

The process of audit conducting divides three stages:

- initial planning;
- preparation and implementation of the overall audit plan;
- preparation and implementation of audit program.

In the National Standards of Audit 3 “Audit planning”, overall audit plan is separated into Initial planning and Audit program.

Principles of audit plan:

- comprehensive planning;
- continuity planning;
- optimal planning.

Preliminary audit strategy should consider:

- client's business and industry;
- material misstatement risk areas;
- number of client locations;
- past effectiveness of controls.

Factors the auditor should understand:

- major sources of revenue;
- key customers and suppliers;
- sources of financing;
- information about related parties.

Planning and audit and designing an audit approach:

- accept client and perform initial audit planning;
- understand the client's business and industry;
- assess client business risk;
- perform preliminary analytical procedures;
- set materiality and assess acceptable audit risk and inherent risk;
- gather information to assess fraud risks;
- develop overall audit plan and audit program.

Internal control components include the following :

- control environment;
- risk assessment;
- control activities;
- information and communication;
- monitoring.

The auditor can suspect fraud under the following circumstances:

- when vouchers, invoices, cheques, contracts are missing etc;

- when control account does not agree with subsidiary books;
- when the difference in trial balance is difficult to locate;
- when there is difference between the balance and the confirmation of the balance by the parties;
- when there is difference between the stock as per records and the stock physically counted;
- when the explanation given by the client is not satisfactory;
- when there is a overwriting of some figures;
- when there is a contradiction in the explanation given by different parties.

Following procedures may be adopted by the auditor to detect the errors:

- check the opening balances from the balance sheet of the last year;
- check the posting into respective ledger accounts;
- check the total of the subsidiary books;
- verify all the castings and the carry forwards;
- ensure that the list of debtors and creditors tally with the ledger accounts;
- make sure that all accounts from the ledger are taken into accounts;
- verify the total of the trial balance;
- compare the various items from the trial balance with that of the previous year;
- find out the amount of difference and see whether an item of half or such amount is entered wrongly.

The auditor should perform the following duties in the respect of fraud:

- examine all aspects of the finance;
- vouch all the receipts from the counterfoils or carbon copies or cash memos, sales mart reports etc;
- check thoroughly the salary and wages register;
- verify the methods of valuation of stocks;
- check up stock register, goods inwards notes, goods out wards books and delivery challenges etc;
- calculate various ratios in order to detect fraudulent manipulation of accounts;
- go through the details of unusual items;

- probable into the details of the problems when there is a suspicion;
- exercise reasonable skill and care while performing the duty;
- make surprise visit to check the accounts.

The audit report is the final step in the entire audit process. The reason for studying it now is to permit reference to different audit reports as we study the accumulation of audit evidence throughout this text. These evidence concepts are more meaningful after you understand the form and content of the final product of the audit. We begin by describing the content of the standard auditor's report. There are four types of audit reports:

- standard unqualified report: The scope paragraph states that the audit is designed to obtain reasonable assurance about whether the statements are free of material misstatement;
- unqualified with explanatory paragraph of modified wording: meets the criteria of a complete audit with satisfactory results and financial statements that are fairly presented, but the auditor believes it is important or is required to provide additional information.
- qualified: the auditor concludes that the overall financial statements are fairly presented, but the scope of audit has been materially restricted or applicable accounting standards were not followed in preparing the financial statements;
- adverse or disclaimer: the auditor concludes that the financial statements are not fairly presented (adverse), s/he is unable to form an opinion as to whether the financial statements are fairly presented (disclaimer), or s/he is not independent (disclaimer).

### **Conclusion for the second chapter**

In the second chapter, initial procedures implementing accounting, accounting policy, types of business entities, cycle of accounting, accounting documents and financial statements are covered. Additionally, the relationship between accounting and audit, planning an audit, cycle of auditing and influence of audit on the economic activity of business entities are obtained. The implementation of consistent and gradual reforms in different sectors of the economy, and investment guarantees

provided by law have been recognized as the foundation for the economic achievements currently being seen in Uzbekistan. A business-friendly political and legal environment has been regarded as an important factor in a business and investment climate that supports macroeconomic stability and economic growth in Uzbekistan. While the education system appears to turn out sufficient numbers of future professionals, there is a need to strengthen the capacity of accounting and auditing education at universities and to build continuity between university and pre-professional education programs. The proper understanding and application of international accounting and auditing standards and requirements requires a solid foundation of education and training for financial statement preparers, auditors, and regulators. To accomplish this, the following actions are recommended:

- to meet the increasing needs of the Uzbek economy requires greater capacity in the current providers of education and training in accountancy. This, in turn, calls for the introduction of new programs to update the skills of university professors in contemporary accounting and auditing techniques, which they can then transfer to their students. Alternatively, secondment of accounting faculty members in Uzbekistan to other universities in the region and/or bringing in professors from other Republics which have already made the necessary changes in curriculum could be considered.

- university curricula may need a comprehensive overhaul to cover, in addition to NSA, also IFRS, as well as the principles and theory of accounting underpinning both NSA and IFRS. Similar consideration should be given to auditing theory and principles underpinning National Standards on Auditing and ISA. Support should be provided particularly to those institutions that strive to create high-quality programs using their own resources.

