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**IMPROVEMENT OF AUDITING CASH FLOW STATEMENT**

**5A230902- “Audit” (on branches and fields)**

**DISSERTATION**

**for obtaining master`s academic degree**

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## **Introduction**

### **Substantiation of subject of Master's dissertation and its topicality.**

Under the liberalization and modernization of economy, creating multifaceted economy is a priority for us if we really want to compete with the rest of the world's global economies. Development of activities of economic entities and further enhancing their financial stability is one of the most important tasks we are focusing on today.

Our government is paying much attention to addressing the current problems of assessment and analysis of the economic potentials of business entities in our country. Organization of accounting, auditing and economic analysis necessitates improvement of methods in sustainable management of companies. If we take into account these circumstances, it will be necessary to state that accounting of cash flows, duly organization and keeping improved audits are today's most topical issues.

Under the conditions of modernization of the economy, much effort is required in the regulation of cash flows, establishment of effective supervision over them, seeking new sources of funds and keeping the status regularly analyzed. In particular, our President I.Karimov states: "If we talk about sustainable development of our country at high rates, we need to believe that the capital allocated to our economy, the growing investments are the reasons for and factors of this phenomenon. It is planned to allocate investments amounting to USD 17 billion 300 million in 2016 for development, modernization, and structural improvements, to ensure that their growth rate reaches 109.3 percent. Foreign investments constitute over USD 4 bln of the actual investments, which is 20.8 percent more than in 2015".<sup>1</sup> It is true that investors get information about companies' economy from the cash flow statements and assess their business, that

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<sup>1</sup> "Our major objective is to go forward by carrying on the ongoing reforms, the structural transformations in our economy, to provide the private businesses, small businesses and entrepreneurship with more freedom despite the existing difficulties": an abstract from the speech of Islam Karimov, the President of Uzbekistan delivered at the meeting held in the Cabinet of Ministers dedicated to the 2015 socio-economic development results and the post important points of the economic program for 2016, "Halk suzi" newspaper, January 16, 2016, Issue №11.

is why improvement and establishment of cash flow accounting and statements, rebuilding it in accordance with the structure and changes in the economy's all sectors, elaboration of special forms of supervision of funds are considered to be critical goal. The cash flow statement data serves as an important basis for assessing the potential attraction of business entity's funds.

Under the current conditions of the ongoing process of liberalization and modernization of the economy in our country, improvement of cash flow statement auditing becomes an important issue. The business entities' financial stability directly depends on correct generation of cash flows during their development. In order to fulfill these tasks, the need is believed to have arisen for organization of audit of business entities' cash flow statements according to the requirements of the national auditing standards, analysis of the statement data, improvement of the auditing process according to the experience gained in foreign countries.

The need for addressing the above points in terms of science determines the dissertation subject and research direction.

**Research object and subject.** JVC «CHIRCHIQSELMASH» and JV «KULTAKNEFTGAZ» LLC, also Auditing organization «PKF MAK ALYANS» LLC have been chosen as the object of the research. Study of the theoretical-methodology bases of cash flow statement audit and formulation of proposals on their improvement are the subject of the research.

**Research purpose and objectives.** The purpose of this master's dissertation is formulation of relevant opinions and proposals on improvement of auditing cash flow statement in business entities under the conditions of modernization of the economy.

Based on the aforesaid purpose, the following objectives have been identified in performance of the research:

- disclosure of the contents and essence of cash flow statement;
- research into the theoretical bases of cash flow statement audit and setting up the main lines of their development;

- highlighting the aspects of procedure of auditing cash flow statement in accordance with the requirements of the National Standards on Auditing;
- disclosure of the methods of preparing cash flow statement in accordance with the International Accounting Standards;
- highlighting the aspects of procedure of auditing cash flow statement in accordance with the requirements of the International Standards on Auditing.
- highlighting the aspects of improvement of analyzing cash flow statement.
  - disclosure of the improvement of auditing cash flow statement in accordance with the International Standards.

**Research main points and hypothesis.** The research main points and hypothesis are as follows:

- it is extremely important to improve the cash flow statement audit procedure;
- the scientific substantiation of cash flow statement audit discloses the methodology of the research subject;
- it is reasonable to audit cash flow statements according to the International Auditing Standards and International Accounting Standards;
- use of international standards in cash flow statement preparation and its auditing cash flow statements can disclose further development potentials.

**Analysis of literature related to the research subject.** The laws of the Republic of Uzbekistan, the works by, decrees, speeches of I.Karimov, the President of the Republic of Uzbekistan, resolutions of the Cabinet of Ministers of the Republic of Uzbekistan, regulations of the Ministry of Finance on accounting, statements and audit methodology, the national and international auditing standards, the works by Uzbekistan and foreign economics scientists and articles printed in the periodicals dedicated to this subject serve as the sources for the subject of the master's thesis. Beside this, the experience of organization of audit in developed foreign countries has been studied.

**Characterization of the techniques used in the research.** A personal timing schedule has been made up for research topics and researches have been carried out according to them:

- the list of methods and directions necessary for the research has been made up and studied and selected for conducting the research;
- a research problem has been developed and characterized;
- questions have been made up for addressing in the research process;
- research topicality, novelty and practical significance have been substantiated;
- the classification and points of view existing on the research subject have been comparatively analyzed;
- the acquired results have been checked for compliance with the requirements of novelty, objectivity and certainty, reliability and integrity;
- conclusion and recommendations have been formulated.

**Theoretical and practical significance of research results.** The research summaries and proposals in the dissertation create opportunities for organization of cash flow statement audit in business entities according to the international auditing requirements. The research results can be used as a practical guidebook in the process of auditing cash flow statements in business entities and by students of higher education institutions.

**Research scientific novelty:** The research scientific novelty is reflected in the following:

- the content and essence of cash flow statement audit have been disclosed;
- the main areas of study of the theoretical bases of cash flow statement audit and its development have been highlighted;
- the aspects of procedure of auditing cash flow statement in accordance with the requirements of the National Standards on Auditing have been highlighted;
- the methods of preparing cash flow statement in accordance with the International Accounting Standards have been disclosed;

- the aspects of procedure of auditing cash flow statement in accordance with the requirements of the International Standards on Auditing have been highlighted;

- the aspects of improvement of analyzing cash flow statement have been highlighted.

- recommendations have been formulated on improvement of auditing cash flow statement in accordance with the international standards.

**Characterization of research structure.** This remainder of the research is divided into three chapters. Chapter one describes the main theoretical bases of auditing cash flow statement. Chapter two explains the practical aspects of auditing cash flow statement. Chapter three presents and discusses the improvement of auditing cash flow statement in accordance with the international standards. Also, the dissertation consists of conclusions and recommendations, the list of used references and appendices.

# CHAPTER I. THEORETICAL BASES OF AUDITING CASH FLOW STATEMENT

## 1.1. The content and essence of cash flow statement

Under the conditions of modernization of the economy financial statements are an important source of information for investment and credit decisions.

In particular, “Marking high rates of steady growth of our country, it is necessary to examine the height of capital investments, investments directed to our economy as a principal cause and factors that brought to steady development. Active implementation of measures and investment projects on structural transformations, modernization, technical and technological renovation of spheres, as well as formation of modern infrastructure ensured disbursement of investments for USD 15,8 bln in 2015. 9,5 percent more than in 2014. Over USD 3,3 bln. or 21 percent of total investments were foreign investments, of which 73% were direct foreign investments”<sup>2</sup>. - has underlined the President Islam Karimov.

