



Issues for Improving the Calculation of the Level of Significance in the Audit of Financial Statements

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Abstract: The article examines the calculation of the level of materiality in the audit of financial statements. As a result of the research, the problems related to the calculation of importance were identified and suggestions for their elimination were developed.

Key words: audit, materiality percentage, IAS, financial statements, IFRS, misrepresentation of reporting items, audit risk

Introduction

"Importance" is a key notion in audit practice because it guides the auditor from the time he or she decides on the types, volume, and duration of audit processes through the time the audit conclusion is written. The auditor's role is to affirm or reject the authenticity of the financial statement while establishing the level of importance of errors committed in the production of the financial statement. Furthermore, the significance of this term is tied to the urgent requirement to record changes in financial statements owing to errors committed in their preparation.

Literature review

There are several viewpoints on exposing the nature of duties in regulatory legal texts and economic literature.

Particularly in International Financial Accounting Standard No. 1 named "...the absence or distortion of items is regarded significant if they (separately or jointly) might impact the economic judgments of users made on the basis of financial statements." Materiality is determined by the magnitude and character of the omission or misrepresentation in the context. The size, kind, or mix of the substances can be crucial "[1], - is defined as

« Accounting policies, accounting estimates changes, and mistakes "...the absence or distortion of items is regarded relevant in circumstances where they might impact the economic judgments of users made on the basis of financial statements," according to International Standards of Financial Accounting No. 8. (individually or together). Materiality is determined by the magnitude and character of the omission or misrepresentation in the specific context. It is suggested that the size or nature of the material, or their combination, might be a deciding factor»[2].

Materiality is defined as follows in International Auditing Standard No. 320 (ISA-320): "Information is material if its exclusion or distortion might impact the economic decisions of users made on the basis of financial statements" [3].

E. A. Arens, A. Bogopolskaya's, V. Andreev's, and other authors' works address certain theoretical elements of significance calculation. The notions of "important," "threshold of



importance," difficult features of calculating the level of importance, and practical reflection of the technique of calculating the level of importance of data are underlined in the works of these scientists. [4].

Sh.I. Ilhamov, a well-known economist, defined it as "the greatest amount of inaccurate amount that may be documented in financial accounts, which is regarded minor, that is, does not allow consumers to have a mistaken view" [5].

The essential markers for estimating the level of importance are included in R.Dustmurodov's textbook, along with the methods for doing so [6].

In addition, in his writings, Z.T.Mamatov states, "They assess the necessity of guaranteeing the essential efficiency of auditing from the planning stage." During the significance evaluation, two methodologies are used: inductive and deductive.

According to K.Ahmadjonov and I.Yakubov's works, "the auditor picks and verifies just the most serious faults in order to execute the audit with high quality at the cheapest price for the customer" [7].

There are several methods to the definitions listed above. However, the audit of financial statements does not completely expose materiality and calculating methodologies.

Methodology

The regulatory legal papers represent the determination of the level of significance in the audit of financial statements. Determining the degree of significance in the audit of financial statements of economic organizations operating in the Republic of Uzbekistan, based on international audit standards, is critical to enhancing the audit's scientific and methodological equipment.

Analysis and Results

In order to summarize the definitions provided in regulatory legal texts, the idea of "importance" is first considered:

- one of the accounting principles;
- one of the primary requirements for financial reporting;
- quality features of accounting information

However, given that the importance of the indicator is dependent on certain factors (for example, the assessment of the indicator or its relative size, the nature of the indicator, and the specific reasons for its occurrence), in my opinion, the definition of the importance given in the local regulatory documents, the importance is dependent not only on the size of the substance, but also on its nature, should be filled with information that affects the indicator. As a result, materiality is a very versatile concept that should be regarded as both an accounting principle, an important requirement for financial reporting, and a characteristic of the quality of accounting information, which determines its ability to influence the decision-making of financial reporting users.

According to the definition of the term "importance," the following are the primary variables in determining the importance of the report material:

- quantitative property of the material;
- qualitative property of the substance;



- nature of the substance;
- a combination of all three variables

Thus, significance criteria are qualitative and quantitative aspects of data that are essential to data consumers. Let's have a look at each of the characteristics stated.

In terms of quantitative importance assessment, it can be assessed in absolute or relative terms. In practice, accepting the absolute value of importance is uncommon. In practice, the most common method is to specify the significance level relative to the fundamental values, i.e. in percentages or shares. In relative measurements, significance levels can be specified as point values (for example, 3%, 5%) or as range values (for example, 3%-5%).

When calculating the level of materiality, it should be remembered that neither the IFRS nor the US GAAP standards specify exact numbers on which things are material. Determining such a threshold is purely subjective, given that the word "materiality" encompasses both quantitative and qualitative components of the research. It should be emphasized that several of the quantitative indicators specified in the IFRS conceptual framework (for example, the ten and seventy-five percent threshold values for the establishment of reporting segments in IFRS 8) are not indications of the degree of importance in any way. In IFRS 8, for example, this threshold is set for the logical sequential disclosure of the same type of information by segments in a comparable and understandable format by all entities - for example, to avoid situations in which two entities with a similar structure and type of activity disclose completely different information. The number of reported items is 3 in one case and 33 in the other. [6].