## **CHAPTER 3. PROSPECTIVE ADVANCING MEASURES OF ACCOUNTING AND AUDIT IN BUSINESS ENTITIES**

### **3.1. Current problems of accounting and suggestions to solve them**

“High quality continuing professional development of accountants and auditors is seen as an enhancement of corporate reporting. It is contended that the continuous professional development of accountants promotes the formation of high-quality corporate reporting. Compliance with continuing professional educational requirements by the auditors and accountants can enhance the accuracy and reliability of corporate financial and management reporting. Among the most important areas of need in terms of workforce development are the training of accounting personnel, the improvement of training programs for accountants and auditors, the updating of the training process for regulatory bodies involved in corporate reporting. It is also advisable to provide continuing professional development not only for chief accountants, but also for the younger accounting staff. A strategic plan for staffing, building high-quality corporate reporting and organizing the monitoring of its implementation is of primary importance.”<sup>15</sup> There are three economic models of accounting in international level:

1. British- American model;
2. Continental model;
3. South America model.

In British- American model, accounting is implemented by taking investors’ and creditors’ interests into account. This model is used in Great Britain, USA, Australia and Canada. Continental model is applied in Japan and European countries. The task of this model is satisfying government decisions and orders, giving tax advices, as well. South America model is intended to assist tax policy and planning accounting systems. We have to use appropriate characteristics of these models in our accounting. The recommendations above require a holistic, multi-

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<sup>15</sup> Professional Development of Accounting and Auditing: Russian Experience and Challenges. Rosa Kaspina. 2014 Published by Elsevier Ltd (from [www.sciencedirect.com](http://www.sciencedirect.com) )



disciplinary approach and should be implemented gradually following the publication of this report. Their implementation will require the cooperation of a wide range of stakeholders, including the government, regulators and the accountancy profession, and should be championed by a senior government figure with sound political support. In addition, input from peer countries may present the Republic of Uzbekistan with unique insights into how similar challenges have been addressed in similar countries.

Managerial accounting helps to increase the reliability of the company and decrease extra expenses. The obstacles which take place in the process of implementing managerial accounting is mentioned below:

- absence or lack of precisely strategic targets of companies;
- incompleteness of initial project of managerial accounting;
- determining tasks incorrectly;
- disunity of team;
- lack of qualified and experienced employees;
- distributing responsibility over subsidiaries wrongly;
- trying to achieve unreal targets and durations;
- not having optimum budget of project;
- deficiency of control over project;
- dishonesty of data and others.

The competitiveness of products and services can be strengthened with the help of managerial accounting. Therefore, we have to take into account followings:

Firstly, the data which was obtained from managerial accounting must be utilized in the process of decision making.

Secondly, creating optimum projects, controlling over current performance and preventing all facing problems in all stages are the key factors to perform managerial accounting tasks.

Thirdly, managerial accounting must be organized together managers. The responsibilities need to be distributed alternatively. Managerial accounting is effective when all subsidiaries and managing mechanisms are covered with it.

Accounting policy is created in every entity and it demonstrates the effectiveness of accounting and business activity of the company. That's why the government should develop and improve rules and instructions related to composing accounting policy. To obtain these task, NSA 1 "Accounting policy and financial statement" is recommended to enhancing and enriching new procedures.

Accountants who work with inventories often make mistakes when they read contracts uncarefully. Accounting of inventories which was purchased with the help of corporative plastic cards and recording the information are still a controversial issues.

Nowadays, communication technologies are developing and plenty of websites are being created every day. Many companies have their own web sites and there are some accounting and auditing problems with them. So, we recommend these types of assets must be recorded as intangible assets and new account ,0495, should be created in order to improving accounting and audit. Expenses related to the prime cost of websites can be followings:

- salaries of employees and other payments occurred setting up website;
- cost of services and other utilized programming software;
- other additional expenses
- amortization of licenses and patents related to the website.

All types of revenue come from websites such as advertising, selling and income from online products and services ought to be recorded in 0495. But there are some kind of websites which do not have business target that is they help to increase the efficiency of services but not to earn money. In such cases, the government should give another type of licenses that means – this type of websites are noncommercial and. And expenses occurs while doing the activity of websites should be recorded in 9430 and these types of expenses must be not levied a tax. And utilization of these types of websites as commercial target must be banned with law.

Brands are considered as an intangible asset in accounting. They are created once and levied to licenses periodically. The value of brands may vary time to time

according to the interests of clients, company's share in the market and other factors. So, we recommend that if companies create their own brand, initial value which is recorded in the balance sheet must be add up to zero. This is because, they spend the company's money to introduce their brand to community and clients. In that case if they are levied a tax, then companies pay extra payment. But, if one company purchases another company's brand, then its purchase value must be represented in the balance sheet taking its market value into account. Above mentioned opinions can be understood by the IAS 38 "Intangible assets", so the procedures related to brands in the NAS 7 "Intangible assets" should be reviewed and improved .

Today, the circulation of accounting documents is also legalized by online that is sending and receiving documents throughout the Internet . It is performed with the help of the website which is called "Didox.uz" and the service requires payment. This website helps to decrease additional expenses and required time. Also, it may be helpful for external and internal auditors since the circulation of documents are classified and systematized. Therefore, there will be two types of sources of accounting data: online and paper version, which prevents from damaging of documents and telecommuting may be available for accountants.

Currently, one of the most controversial problems of the economy is reforming the existing accounting and reporting system in country in accordance with international requirements. The goals of reforming the accounting and reporting of the Republic of Uzbekistan include the following:

- create the conditions for the introduction of a system of effective regulation of processes taking place in the economy of the Republic;
- transformation of the accounting system, as well as of the National Accounting Standards to the International Financial Reporting Standards (IFRS);
- timely detection of retrospective economic development trends based on the collection, processing and transmission of information system, forecasting and assessment of the consequences of management decisions.