Really, investors, lenders and other creditors need information to help them assess the prospects for future net cash inflows to an entity. Financial statements are written records of a business's financial situation. They include standard reports like the balance sheet, income or profit and loss statements, and cash flow statement. They stand as one of the more essential components of business information, and as the principal method of communicating financial information about an entity to outside parties. In a technical sense, financial statements are a summation of the financial position of an entity at a given point in time. Generally, financial statements are designed to meet the needs of many diverse users, particularly present and potential owners and creditors.

Both International Accounting Standards Board (2010) and Financial Accounting Standards Board (2010) state in their respective Conceptual

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<sup>2</sup> “Our major objective is to go forward by carrying on the ongoing reforms, the structural transformations in our economy, to provide the private businesses, small businesses and entrepreneurship with more freedom despite the existing difficulties”: an abstract from The Cabinet of Ministers of the Republic of Uzbekistan convened for an extended meeting on January 15 to discuss the outcomes of socio-economic development in the country in 2015 and the crucial priorities of economic program for the year 2016”. President of the Republic of Uzbekistan Islam Karimov delivered a keynote speech at the session. “Halk suzi” newspaper, January 16, 2016, Issue №11.



Frameworks for Financial Reporting Chapter 1: The Objective of General Purpose Financial Reporting paragraphs OB2 and OB3 that: The objective of financial statements<sup>3</sup> is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Decisions by investors depend on the returns that they expect from an investment, for example dividends, principal and interest payments or market price increases. Similarly, decisions by lenders and other creditors depend on the principal and interest payments or other returns they expect. Investors, lenders and other creditors expectations about returns depend on their assessment of the amount, timing and uncertainty of future net cash inflows to the entity. Consequently, existing and potential investors, lenders and other creditors need information to help them assess the prospects for future net cash inflows to an entity. In addition to providing information useful in predicting an entity's future cash flows, financial statements should provide information that is useful in assessing an entity's liquidity and solvency.

Indeed, financial statements are an important source of information for investment and credit decisions. Cash flow statement is a part of the financial statements, it shares the same objectives set to financial reporting in general.

Cash plays a very important role in the economic life of a business. A firm needs cash to make payment to its suppliers, to incur day-to-day expenses and to pay salaries, wages, interest and dividends etc. In fact, what blood is to a human body, cash is to a business enterprise. Thus, it is very essential for a business to maintain an adequate balance of cash. For example, a concern operates profitably but it does not have sufficient cash balance to pay dividends, what message does it convey to the shareholders and public in general. Thus, management of cash is very essential. There should be focus on movement of cash and its equivalents. Cash means, cash in hand and demand deposits with the bank. Cash equivalent consists of bank overdraft, cash credit, short term deposits and marketable

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<sup>3</sup> The term "financial statements" used in this study refer to the term "general purpose financial reporting" that is used by both FASB (2010) and IASB (2010).

securities. Cash Flow Statement deals with flow of cash which includes cash equivalents as well as cash. This statement shows the incoming and outgoing of cash. The statement assesses the capability of the enterprise to generate cash and utilize it.

A cash flow statement, also known as statement of cash flows<sup>4</sup>, is a financial statement that shows how changes in balance sheet accounts and income affect cash and cash equivalents, and breaks the analysis down to operating, investing and financing activities. The cash flow statement is a financial report that describes the sources of a company's cash and how that cash was spent over a specified time period. It does not include non-cash items such as depreciation. This makes it useful for determining the short-term viability of a company, particularly its ability to pay bills. Because the management of cash flow is so crucial for businesses and small businesses in particular, most analysts recommend that an entrepreneur study a cash flow statement at least every quarter. International Accounting Standard 7 (IAS 7) is the International Accounting Standard and National Accounting Standard 9 (NAS 9) is the National Accounting Standard of Uzbekistan that deals with cash flow statements.

The cash flow statement is similar to the income statement in that it records a company's performance over a specified period of time. The difference between the two is that the income statement also takes into account some non-cash accounting items such as depreciation. The cash flow statement strips away all of this and shows exactly how much actual money the company has generated. Cash flow statements show how companies have performed in managing inflows and outflows of cash. It provides a sharper picture of a company's ability to pay creditors, and finance growth.

The cash flow statement is useful for these purposes: the information about an entity's cash flows during a period helps users predict its future net cash inflows, understand its operations, evaluate its financing and investing activities,

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<sup>4</sup> Helfert, Erich A. "The Nature of Financial Statements: The Cash Flow Statement". Financial Analysis - Tools and Techniques.

assess its liquidity or solvency and interpret other information about financial performance.

Cash flow information is useful in providing users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows<sup>5</sup>. The objective section of IAS 7 further states that the economic decisions taken by users require an evaluation of the ability of an entity to generate cash and cash equivalents and the timing and certainty of their generation.

The statement of cash flows of any given business entity is mainly involved in the cash inflows and cash outflows within the business entity. Persons using the financial statements are usually interested in how the enterprise generates cash and uses cash and cash equivalents. This is a universal case regardless of the kind of enterprise's activities or whether cash can be viewed as a product of enterprise. All business entities do need cash to conduct their daily operations, pay their obligations and provide returns to their investors.

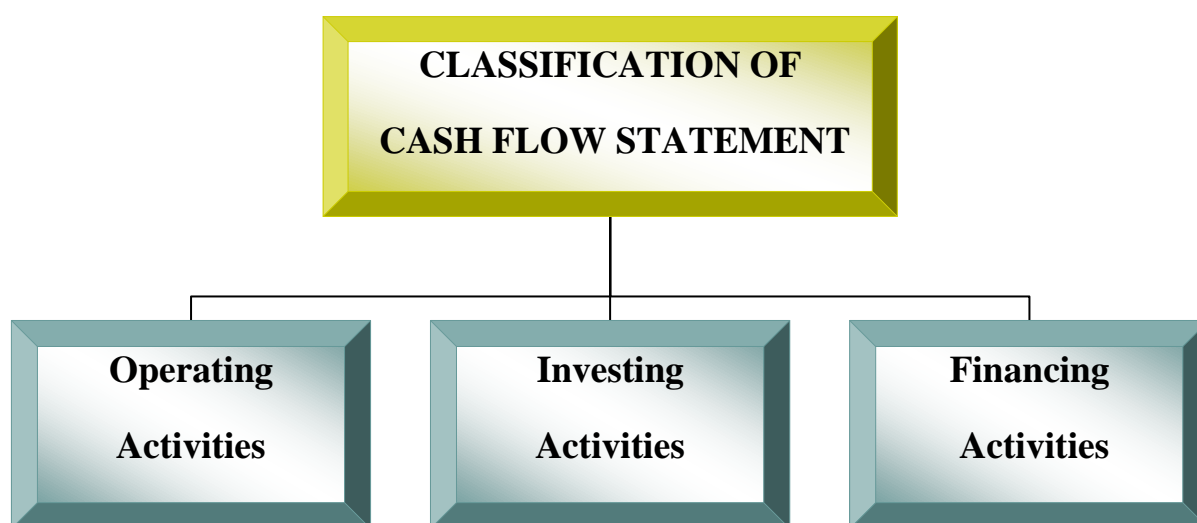
Cash flow statements are therefore used in conjunction with other financial statements to give information that enables the users to evaluate the net assets of the enterprise. It also provides information about the financial structure of the enterprise, liquidity and solvency position. The users also will be able to assess the ability of the enterprise to affect amounts and the timing of cash flow in order to adapt to changing circumstances and opportunities. Cash flow statements will also enable the users to assess the ability of the enterprise to generate cash and cash equivalents through studying of such statements. The users will also be able to develop models from such cash flow statements that can assess and compare present value of the future cash flows of different business enterprises and enable comparability of reporting of operating performance between business entities. Cash flow statements of the previous years are also useful as they act as an indicator to the users about the amount, timing and certainty of the future cash