In comparison to the IFRS, the International Standards on Auditing (ISA) go into greater detail about establishing the level of materiality because auditors are explicitly obliged by these standards to execute their primary function. Two methodological approaches can be used in auditing practice to determine the amount of materiality:

1) deductive technique consists in finding the overall level of importance and distributing it among the reporting items;

2) inductive method consists in evaluating the relevance of individual things first, then calculating the total importance based on the sum of all grades. [7].

Furthermore, audit theory and its foreign practice have a variety of methodological approaches for calculating significance in financial statement audits, the methodology for which is described in Table 1.

Table 1

Methodological methods for calculating materiality in the audit of reports

The name of the method	Algorithm	Advantages	Disadvantages
A method of assessing	1) Choosing the primary indicator (according to ISA-320 - Income, profit before taxes, gross income, gross costs, capital or net assets); 2) Calculating the percentage in relation to the value of the basic	- ease of calculating;	- fails to account for the unique characteristics of business activities; - the potential of improperly



<p>importance as a percentage of the value of the base indicator</p>	<p>indication (auditor's professional judgment); 3) distribution of large discrepancies among the most essential reporting elements, taking into account the item's relative weight (debit or credit turnover) in the total result</p>	<p>- aids in adhering to the ideals of economy and expediency.</p>	<p>calculating the threshold of relevance (items with a high specific weight in the balance currency may have a small turnover by volume, and vice versa, items with a small specific weight will have a large turnover).</p>
<p>A method of determining the level of significance as an average percentage</p>	<p>Inconsistencies in financial statements are regarded inconsequential when they are less than: - 5% of balance profit - 2% of net income - 2% of balance currency - 10% of equity capital - 2% of total costs, according to this technique.</p>	<p>- calculation simplicity; - helps to adhere to the principles of thrift and expediency.</p>	<p>- does not take into consideration the specifics of business activities; - cannot be applied in all situations (if the significance level has a very wide range or the selected key indicators are not significant or not at all).</p>
<p>Determining the level of materiality in relation to audit risk</p>	<p>Failure refers to assigning a proportionate amount of priority to the accounting system's risk.</p>	<p>- in comparison to the previous two approaches, it considers the accountant's pre-human aspect, that is, the probability of omission or error in the accounts across the whole chain, from the accounting document to the financial statement data, in the process of representing economic activity</p>	<p>- At the audit planning stage, determining the materiality level for an item only by pre-calculating the risk of the accounting system for the same item is not always practicable.</p>



		accounting.	
The method of fuzzy logic	<p>1) the degree of relevance is established;</p> <p>2) the significance of the element is established;</p> <p>3) Factors influencing the relevance of the material (omission mistakes) are identified and assigned a weight coefficient ranging from 0 to 1; 4) the intensity of each factor's effect is established using expert judgment and the application of relevant coefficients (from 0 to 1).</p> <p>5) The weight coefficient is multiplied by the effect of each element to establish its important rating.</p> <p>6) final significance indicator: the greatest value from the acquired importance values for each element is calculated;</p> <p>7) the final significance value is interpreted.</p>	<p>- assists in making more rational and well-considered judgements regarding the significance of the material;</p> <p>- takes into consideration the peculiarities of business activities;</p>	- computational difficulty.

According to experience, a single percentage number of significance cannot be applied to all corporate units. As a result, some scientists believe that the degree of relevance should be assessed by computation. [8]:

$$\Pi(\%) = 2 + \left[1 + \sqrt{\frac{\text{ДО}}{\text{СБ}}} \right]$$

Here

Π – importance percentage;

ДО – cash flow according to accounting charts for the reporting period (according to the data of the final line of the balance sheet);

СБ – balance at the end of the reporting period.

The downside of the above approach is that the level of materiality for any quantitative value of cash flow and balance always exceeds 3%, although determining the importance of errors at this level is not always advised.



Conclusion

1. The following are the key criteria in determining the significance of the report material, according to the definition of the word "Importance": the quantitative characteristic of the substance, the qualitative characteristic of the substance, its nature, and the combination of all three aspects.

2. "Determining the level of materiality in each individual instance remains a highly complicated individual procedure for the compilation of each financial statement in accordance with the IFRS and the following audit in accordance with the criteria of the IAS." To solve this difficulty, highly expert judgment must be used to models in judging individual and aggregated relevance.

3. The ways of assessing relevance in report auditing, their calculation algorithm, benefits and drawbacks are presented.

4. There is a formula for calculating a single percentage value of importance. This value, however, cannot be applied to all corporate organizations.

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