The main measures to achieve the stated objectives of the reform of accounting and financial reporting consist of the solution of the following problems:

- Review of the general methodological bases of accounting and financial reporting and its transformation in accordance with generally accepted in the world practice;

- formation of the system of NSA and financial reporting, providing users with useful financial information;

- provision of the relationship between the reform of accounting and financial reporting with the main trends in the harmonization of standards at the international level;

- provision of methodological assistance to business entities in understanding and implementing a modernized and approximate to the requirements of IFRS model of the national accounting system and the preparation of financial statements;

- qualitative preparation and retraining of personnel in the field of accounting on the basis of a training program developed in accordance with the requirements of IFRS.

Improvement of regulatory and legal acts in the field of accounting and financial reporting involves the introduction of new National Accounting Standards for NSA, such as:

- NSA “Related Party Information” in accordance with IAS 24 “Related Party Disclosures”;

- NSA “Accounting for Investments in Associated Business Entities” in accordance with IAS 28 “Investments in Associates and Joint Ventures”;

- NSA “Accounting for joint activities” in accordance with IAS 31 “Interests in Joint Ventures”

- IAS 12 “Income Taxes” and IAS 21 “The Effects of Changes in Foreign Exchange Rates” ought to be added to NSA;

- NSA “Earnings per share” in accordance with IAS 33 “Earnings per share”;

- NSA “Accounting for impairment of assets” in accordance with IAS 36 “Impairment of Assets”;

- NSA “Accounting for investment property” in accordance with IAS 40 "Investment Property".

The Republic of Uzbekistan should create a working body comprised of representatives of the various stakeholder groups to advise policymakers and regulators on how to best implement the recommendations. Based on the successful experience of other countries, it seems appropriate that this group develop, with the assistance of local and international experts, a detailed Development Strategy, which would clearly set out key reform actions, prioritized by importance, and allocate responsibilities for their implementation. Government, stakeholders and development partners should work together to secure those resources to achieve the common goal of enhancing the quality and availability of financial information in the Republic of Uzbekistan.

Although NSA were based on IAS, statutory accounting framework substantially differs from IFRS. The following are the examples of the areas of key differences between the Uzbekistan standards and IFRS, including accounting for and disclosure of:

- financial instruments
- impairment of assets
- investments in subsidiaries, associates and joint ventures, and
- deferred tax.

In voluntarily apply IFRS enterprises with foreign investment and joint ventures in the preparation of financial statements for foreign investors, but such companies simultaneously maintain accounting records and financial statements with the national standards. In business practice, companies of Uzbekistan on a voluntary basis at the request of the bank's financial statements prepared using IFRS - to receive a bank loan. This is done to ensure that the most reliable way was presented a picture of the financial condition of the enterprises applying for a loan.

International accounting and auditing requirements do not exist in a vacuum; they are designed to fit the needs of disclosure-based governance and regulatory regimes, where high-quality audited financial statements provide information that can be relied upon by a range of users external to the reporting entity for significant decision-making purposes. Where such disclosure-based environments exist, or are

being put in place, the conditions for successful implementation of international standards are more favorable than in the absence of such environments, given the differences in incentives for concerned policy makers and stakeholders. Thus the relative importance of foreign direct investment flows, as compared with foreign portfolio investment flows, has an influence on shaping the conditions for implementation, as do patterns of share ownership. Where relatively concentrated blocks of equity ownership are in the hands of controlling shareholders (often the State, founding families, managers who have gained control of enterprises during privatization, or foreign “strategic” shareholders), the mechanisms of corporate governance are less reliant on external disclosure, since the controlling shareholders have alternative access to internal, non-disclosed information. The same can hold for providers of finance, who may place greater reliance on the value of collateral or add specific financial reporting requirements in loan covenants. Similarly, when regulators and other authorities have the power to impose their own reporting requirements ( for tax or prudential reporting), they may not see the need to invest in improving the regime for general purpose financial reporting and auditing. The enhanced transparency that flows from the robust application of international standards may not be perceived by certain influential stakeholders as being in their interests, and public policy decisions may be skewed in a manner which is not welfare-maximizing for the economy as a whole. Formal requirements for the application of international standards may be introduced, perhaps in response to external pressure, but the likelihood of successful implementation must always be assessed against the backdrop of political economy realities.

The application of international standards requires certain minimum levels of capacity (appropriately qualified individuals), which depends on the availability of opportunities for relevant and adequate education, training and experience. The greater the gap between existing national and international standards, and the shorter the period to complete the transition, the greater the capacity building challenge to overcome. The development and enhancement of capacity applies to educators, regulators and users as much as to preparers and auditors, and places demands on

both institutions and individuals. Systems, methodologies, application guidance, curricula, teaching and training materials, examination and certification procedures, and much else must be adapted to support the new obligations. Differences in language can limit the application of resources developed elsewhere, as well as the transfer of knowledge and experience from one country to another. Where the number of entities subject to international standards is modest because of local specificities (few public interest entities), cost benefit considerations may constrain investments to support the implementation of international standards, at least in the short- to medium-term. Mechanisms to apportion the costs of implementation to those stakeholders who will benefit may not function adequately due to free-rider problems often associated with the financing of public goods, and public financing may not be a viable alternative because of conflicting demands on scarce resources. Even where resources can be mobilized to launch the process of capacity development and enhancement (such as through development assistance), putting in place financing mechanisms that are sustainable in the longer term is more of a challenge. Unfortunately, there are many examples of reform initiatives that began well but collapsed when the initial pump-priming funding ran out.