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<sup>5</sup> The objective section of International Accounting Standards 7 as well as International Accounting Standards 1 *Presentation of Financial Statements* (henceforth IAS 1) paragraph 111.

flow. They are also useful in gauging the accuracy of the past assessments of future cash flows. In return this is important to the users in examining the relationship between the profitability and net cash flow and impact of changing prices (IAS 7, n.d; IPSAS 2, 2000).

According to International Accounting Standard 7 (IAS 7) and National Accounting Standard 9 (NAS 9) statement of cash flow comprises of generally three element; the cash flow that results from operating activities, investing activities and financial activities. Classification of cash flow statement is shown in Figure 1.1



**Figure 1.1 Classification of Cash Flow Statement<sup>6</sup>**

An entity presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its business. Classification by activity provides information that allows users to assess the impact of those activities on the financial position of the entity and the amount of its cash and cash equivalents. This information may also be used to evaluate the relationships among those activities.

A single transaction may include cash flows that are classified differently. For example, when the cash repayment of a loan includes both interest and capital, the interest element may be classified as an operating activity and the capital element is classified as a financing activity.

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<sup>6</sup> Made by author

The operating activities of an enterprise are the principal revenue producing activities and cash flows from such operating activities that are essentially derived from the principal revenue producing activities of the enterprise. The operating activities of an enterprise therefore originate from the transactions and other related events that enter into the reports of determining the profit or loss of a business entity. The resultant amounts of cash flow from the operating activities will then be an important indicator in determining to what extent the operations of the business entity have sufficiently generated cash flow to be able to repay back their loans. They also give a picture of how the entity will be able to maintain its operating capability, pay dividends and ultimately, be able to make new investments without necessarily sourcing financial assistance from external sources.

According to IAS 7, cash flows from operating activities are primarily derived from the principal revenue-producing activities of the entity. Therefore, they generally result from the transactions and other events that enter into the determination of profit or loss. Examples of cash flows from operating activities are:

- ❖ cash receipts from the sale of goods and the rendering of services;
- ❖ cash receipts from royalties, fees, commissions and other revenue;
- ❖ cash payments to suppliers for goods and services;
- ❖ cash payments to and on behalf of employees;
- ❖ cash receipts and cash payments of an insurance entity for premiums and claims, annuities and other policy benefits;
- ❖ cash receipts and payments from contracts held for dealing or trading purposes.

Some transactions, such as the sale of an item of plant, may give rise to a gain or loss that is included in recognized profit or loss. The cash flows relating to such transactions are cash flows from investing activities. The cash receipts from rents and subsequent sales of such assets are also cash flows from operating activities. An entity may hold securities and loans for dealing or trading purposes, in which case they are similar to inventory acquired specifically for resale.

Therefore, cash flows arising from the purchase and sale of dealing or trading securities are classified as operating activities. Similarly, cash advances and loans made by financial institutions are usually classified as operating activities since they relate to the main revenue-producing activity of that entity.

Investing activities as part of the statement of cash flow element is the acquisition and disposal of long term and other investment in the business entity that are not included in the cash equivalents. This separate disclosure of the cash flows that arises from the investing activities is important as the cash flow represents the extent to which the expenditure in the enterprise have been made especially on the resources that are intended to generate future income and cash flow. Other accumulated cash flows that arise from acquisitions and disposals of subsidiaries or other business units are represented differently and then classified as investing activities. Examples of cash flows arising from investing activities are:

- ❖ cash payments to acquire property, plant and equipment, intangibles and other long-term assets. These payments include those relating to capitalised development costs and self-constructed property, plant and equipment;
- ❖ cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;
- ❖ cash payments to acquire equity or debt instruments of other entities and interests in joint ventures;
- ❖ cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures;
- ❖ cash advances and loans made to other parties;
- ❖ cash receipts from the repayment of advances and loans made to other parties;
- ❖ cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities;

❖ cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

When a contract is accounted for as a hedge of an identifiable position, the cash flows of the contract are classified in the same manner as the cash flows of the position being hedged.

Financing activities are also part of statement of cash flow elements and these are activities that result in changes in activities in size and composition of the contributed equity and borrowings of the entity. It's therefore important for an entity to separate the disclosure of cash flows arising from financial activities. This is because such information from financing activities is useful in predicting claims on future cash flows by providers of capital to the entity. Business entities are therefore required to report separately on major classes of gross cash receipts and gross cash payments that arise both from the investing activities and financing activities. Examples of cash flows arising from financing activities are:

- ❖ cash proceeds from issuing shares or other equity instruments;
- ❖ cash payments to owners to acquire or redeem the entity's shares;
- ❖ cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short or long-term borrowings;
- ❖ cash repayments of amounts borrowed;
- ❖ cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

Cash inflow is the money that is coming into business enterprise whereas the cash outflow is the money that goes out of the business enterprise. The cash inflows from operating activities constitute; all sales receipts of the business enterprise, sale of loans and the ultimate interest earned on such awarded loans and the payment collection on behalf of their customers, and other such activities that bring money into the business entity.

The cash outflows from the operating activities include all purchases made by the business enterprise, the advertisement made and other transport or shipping

costs, and other such activities that make money to exit from the business enterprise. Investing activities mainly involves cash being spent and thus money going out of the business enterprise and money coming into the business entity as a result of the investment made. Such investing activities can be cash outflow activities for example, purchasing of an asset like equipments or machinery to enable the proper working of the entity. Financing activities on the other hand involves both the cash inflow and cash outflow within the business entity. Money received from the business entity investors, for example the banks and other shareholders within the business entity are cash inflow to the business enterprise. The dividends for example that the business entity pays to the shareholders at given time intervals are cash outflows from the business enterprise. Therefore, activities that are part of the statement of cash flow involve both the cash inflow and cash outflow.

So, cash flow statement is an essential tool in the business world as it provides useful information about the business enterprise. They predict the future cash flow and this helps in budgeting of such business entities. Auditing cash flow statements are also useful to the potential investors as it gives the business financial health status that helps in informing investment decisions.

## **1.2. The purpose, objectives and information sources of auditing cash flow statement**

Audit of financial statements is the process of determining whether all financial statements of an organization which have been announced are accordance with specific standard or not. This is a process of checking the level of trustworthiness of the announced financial statement.

The purpose of cash flow statement audit is to provide reasonable assurance that the cash flow statement is presented fairly, in all material respects or give a true and fair view in accordance with the Standard on Auditing.

Under the principles of National Standards on Auditing (NSA 70), 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.