The effectiveness of regulatory bodies in the monitoring and enforcement of accounting and auditing standards is a strong determinant of the quality of application such standards. This is true for a variety of reasons, among them: the inability of third party users to assess compliance with standards, agency theory problems that can lead to imperfect alignment of the interests of various stakeholders concerned with the quality of a company's financial reporting, and the public goods and coordination issues associated with the application of accounting and auditing standards. Recent scandals have drawn attention to weaknesses in previous approaches to monitoring and enforcement, as well as to the limitations of systems that place significant reliance of self-regulation. The risks of conflicts of interest now receive greater attention; steps have been taken to ensure greater segregation of functions between those involved in the financial reporting process. Significant efforts have also been made to enhance the capacity and powers of various

regulatory bodies. The need for public interest oversight of the audit profession, setting of auditing and ethical standards, and audit quality assurance programs is acknowledged, as is the need for the various regulatory bodies concerned with different aspects of financial reporting to improve the coordination of their activities, all within a coherent and consistent legislative framework.

Effective regulation is the key to successful implementation of international standards, but international accounting and auditing standards themselves do not set out requirements as to how such effective regulation should be exercised. Guidance is not provided on how to “import” international standards into national legislative and regulatory systems, on the design and operation of appropriate regulatory frameworks, or on the interfaces with other regulatory instruments and institutions (such as those for banking and securities regulation) which could contribute to the monitoring and enforcement of international standards. As currently drafted, international accounting and auditing standards implicitly assume the existence of legal, institutional and policy conditions (“preconditions”) that are often undeveloped or absent in many countries. The structure of national economies, and the role played by high quality external financial reporting, shape the extent to which these “preconditions” present themselves, and efforts to promote the implementation of international standards need to have regard to strengthen the regulatory arrangements essential for the successful implementation of international standards, countries should give greater attention to regulators pre conditions. To do this, however, they need help in understanding what needs to be done to frame the appropriate legal and institutional requirements within a policy framework that ensures consistency with other related areas of regulation, including company law. Also, National Standards of Accounting should be updated time to time to decrease differences. The International Accounting Standards Board is committed to narrowing these differences by seeking to harmonise regulations, accounting standards and procedures relating to the preparation and presentation of financial statements. Our government had better to cooperate together the organization.



### **3.2. Probable issues during the audit process of business entities, solutions to prevent them and suggestions to increase its potential efficiency**

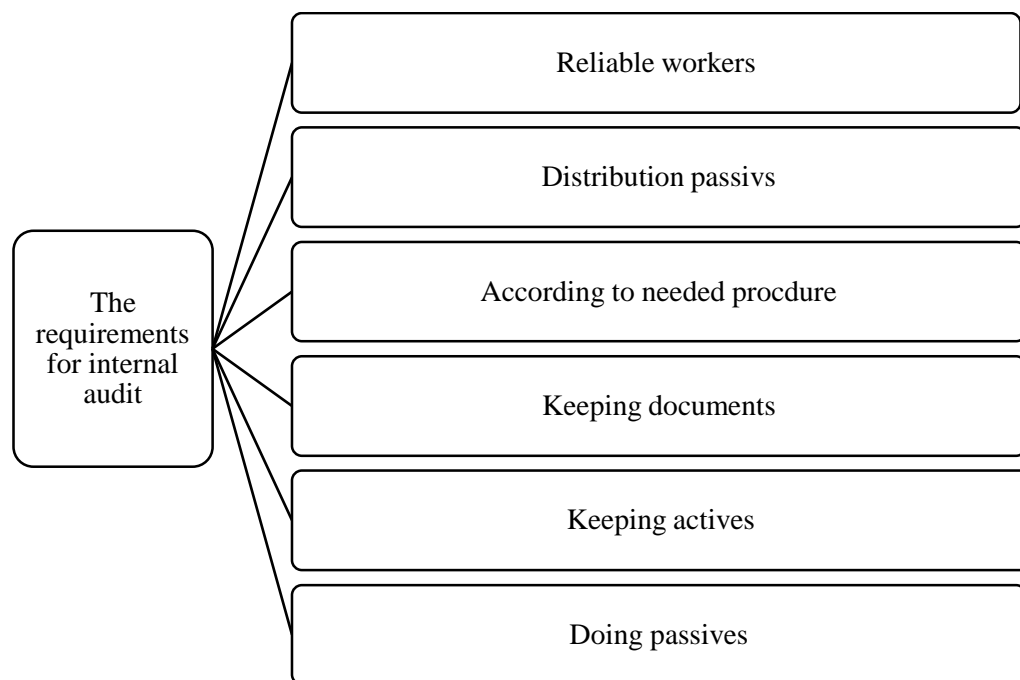
Recent audit-market pressures have led to “radical and pervasive” changes to the audit methodologies of some accounting firms. In an effort to reduce audit costs while increasing both an audit’s effectiveness and its value to the client, these firms have developed a new audit methodology. The methodology incorporates the analysis of a client’s business and strategic risks into client business models that allow the formation of knowledge-laden expectations about the client’s financial position and results of operations.

There are indirect forms of auditor involvement that are appropriate. The auditor can

1. Recommend a series of control and audit guidelines that all new systems should meet.
2. Independently review the work of the systems development team, evaluate both the quality of the systems development effort and its adherence to control and audit guidelines, and report the findings to management.

In both cases, the auditor is working through management rather than with the systems development team. To coordinate the work of the internal audit department should develop plans and schedules as a whole and for each professional. In the course of its activities internal auditors need to have certain methodological support for the audit, which includes a certain system of techniques and procedures for verifying the legality and validity, completeness, timeliness, reliability, and the reality of operations. The organization's management is very close contact with the departments (services) of internal audit, therefore the officials directly involved in the tests, the results are used in the activity. Therefore, their active participation is essential to the effective functioning of the internal audit in the enterprise. An important factor in evaluating the results of the internal audit is to develop recommendations for addressing the identified violations and problems that may arise in the future, the qualitative side of the check characterize its completeness, cost and efficiency. Economic efficiency is achieved by preventing violations of timely amendments to the accounting and tax reporting, which will lead to a

reduction in, or elimination of, tax penalties.



**Darawing 6. Requirements for internal audit<sup>16</sup>**

The main condition for the effective operation of the internal audit is its regulation of auditing standards, norms and guidelines. The standards define a common approach to the audit, the auditor's report types, methodological issues, the basic principles of the representatives of the auditing profession, regardless of the circumstances of the audit. Many of the standards, you can use an external audit and internal auditors, such as audit planning, audit evidence, the applicability of the going concern and others.

But still the hallmark of the standard is that it contributes to the efficiency of enterprise management. With the help of the Regulations on the Internal Audit Service carried out the regulation of its activities (rights, obligations and responsibilities) and relationships with other departments and experts during an audit of a particular area of accounting. Regulations on the Internal Audit Service are the basis for the audit and the preparation of the audit program, and in the case of a dispute in the course of the audit or after they serve as confirmation of the auditor performing the procedures. Evaluating the effectiveness of the internal audit - not an

<sup>16</sup>Turaev A.N. "Improvement internal audits in the business entities" thesis. "Xalqaro moliya va hisob" elektron jurnali. № 2, oktabr, 2016 yil

easy task, yet this aspect is of great importance, both for customers and for performers.

To measure the efficiency of the internal audit service in quantitative terms is not always possible, so this assessment is necessary to determine both quantitative and qualitative criteria.

However, the head of the Internal Audit Service has every right to evaluate the work he headed units using a wide range of both quantitative and qualitative indicators, and Senior narrower (about six to seven figures), or vice versa, so the system of indicators to measure the effectiveness of the internal audit service should take into account the interests of both sides. To evaluate the internal auditing can use the following indicators:

- percentage of the plan checks (the ratio actually performed audits for the period of the planned number);
- the number of inspections carried out for the period per employee of the internal audit (internal auditor);
- the number of consultations for the period per employee;
- compliance audit deadlines, by section and in general;
- availability of sufficient working documents substantiating the findings of auditors audit the divisions;
- cost-effectiveness of the recommendations made;
- professional level of auditors;
- implementation of the approved audit plan;
- the percentage of the audit recommendations.

In addition to evaluating the performance of the internal audit service, you must also pay attention to improving the quality of its work. Improving the quality of the internal audit are addressed through the development and implementation of specific programs. Among the activities carried out within them are:

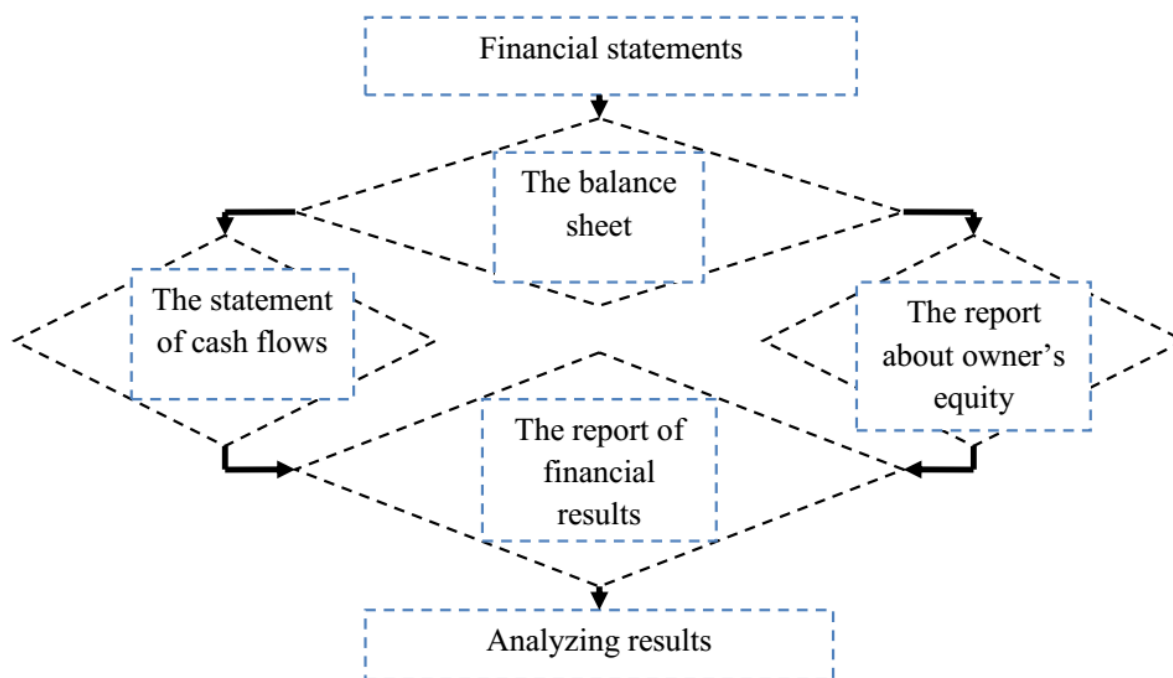
- assessment of compliance by members of the internal audit requirements of independence, skills and competence, honesty and objectivity, confidentiality and professional ethics;

- order assignments professional staff, whose qualifications are appropriate to the nature of these tasks;
- execution of all types of work in accordance with certain guidelines and quality requirements;
- identification of reserves for improvement of the activity of internal auditors and generally all of the internal audit;
- employees receive additional consultation with a lack of experience or knowledge in the particular circumstances;
- allow visits by internal auditors scientific conferences and seminars in order to obtain comprehensive knowledge in the fields of accounting, taxation, auditing, finance, etc .
- assessment of the work of the internal audit side of the structure, which may be the authoritative external auditors and consultants.