The main statements that financial audit will concern are balance sheet, financial results statement, cash flow statement.

The objectives of audit is assessment of the correctness of filling out forms of cash flows statement, matching its performance data of synthetic accounting and verification of the completeness of information disclosure in the notes to the financial statements. Statement's compliance indicators of cash flows to requirements of normative documents are checked:

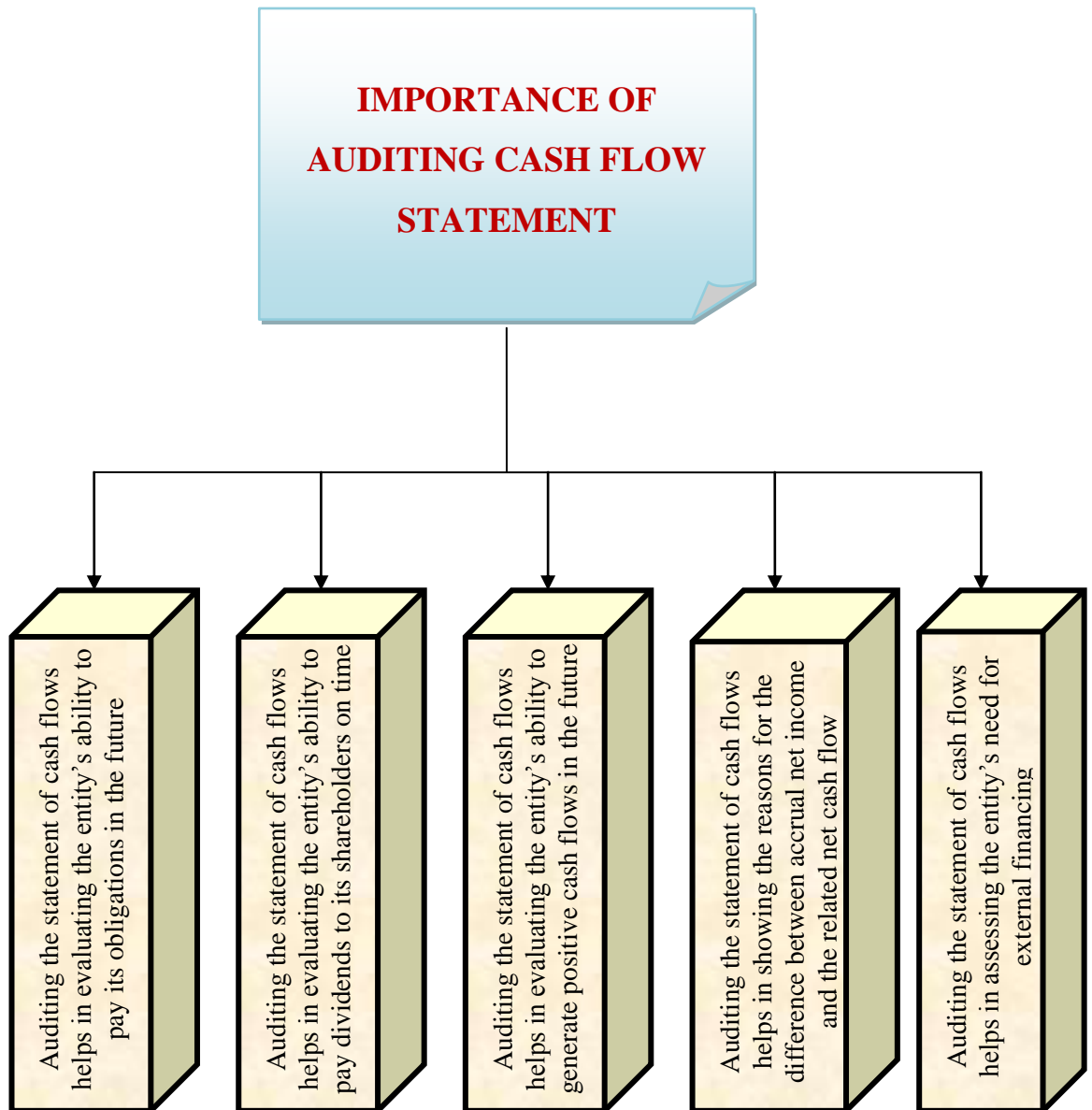
- the structure and content of the forms of cash flows statement;
- correct assessment of statement records;
- the linkage between records of statements, compliance indicators, reflected in different forms of statements.

In audit of financial statement the auditing cash flow statement of company are of particular important. It is noteworthy that in the normative documents, special literature cash flows statement audit's problems only is reflected in a general way.

The absence of auditing the statement of cash flows may lead to negative consequences in financial markets. It will weaken the ability of different stakeholders to assess the future and continuity of the entity, given that their assessments of its liquidity and solvency will be less accurate due to the lower credibility of the information that the assessments were based on.

In particular, present and potential investors will be less able to predict future cash flows (especially dividends) and future share prices, while lenders will be less able to assess credit risk and predict future repayment of loans. Finally, in the absence of auditing the statement of cash flows, the possibility that management of some companies will manipulate when reporting the statement of cash flows will increase, to the detriment of users of the financial statements who base their financial decisions on these statements.

The audit of cash and cash transactions is important, since cash is the primary target of employee fraud, and it is endemic to each of the client's accounting cycles (Louwers, Ramsay, Sinason, Stawser & Thibodeau, 2011). Figure 1.2 shows the importance of auditing cash flow statement.



**Figure 1.2 Importance of auditing cash flow statement<sup>7</sup>**

Auditors are generally and ultimately appointed by the shareholders and report to them directly and others charged with governance. However, many companies' audited financial statements, and particularly public companies, are on public record. For large public companies, they may also be used by other parties for varying purposes. In addition to shareholders, these may include, for example,

<sup>7</sup> Made by author

potential investors considering buying the company's shares and suppliers or lenders who are considered to run business with it (Figure 1.3). In certain circumstances the auditor may be required to communicate control deficiencies to management and those charged with governance. These communications add value to the company and enhance the overall quality of business processes.



**Figure 1.3 Benefits of the audited cash flow statements<sup>8</sup>**

From above mentioned opinions, to manage enterprise activities the importance of cash flows statement is considered significantly in present market conditions. That's why, accordance with the purpose it is considered to manage bestow these financial statements properly and on time. Especially, nowadays in the composition of financial statements, the form “cash flows statement” is being actual, appeared opportunities to evaluate the emplacement of enterprise money funds, its movement, structure through the present statement information.

To organize theoretical and methodological basis of the account of cash flows fund correctly in the enterprises is based on the methodological basis of accounting in many ways. To implement and use regulatory documents in practice, initially it is expedient to concretize the emplacement of accounting. It is not enough to know only the accounting and audit legislation on the transmission of

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<sup>8</sup> Made by author

cash flows statement audit. Thus, to evaluate the fairness of information of financial and accounting statement according to the cash flow statement audit, that we have to learn the audit sources and regulatory-legal basis by dividing into the following groups:

1. Regulatory documents of organizing accounting;
2. Accounting documents;
3. Regulatory documents of organizing audit;

Cash flow statement is prepared in accordance with the National Accounting Standard of the Republic of Uzbekistan (NAS 9) or International Accounting Standard (IAS7). Regulatory-legal basis of cash flow statement audit in accordance with the requirements of the National Auditing Standards is presented in Table 1.1

**Table 1.1:  
Regulatory-legal basis of cash flow statement audit in accordance with  
the requirements of the National Auditing Standards<sup>9</sup>.**

| №  | Regulatory documents   |
|----|--|
| 1  | "The Law on Accounting Activity" (new edition) . It was adopted in April 13, 2016.   |
| 2  | "The Law on Audit Activity" (new edition). It was adopted in May 26, 2000.   |
| 3  | With the №21 "Handbook on Economic entities, financial-economical activities of accounting plan and its usage" named NAS. Certified by the Ministry of Finance of the Republic of Uzbekistan on September 09, 2002 with №103 and was registered by the Ministry of Justice of the Republic of Uzbekistan in October 23,2002 with №1181 |
| 4  | "Enactment on producing product and the structure of the expenses for the sale also the order of formation of financial results" approved by the Cabinet of Ministers of the Republic of Uzbekistan on February 05, 1999 with №54  |
| 5  | "Conceptual basis on preparing and providing financial accounting"   |
| 6  | "Account policy and financial statements" NAS 1  |
| 7  | «Statement of financial results» NAS 3   |
| 8  | «Statement of cash flows» NAS 9  |
| 9  | "Planning an audit" NSA 3  |
| 10 | "Audit evidence" NSA 50  |
| 11 | "Forming an opinion and reporting on financial statements" NSA 70  |
| 12 | «Rules of filling out of the financial statement forms» is adopted by the Ministry of Finance of the Republic of Uzbekistan on December 27, 2002 with the order №140   |

<sup>9</sup> Made by author

Audit of cash flow statements is conducted in accordance with the International Financial Reporting Standards (IFRS), International Standards on Auditing (ISAs), National Accounting Standards (NAS) and National Standards on Auditing of the Republic of Uzbekistan.

National Standard on Auditing of the Republic of Uzbekistan (NSAs) and International Standards on Auditing– (International Standards on Auditing - ISAs) are appointed the rules of auditing inspection. Regulatory-legal basis of cash flow statement audit in accordance with the requirements of the International Auditing Standards is presented in Table 1.2

**Table 1.2**

**Regulatory-legal basis of cash flow statement audit in accordance with the requirements of the International Auditing Standards<sup>10</sup>:**

| <b>№</b> | <b>Regulatory documents</b>  |
|----------|--|
| 1        | IAS 7, “Cash Flow Statement”   |
| 2        | ISQC 1, “Quality Control for Firms That Perform Audits and Reviews of Financial Statements and Other Assurance and Related Services Engagements” |
| 3        | ISA 200, “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing”      |
| 4        | ISA 210, “Agreeing the Terms of Audit Engagements”   |
| 5        | ISA 220, “Quality Control for an Audit of Financial Statements”  |
| 6        | ISA 300, “Planning an Audit of Financial Statements”   |
| 7        | ISA 315, “Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment”                     |
| 8        | ISA 320, “Materiality in Planning and Performing an Audit”   |
| 9        | ISA 330, “The Auditor’s Responses to Assessed Risks”   |
| 10       | ISA 500, “Audit Evidence”  |
| 11       | ISA 700, “Forming an Opinion and Reporting on Financial Statements”  |

To accomplish the cash flows statement, the followings are considered to be information sources: 5000-«Cash», 5100-«Cash at bank», 5200-«Cash in foreign currency at bank», 5500-«Cash in special account at bank», 5600-«Cash equivalents», 5700-«Cash on the road», 5800 «Short-term investments» also «Cash receipts from customers», «Cash payments to suppliers for goods and

<sup>10</sup> Made by author

services», «Cash payments to staff and on behalf of employees», «Other cash receipts and payments of operating activities», «Purchase and sale of long-term assets», «Purchase and sale of intangible assets», «Purchases and sales of long-term/short-term investments», «Other cash receipts and payments of investing activities», «Cash receipts and payments of interest», «Cash receipts and payments of dividends», «Cash receipts from issuing shares or other equity instruments», «Cash payments redeem of shares», «Cash receipts and payments on long-term and short-term credit, loans», «Cash receipts and payments on long term lease (financial leasing)», «Other cash receipts and payments of financing activities», «Cash payments of income taxes».

The followings are the main sources of auditing cash flow statement (Figure 1.4):

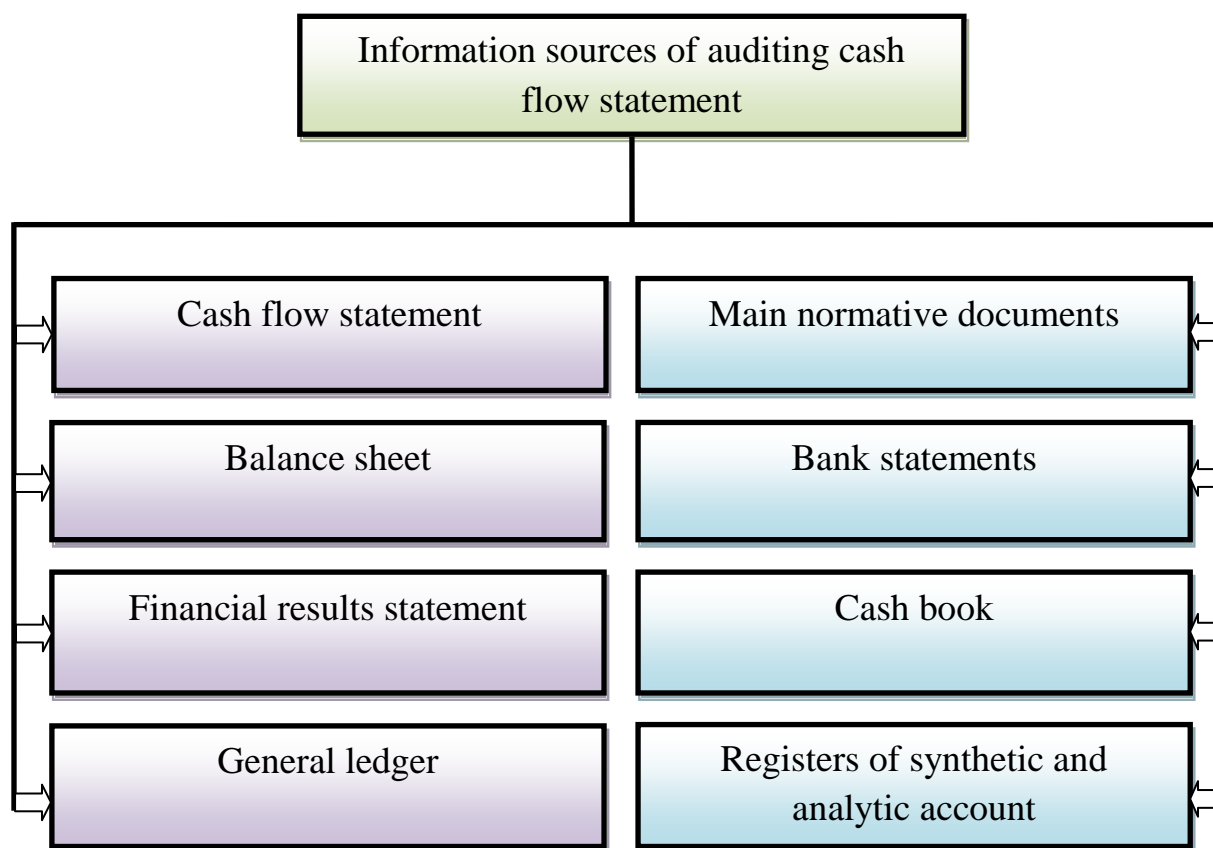


Figure 1.4 Information sources of auditing cash flow statement<sup>11</sup>

On the basis of order №140 of the Ministry of Finance of the Republic of Uzbekistan dated December 27, 2002 «Rules of filling out of the financial

<sup>11</sup> Made by author

statement forms» were filled the statement of cash flows and followings were stated in the appropriate lines thereof. Table 1.3 shows a classified statement of cash flows (form-4) of the Republic of Uzbekistan.