Internal quality control of the work of internal audit management service should be paid special attention, since this aspect has a dominant influence on the efficiency of the internal audit function as a whole. This structural unit of the economic entity is necessary to form the internal quality control system audit, which will perform a preliminary, current and subsequent control. Preliminary checks carried out at the planning stage of the internal audit. Current internal control of performers includes the main elements of guidance and inspection of the work performed. The subsequent control is to verify the results of the work performed by each internal auditor.

It should be noted that, subject to the availability of the internal system of audit quality control approach to improve the efficiency of the internal audit service will result and most contribute to the improvement of its work.

An integrated approach to the conditions of the functioning of the internal audit helps to ensure high efficiency of the entire system of internal control in the company. In turn, this reduces the risk in conducting the external audit, and hence the cost of it.



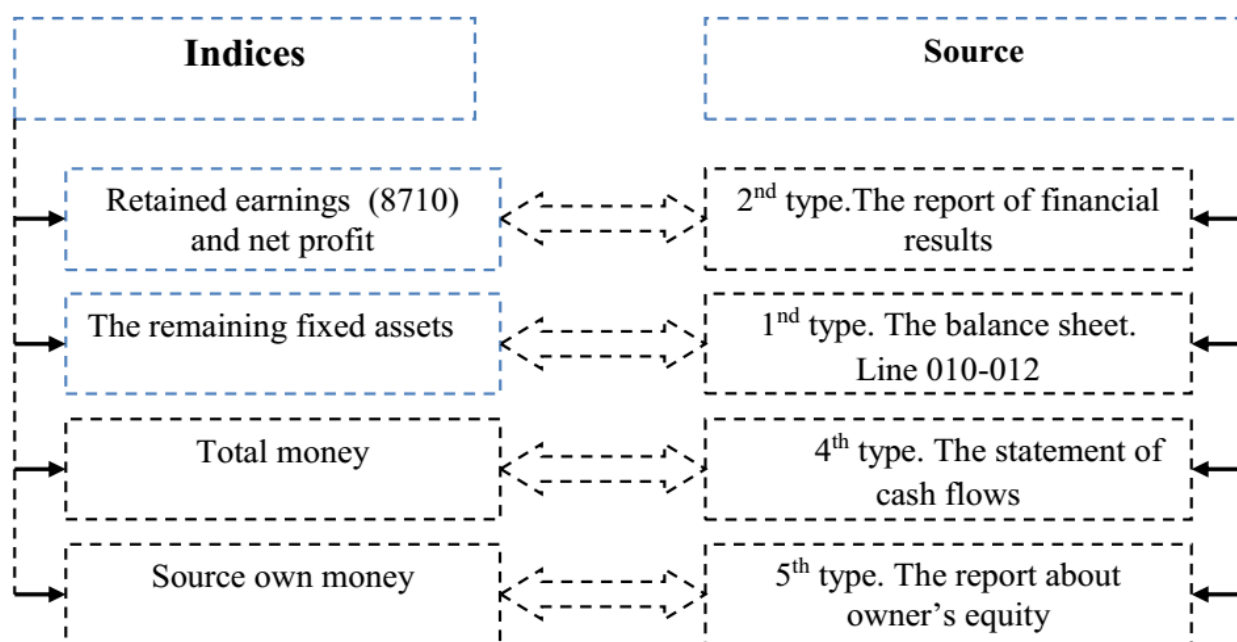
**Drawing 8. The model for auditing financial statement<sup>17</sup>**

The reliability and efficiency of the internal audit function can be assessed as "high", "medium" and "low", and it is evaluated by the external auditor. The evaluation process consists of several stages: a general acquaintance with the internal audit, initial assessment of its reliability and validation to make an assessment.

On stage, a general acquaintance with the internal audit, the external auditor obtains a general idea of the internal audit activity and the extent described in the Regulations of the Internal Audit Service.

The initial assessment of the reliability of the internal control is carried out by the external auditor on the basis of its own methods and techniques. The external auditor considers that to verify the reliability of the internal audit is necessary to study accounting and business records are not selectively, but for the entire reporting period. At the stage of evaluation of the external auditor of the reliability of the internal audit, control procedures should be aimed at finding out how the service is to prevent, detect and correct errors and distortions that occur in the course of business operations.

<sup>17</sup>Turaev A.N. "Improvement internal audits in the business entities" thesis. "Xalqaro moliya va hisob" elektron jurnali. № 2, oktabr, 2016 yil



**Drawing 9. The special chosen information base<sup>18</sup>**

All stages of the assessment of the internal audit are recorded in the working papers of the external auditor. This provides an assessment of the reliability of the internal audit and justified degree of confidence in it when planning the scope of audit procedures.