**Table 1.3**

**Statement of cash flows (Form №4)<sup>12</sup>**

| The name of indicators   | Code. Line | Income | Outcome |
|--|------------|--------|---------|
| <b>Operating activities</b>  |            |        |         |
| Cash receipts from customers   | 010        |        |         |
| Cash payments to suppliers for goods and services  | 020        |        |         |
| Cash payments to staff and on behalf of employees  | 030        |        |         |
| Other cash receipts and payments of operating activities   | 040        |        |         |
| <b>Net cash income/outcome of operating activities (line. 010-020-030+/-040)</b>                     | <b>050</b> |        |         |
| <b>Investing activities</b>  |            |        |         |
| Purchase and sale of long-term assets  | 060        |        |         |
| Purchase and sale of intangible assets   | 070        |        |         |
| Purchases and sales of long-term/short-term investments  | 080        |        |         |
| Other cash receipts and payments of investing activities   | 090        |        |         |
| <b>Net cash income/outcome of investing activities (line. 060+/-070+/-080+/-090)</b>                 | <b>100</b> |        |         |
| <b>Financing activities</b>  |            |        |         |
| Cash receipts and payments of interest   | 110        |        |         |
| Cash receipts and payments of dividends  | 120        |        |         |
| Cash receipts from issuing shares or other equity instruments  | 130        |        |         |
| Cash payments redeem of shares   | 140        |        |         |
| Cash receipts and payments on long-term and short-term credit, loans                                 | 150        |        |         |
| Cash receipts and payments on long term lease (financial leasing)                                    | 160        |        |         |
| Other cash receipts and payments of financing activities   | 170        |        |         |
| <b>Net cash income/outcome of financing activities (line. 110+/-120+130-140+/-150+/-160+/-170)</b>   | <b>180</b> |        |         |
| <b>Taxation</b>  |            |        |         |
| Cash payments of income taxes  | 190        |        |         |
| Other cash payments of taxes   | 200        |        |         |
| <b>Total: Tax payments (line. 190+200)</b>   | <b>210</b> |        |         |
| <b>Total: Net cash income/outcome of financial-economical activities (line. 050+/-100+/-180-210)</b> | <b>220</b> |        |         |
| <b>Cash at the beginning of the period</b>   | <b>230</b> |        |         |
| <b>Cash at the end of the period</b>   | <b>240</b> |        |         |

The form of cash flows statement consists of the followings main identification details:

- Company's name, property form, legal address,

<sup>12</sup>“Statement of cash flows” Under order of the Ministry of Finance of the Republic of Uzbekistan, dated December 27, 2002 № 140

➤ Subordination, identification number and other details which may indicate any information related to company, coverage of financial statements of separate companies and company's group, namely this statement is to be gathered in one and be in single form. Statement day and term which was covered by financial statement.

### **Summary of Chapter I**

This chapter has provided the theoretical bases of auditing cash flow statement, describing theories on auditing cash flow statement and this chapter included a description of the contents and essence of cash flow statement also described the purpose, objectives and information sources of auditing cash flow statement.

Thus, the cash flow statement is useful for these purposes: the information about an entity's cash flows during a period helps users predict its future net cash inflows, understand its operations, evaluate its financing and investing activities, assess its liquidity or solvency and interpret other information about financial performance. Auditing cash flow statements are also useful to the potential investors as it gives the business financial health status that helps in informing investment decisions. The purpose of cash flow statement audit is to provide reasonable assurance that the cash flow statement is presented fairly, in all material respects or give a true and fair view in accordance with the Standard on Auditing. Audit of cash flow statements is conducted in accordance with the International Financial Reporting Standards (IFRS), International Standards on Auditing (ISAs), National Accounting Standards (NAS) and National Standards on Auditing of the Republic of Uzbekistan. National Standard on Auditing of the Republic of Uzbekistan (NSAs) and International Standards on Auditing– (International Standards on Auditing - ISAs) are appointed the rules of auditing inspection.

Based on a theoretical framework, I have discussed the importance of auditing cash flow statement and other theoretical aspects of auditing cash flow statement, the next chapter more extensively addresses the practical aspects of auditing cash flow statement.



## **CHAPTER II. PRACTICAL ASPECTS OF AUDITING CASH FLOW STATEMENT**

### **2.1. The procedure of auditing cash flow statement in accordance with the requirements of the National Standards on Auditing**

The procedure of auditing cash flow statement in accordance with the requirements of the National Standards on Auditing of Republic of Uzbekistan should be provided on the followings.

We'll consider all stages of the procedure of auditing cash flow statement as the object of the research of JSC «CHIRCHIQSELMASH».

For the effectively goal achieve in any desired activity type, also auditing activity too is made the thorough and accurate plan or program. Plan of auditing cash flow statement is conducted in accordance with the National Standard on Auditing of the Republic of Uzbekistan (NSA 3) “Planning an Audit”.

NSA 3 requires the auditor to plan the audit so that the engagement is performed in an effective manner<sup>13</sup>. Planning also helps the firm perform the engagement efficiently.

The auditor should plan the audit properly to ensure that it is conducted in an effective and efficient manner. The auditor should prepare an audit plan, which should include a description of:

- the nature, timing and extent of planned risk assessment procedures;
- the nature, timing and extent of planned further audit procedures at the assertion level;
- other planned audit procedures that are necessary so that the engagement complies with the applicable standards. Such procedures may include or describe: a review of the legal framework for the audit; a brief description of the activity, programme or entity to be audited; the reasons for carrying out the audit; the factors affecting the audit, including those determining the materiality of matters to

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<sup>13</sup> National Standard on Auditing of the Republic of Uzbekistan (NSA 3) “Planning an Audit”.

be considered; the audit objectives and scope; the audit approach and characteristics of the audit evidence to be collected, also the procedures required to collect and analyse evidence; a timetable for the audit; the form, content and users of the auditor's report and management letter.