Internal audit is an integral part of the administrative control of the enterprise. It is represented that internal auditing is determined by management based on the needs of management as subdivisions of the enterprise and the enterprise as a whole. The object of the audit is the decision of individual functional management tasks, the development and validation of enterprise information systems. The purpose of internal auditing is determined by management companies, funds are selected independently intra provisions or standards defined by the internal audit activity performing, the organization of work - the performance of specific tasks of management, the relationship between management and the internal auditor is subordinate to the management company auditors. Subjects of internal audit employees are subordinate to the management company located in the state of the enterprise. Qualification of the internal auditor is determined at the discretion of the

<sup>18</sup>Turaev A.N. "Improvement internal audits in the business entities" thesis. Xalqaro moliya va hisob" elektron jurnali. № 2, oktabr, 2016 yil

company's management, the payment of a payroll staffing. Internal auditors are responsible for the leadership of the duties. The methods of internal audit may be the same with the external audit, there are differences in the degree of accuracy and activity.

Central to an auditor's understanding of the inner workings of the client's business is her knowledge of the client's internal control system. Evidence related to how this client knowledge is stored in an auditor's memory may provide insight into how higher-level knowledge of the client's business is organized in memory. This sub-section reviews the key findings in the area of auditors' internal control knowledge. There are four interlocking and iterative phases in a strategic-systems audit:

Phase 1: Strategic Analysis – The auditor analyzes the client's business strategy, including the environment in which it operates, whether it has a sustainable competitive advantage, what its business risks are, and how the risks are being managed.

Phase 2: Business Process Analysis – The auditor identifies business processes that are key to the client achieving success. S/he analyzes these processes in detail to gain a deep understanding of significant business risks and mitigation strategies, including performance metrics and management controls.

Phase 3: Risk Assessment – This is a continuous process that considers the reasonableness of the client's assessments of its business risks, the adequacy of management's controls to minimize the risks, and the residual risks remaining after controls have been applied.

Phase 4: Business Measurement – Building on the evidence gathered in the previous phases, the auditor evaluates the client's revenue recognition policies, assesses its quality of earnings, analyzes the consistency of the client's financial and nonfinancial performance measures, and reviews any going-concern issues.

“Inappropriate testing of the appropriateness of the entity's applicability of the going concern basis of accounting can lead to a low quality audit. It is clear that a qualified audit report caused by going concern issues is a signal for investors that

either the management of the company is unable to keep the company profitable, or that they have attempted to present an over- favourable view of the company's performance and/or position. Thus, there is clear relation between going concern audit reporting and audit quality”<sup>19</sup>

In developed countries, new type of auditing-“Witness auditing” developed. This type of audit service is becoming popular especially in banking field. At the process of giving credits to business entities, witness auditing is used as auditors guarantee the availability of creditableness of the company to the borrowers. Audit firms observe the companies that they follow whether companies perform terms of credit agreement or not. Therefore, new standards belonging to this type of audit activity were approved in the USA.

The financial position and other financial documents and other accounting data must be analyzed every year by the external auditor, internal auditor or accountants and be presented to the Statistic committee of the Republic of Uzbekistan since these actions can help to reduce the risk of bankruptcy. This is because, if company's business goes wrong then the government examine again the company financial condition and may help to them.

There are following problems which appears implementing international standards of audit in our country:

- clients do not realize the advantage of audit leaning on international standards;
- auditing based on international standards costs much more expensive than national standards;
- lack of auditors who have experience with international standards of audit and some auditors do not realize the meaning of international standards.

To solve above mentioned problems, providing auditors with Uzbek and Russian translations of international standards, modern learning books, supplements, modern technologies and improving education of auditors must be organized.

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<sup>19</sup> Thesis- Audit reporting challenges: auditing the going concern basis of accounting (from [www.elsevier.com/scopus](http://www.elsevier.com/scopus) )



Moreover, the activity of private auditor is recommended to be legalized by the government.

### **Conclusion for the third chapter**

On September 19, 2017 the President of the Republic of Uzbekistan Shavkat Mirziyoyev addressed the general debate of the 72nd session of the United Nations General Assembly. In his address Shavkat Mirziyoyev has accentuated on the course of implementation of the Strategy of development of Uzbekistan on five priority areas. “While developing it, as if we have looked at ourselves from outside, so as not only to objectively assess our potential and opportunities, but also pay a close attention to our failures and mistakes”<sup>20</sup>, – the Head of our country has stated.

In Uzbekistan, National Auditing Standards are currently used, which are developed on the basis of International standards on auditing, but are approximated to International standards on auditing only by some parameters.

It should be noted that the goals of reforming the International Financial Reporting Standards and the International Standards on Auditing in the context of overcoming the consequences of the global financial and economic crisis in the short and medium term have been defined. It was also noted the need for joint work and enhanced coordination of the activities of international organizations that establish accounting and auditing standards in order to establish effective and unified global standards. The results of our study showed that conclusions:

- at the current stage of the economic development of our country It is necessary to combine the use and use of both national auditing standards (on a scale business activity), and international standards (at the level of joint-stock companies and economic entities, implementing corporate governance);

- it is necessary to move rationally and systematic from national to international standards of auditing and generalization results of the audit. For this

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<sup>20</sup> The speech of the President of the Republic of Uzbekistan Shavkat Mirziyoyev from the general debate of the 72nd session of the United Nations General Assembly. On September 19, 2017

purpose, it is necessary further improvement of existing standards because our economy has reached a global level of organization and management activities and entered into international economic integration.

-it is necessary to prepare and improve qualification of audit staff in accordance with international requirements.