The structure of plan of cash flow statement is shown in Table 2.1

**Table 2.1**

**PLAN OF CASH FLOW STATEMENT AUDIT<sup>14</sup>**

|                             |                       |
|-----------------------------|-----------------------|
| Auditing company:           | JSC «CHIRCHIQSELMASH» |
| Auditing term:              | February 28, 2015     |
| Quantity of hour/per person | 10 hour/ 2 person     |
| Head of auditing group      | Sariev T.             |
| Team member                 | Sariev T., Yakubov M. |
| Risk assessment             | %5                    |

| No | Type of planning works   | Period                 | Executer   | Remark |
|----|--|------------------------|------------|--------|
| 1  | 2  | 3                      | 4          | 5      |
| 1  | Audit of matching of the cash flow statement and indicator of accounting registers to each other | 2.03.2015<br>3.03.2015 | Sariev T.  |        |
| 2  | Auditing operating activities  | 2.03.2015<br>3.03.2015 | Sariev T.  |        |
| 3  | Auditing investing activities  | 2.03.2015<br>3.03.2015 | Yakubov M. |        |
| 4  | Auditing financing activities  | 2.03.2015<br>3.03.2015 | Yakubov M. |        |

According to standard (NSA 3), after making general plan of audit by having made the audit program. The audit program documents the nature, timing and extent of audit procedures to be performed at the assertion level for each material class of transactions, account balance and disclosure. The program sets out the nature, timing and extent of the audit procedures required to implement the overall plan and serves as a set of instructions to the engagement team and as a means to control and record the proper execution of the audit. The audit program will often

<sup>14</sup> Made by author, according to the information of the JSC «CHIRCHIQSELMASH».

be drafted by the senior and reviewed by the manager and approved by the engagement partner. However, the extent of the manager's role will depend on the senior's previous experience and knowledge of the entity.

The structure of program of cash flow statement is shown in Table 2.2

**Table 2.2**

**PROGRAM OF CASH FLOW STATEMENT AUDIT<sup>15</sup>**

|                             |                       |
|-----------------------------|-----------------------|
| Auditing company:           | JSC «CHIRCHIQSELMASH» |
| Auditing term:              | February 28, 2015     |
| Quantity of hour/per person | 10 hour/ 2 person     |
| Head of auditing group      | Sariev T.             |
| Team member                 | Sariev T., Yakubov M. |
| Risk assessment             | %5                    |

| №  | The list of checked up questions and auditing treatment                      | Auditing treatment is based on tests, methods and others | Period                 | Executer  |
|--|--|--|------------------------|-----------|
| 1  | 2  | 3  | 4                      | 5         |
| 1. Audit of matching of the cash flow statement with indicator of accounting registers to each other |  |  |                        |           |
| 1.1  | Determine reconciliations for significant cash accounts                      | Controlling,   | 2.03.2015<br>3.03.2015 | Sariev T. |
| 1.2  | Compare book balances to the general ledger                                  | Investigation, calculating, analytic actions             | 2.03.2015<br>3.03.2015 | Sariev T. |
| 1.3  | Determine whether the items cleared by tracing to subsequent bank statements | Analytic methods   | 2.03.2015<br>3.03.2015 | Yakubov M |
| 1.4  | Obtain a schedule of suspense activity                                       | Calculation, analytic methods                            | 2.03.2015<br>3.03.2015 | Yakubov M |
| 2. Audit of accuracy preparing of cash flows statement   |  |  |                        |           |
| 2.1  | Audit of accuracy preparing operating section of cash flow statement         | Calculation, analytic methods                            | 2.03.2015<br>3.03.2015 | Sariev T. |
| 2.2  | Auditing of accuracy preparing financing section of cash flow statement      | Controlling, analytic methods                            | 2.03.2015<br>3.03.2015 | Sariev T. |
| 2.3  | Auditing of accuracy preparing investing section of cash flow statement      | Calculation, analytic methods                            | 2.03.2015<br>3.03.2015 | Yakubov M |
| 2.4  | Audit of accuracy preparing cash flow statement form                         | Controlling  | 2.03.2015<br>3.03.2015 | Yakubov M |

<sup>15</sup> Made by author, according to the information of the JSC «CHIRCHIQSELMASH».

After the auditor has planned the audit the auditor needs to gather sufficient appropriate audit evidence on which to base his audit opinion.

Audit evidence of cash flow statement is conducted in accordance with the National Standard on Auditing of the Republic of Uzbekistan (NSA 50) “Audit Evidence”.

Audit evidence is necessary to support the auditor’s opinion and report<sup>16</sup>. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits (provided the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit) or a firm’s quality control procedures for client acceptance and continuance. In addition to other sources inside and outside the entity, the entity’s accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared using the work of a management’s expert. Audit evidence comprises both information that supports and corroborates management’s assertions, and any information that contradicts such assertions. In addition, in some cases the absence of information is used by the auditor, and therefore, also constitutes audit evidence.

There is following step process in auditing the statement of cash flows. These steps consist of:

1. Determine reconciliations for significant cash accounts.
  - a) Prove mathematical accuracy.
  - b) Agree book balances to the general ledger and agree to confirmations.
  - c) For large or unusual outstanding checks, deposits in transit and other reconciling items:
    - 1) Obtain an understanding of the nature of the items.
    - 2) Examine supporting documentation.

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<sup>16</sup> National Standard on Auditing of the Republic of Uzbekistan (NSA 50) “Audit evidence”

3) Determine whether the items cleared by tracing to subsequent bank statements.

4) Investigate items that did not clear within a reasonable time.

2. Determine whether transfers near period end between bank accounts (including transfers between branches, divisions and subsidiaries) were recorded in the same period.

3. Determine whether confirms indicate the possibility of related party relationships or transactions that were previously unidentified or undisclosed.

4. Count selected, especially those that are an integral part of the operations.

a) Prove mathematical accuracy, agree to general ledger.

b) Compare balances to comparable prior periods (expectation).

c) Discuss significant unexpected differences with appropriate client personnel.

d) Determine whether results identify areas where additional procedures are required and if so, tailor an appropriate response.

5. The accounting schedules are made on the base of led out account "Cash"-5010, "Cash at bank" -5110 and on account "Cash in special account at bank"-5510 of company. It should match with an amount of drawn out accounting schedules lists in order to identify the account of debit and credit determinates balance, amount of debit and credit's schedules in generalized accounting schedules.

6. Compute the change in the cash and cash equivalent accounts for the period of the statement. The statement of cash flows is not complete until it is explained the change from the beginning balance in the cash account to the balance at year-end.

7. Convert the financial results statement from an accrual-basis to a cash-basis summary of operations. The final result will be cash flows from operating activities.

8. Analyze the long-term assets to identify the cash flow effects of investing activities. Analyze the long-term debt and stockholders' equity accounts to determine the cash flow effects of any financing transactions.

9. Auditing statement of cash flows should be classified all according to operating, investing and financing activities.

10. Report any significant investing or financing transactions that did not involve cash in a separate schedule to the statement of cash flows.

Finally, it is required to audit accuracy of cash flows statement form of JSC «CHIRCHIQSELMASH». Table 2.3 shows a classified statement of cash flows for JSC «CHIRCHIQSELMASH».

JSC «CHIRCHIQSELMASH» produces UZS 2038463.0 thousand receipts from customers in 2014 year. The company recognized UZS 2439252.0 thousand of revenue on the financial results statement. However, the company's accounts receivable rose by UZS 400789.0 thousand, indicating that the company actually collected UZS 2038463.0 thousand. This information were approved with accuracy of accounts information and appropriate documents. Company paid suppliers UZS 1637380.0 thousand. Cash payments to staff and on behalf of employees were reported UZS 572645.0 thousand.

Operating expenses of UZS 2580350.0 thousand, as reported on the JSC «CHIRCHIQSELMASH» financial results statement. Cash receipts of cash flow statement was reported UZS 606870.0 thousand and payments of operating activities was UZS 187135.0 thousand.