In addressing these issues and the main research problem, the following recommendations and proposals have been developed:

1. It is necessary to increase the level of transparency and meaningful value of the audit report;

2. Improved information communication is required between the auditor and investors, as well as between the auditor and persons, responsible for corporate governance;

3. It is important to strengthen the attention of management and those responsible for corporate governance (for example, the audit committee), to the disclosure of given in the auditor's opinion;

4. It is important to achieve the attention of the auditor to the issues, which will be presented in the audit report, which may indirectly contribute to a more active manifestation of professional skepticism.

## **CONCLUSION AND OFFERS**

"The implementation of an active investment policy for the implementation of strategically important projects aimed at modernizing, technical and technological

renovation of the leading basic industries, the development of a powerful modern network of transport and infrastructure communications."<sup>21</sup>

If we consider with current point of view, the main attention is paid for solve existing problems in companies and achieve the most effective condition. Based on ideas given, we can conclude that establishment of internal audit in those companies and assessment of their effectiveness is demand of contemporary companies. Any company might be under control of several positive and negative factors. Negative factors might eliminate positive ones and vice versa. Companies are obliged to be suitable for those factors. Factors, in fact, serve for specified aim. In condition of market economy, company serves for in the same time subject and object of economical relations, and companies can affect dynamics of various factors. On conclusion, all of these factors are linked with effective establishment of accounting and audit.

On the way of establishment of effective working accounting, internal audit and external audit we can reach the following conclusion:

- purpose of establishment of internal audit in joint-stock companies is to control over obedience of staff for employment standards, prevent conflicts between workers, supplying reliableness of features of operations carried out by companies and as much as possible eliminate existing risks;
- in joint-stock companies, to supply equality of shareholders` rights and providing objectiveness and independence of internal audit staff;
- investors and shareholders have one certain question, this is how company is using its sources of money and for which project money is spending, or how much profit company is acquiring. For achieving complete requirement of these tasks, internal audit should carry out its activity completely and needs to be informative for shareholders;
- managerial accounting is also essential to the economic activity of business entities and helps to increase efficiency of financial accounting;

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<sup>21</sup>I.Karimov. Jahon inqirozining oqibatlarini yengish, mamlakatimizni modernizatsiya qilish va taraqqiy topgan davlatlar darajasiga ko'tarilish sari. "O'zbekiston",-T. 2010, 167p.

- accounting policy is core of the system as composing it must be organized carefully;

- international standards of accounting and audit are the key elements to develop our economy, accounting and the activity of the companies in world market;

- transparency of audit reports guarantees the flow of foreign investors and encourage them to invest since honesty is needed in business sphere;

- it is necessary to prepare and improve qualification of audit and accounting staff in accordance with international requirements.

In addressing these issues and the main research problem, the following recommendations and proposals have been developed:

1. It is necessary to increase the level of transparency and meaningful value of the audit report;

2. It is important to strengthen the attention of management and those responsible for corporate governance (for example, the audit committee), to the disclosure of given in the auditor's opinion;

3. National accounting and audit standards should be updated time to time and the differences between International Standards ought to be shortened;

4. IAS 24 “Related Party Disclosures”, IAS 28 “Investments in Associates and Joint Ventures”, IAS 31 “Interests in Joint Ventures”, IAS 12 “Income Taxes”, IAS 33 “Earnings per share”, IAS 36 “Impairment of Assets”, IAS 40 “Investment Property” should be created in our national standards;

5. The government should develop and improve rules and instructions related to composing accounting policy. To obtain these task, NSA 1 “Accounting policy and financial statement” is recommended to enhancing and enriching new procedures;

6. Many companies have their own web sites and there are some accounting and auditing problems with them. So, we recommend these types of assets must be recorded as intangible assets and new account ,0495, should be created in order to improving accounting and audit.

7. We recommend that if companies create their own brand, initial value which is recorded in the balance sheet must be add up to zero. This is because, they spend the company's money to introduce their brand to community and clients.(see: IAS 38)

8. The circulation of accounting documents is also legalized by online that is sending and receiving documents throughout the Internet . It is performed with the help of the website which is called "Didox.uz". If companies use such kind of electron circulation of documents, then they can much save much more money and time;

9. Moreover, the activity of private auditor is recommended to be legalized by the government;

10. In developed countries, new type of auditing-"Witness auditing" developed. This type of audit service is becoming popular, so it is recommended to legalize this type of audit service with standards;

11. It is necessary to provide auditors and accountants with the Uzbek or Russian translation of international standards and useful financial information.

For example, good accounting standards are jeopardized if practitioners do not understand how to translate them into journal entries; a rigorous statutory and regulatory framework is unlikely to be effective if it is not enforced. Additionally, some recommendations will not have an immediate effect but will still remain of high priority if the financial reporting environment in the Republic of Uzbekistan is to be upgraded to international standards within a reasonable time frame. Achievement of these objectives requires continuous reorganization and improvement of the Uzbek legal framework, institutions, the accounting and auditing professions and the education system. Policies should not be developed and enacted, however, without giving due regard to a country's ability to carry them out (both in terms of capacity and resources). A relatively lenient rule that is robustly and consistently enforced is preferable to a good, rigorous one that is unenforceable, as the lenient rule can be progressively made more rigorous as the circumstances allow. The policy recommendations below, while challenging, can be carried out in

the short to medium term and will support the Republic of Uzbekistan's long-term objectives. They fall into three key areas:

- statutory framework
- institutional capacity building
- professional education and training

Among the large-scale transformations in our country President has highlighted liberalization of an entire economic system and creation of favorable investment climate. "We proceed from one simple truth: the richer the people are – the stronger shall be the state", – the President of Uzbekistan has emphasized<sup>22</sup>.

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