As a result of, the net cash flow from operations equals UZS 248173.0 thousand. Actually the net cash provided by operations UZS 248173.0 thousand.

The second section of cash flow statement lists investing activity and third section of cash flow statement lists financing activity for JSC «CHIRCHIQSELMASH» was determined that such cash flows on these activities had not been detected.

The final use of cash flows is Taxation lines. The cash flow statement reported tax payments of UZS 242326.0 thousand. Therefore, the company used UZS 242326.0 thousand for taxes in the year 2014.

The net cash provided by financial-economical activities UZS 5847.0 thousand. The balance sheet cash balance increased by UZS 5847.0 thousand, from

UZS 20311.0 thousand at year-end 2014 to UZS 14464.0 thousand at year-end 2013. The net cash provided by operations (248173.0) plus the net cash used by investing activities (0) plus net cash flow from financing (0) plus the net cash flow from financial-economical activities (5847.0) also totaled UZS 5847.0 thousand. During the audit process, this information were approved with accuracy of accounts information and appropriate documents.

**Table 2.3**

**Statement of cash flows (form 4): JSC «CHIRCHIQSELMASH»<sup>17</sup>**  
for the Year Ending 2014 (in thousands of Uzbekistan soums)

| The name of indicators   | Code. Line | Income        | Outcome       |
|--|------------|---------------|---------------|
| 1  | 2          | 3             | 4             |
| <b>Operating activities</b>  |            |               |               |
| Cash receipts from customers   | 010        | 2038463       | X             |
| Cash payments to suppliers for goods and services  | 020        | X             | 1637380       |
| Cash payments to staff and on behalf of employees  | 030        | X             | 572645        |
| Other cash receipts and payments of operating activities   | 040        | 606870        | 187135        |
| <b>Net cash income/outcome of operating activities (line. 010-020-030+/-040)</b>                     | <b>050</b> | <b>248173</b> | <b>X</b>      |
| <b>Investing activities</b>  |            |               |               |
| Purchase and sale of fixed assets  | 060        |               |               |
| Purchase and sale of intangible assets   | 070        |               |               |
| Purchases and sales of long-term/short-term investments  | 080        |               |               |
| Other cash receipts and payments of investing activities   | 090        |               |               |
| <b>Net cash income/outcome of investing activities (line. 060+/-070+/-080+/-090)</b>                 | <b>100</b> |               |               |
| <b>Financing activities</b>  |            |               |               |
| Cash receipts and payments of interest   | 110        |               |               |
| Cash receipts and payments of dividends  | 120        |               |               |
| Cash receipts from issuing shares or other equity instruments  | 130        |               |               |
| Cash payments redeem of shares   | 140        |               |               |
| Cash receipts and payments on long-term and short-term credit, loans                                 | 150        |               |               |
| Cash receipts and payments on long term lease (financial leasing)                                    | 160        |               |               |
| Other cash receipts and payments of financing activities   | 170        |               |               |
| <b>Net cash income/outcome of financing activities (line. 110+/-120+130-140+/-150+/-160+/-170)</b>   | <b>180</b> |               |               |
| <b>Taxation</b>  |            |               |               |
| Cash payments of income taxes  | 190        | X             |               |
| Other cash payments of taxes   | 200        | X             | 242326        |
| <b>Total: Tax payments (line. 190+200)</b>   | <b>210</b> | <b>x</b>      | <b>242326</b> |
| <b>Total: Net cash income/outcome of financial-economical activities (line. 050+/-100+/-180-210)</b> | <b>220</b> | <b>5847</b>   | <b>0</b>      |
| <b>Cash at the beginning of the period</b>   | <b>230</b> | <b>14464</b>  | <b>X</b>      |
| <b>Cash at the end of the period</b>   | <b>240</b> | <b>20311</b>  | <b>X</b>      |

<sup>17</sup> Made by author, according to the information of the JSC «CHIRCHIQSELMASH».

Thus, accuracy of cash flow statement form of JSC «CHIRCHIQSELMASH» confirms that it is verified during the audit.

Finally, the auditors exercise professional judgement and form their overall conclusion, based on the tests they have carried out, the evidence they have obtained and the other work they have done.

National Standards on Auditing (NSA 70) of the Republic of Uzbekistan “Forming an opinion and reporting on financial statements” requires from the audit report to give explicit information concerning the auditor’s responsibility and to express an opinion on the financial statements based on the conducted audit<sup>18</sup>. Included in the auditor’s responsibility section is an explanation of the audit procedures and scope to ensure the user understands the extent and scope of an audit.

National Standards on Auditing (NSA 70) of the Republic of Uzbekistan “Forming an opinion and reporting on financial statements”, the form and content of an audit report (audit report for audits conducted in accordance with NSA 70) is as follows:

1. Introduction.
2. Analytical part.
3. Final part.

The audit report must be signed by page auditor carrying out the audit and the head of the audit organization. The audit report is presented to the customer audit with all necessary details of the customer.

Auditor’s opinion. Expressing an unmodified opinion on the financial statements, the auditor’s opinion is that the financial statements are prepared, in all material aspects, in accordance with (the applicable reporting framework).

According to NSA 70, results of audit can be expressed of the audit organization in the following ways:

- the auditor's report with the expression of a positive opinion;

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<sup>18</sup> National Standards on Auditing (NSA 70) of the Republic of Uzbekistan “Forming an opinion and reporting on financial statements”



- the auditor's report with the expression of negative opinion;
- audit report with an expression of opinion with a reservation;
- audit report with a disclaimer of opinion.

## **2.2. The methods of preparing cash flow statement in accordance with the International Accounting Standards**

On April 24, 2015, the President of the republic of Uzbekistan issued Resolution No. PF-4720 «On measures for the introduction of modern methods of corporate governance in joint stock companies» which will be a basic measuring stick in increasing the prestige and economic potential of our country on the global scale. The resolution defines a range of clear objectives directed to achieve the goals of increasing the role of joint-stock companies in direct mobilization of foreign investment funds, provision of openness and attractiveness of companies for potential investors, applying modern corporate governance procedures and strengthening the role of stockholders in strategic management of companies. The objectives include<sup>19</sup>:

- ❖ Profound analysis of international expertise and establishing modern company management strategies based on the international experience;
- ❖ establishing joint-stock companies with participation of foreign capital, creating favorable conditions to attract foreign investments to joint-stock companies;
- ❖ elaborating Corporate governance Code;
- ❖ enhancing openness of activities of joint-stock companies, publishing their auditing and financial reporting in international standards;
- ❖ it should be noted that all joint-stock companies shall publish annual financial reports and render external auditing in accordance with International Auditing Standards (ISAs) as well as International Financial Reporting Standards (IFRS);

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<sup>19</sup> The Decree UP-4720 of the President of Uzbekistan «On measures for the introduction of modern methods of corporate governance in joint stock companies» from April 24, 2015. [www.lex.uz](http://www.lex.uz)

There is a necessity of preparing cash flow statement and its audit according to the International standards. The cash flow statement is prepared in accordance with International Accounting Standard 7 (IAS 7). According to International Accounting Standard 7 (IAS 7), companies may produce a statement of cash flows using either the indirect or direct method. Either method should result in identically the same sources and uses of cash within the operating, investing, and financing sections of the statement of cash flows<sup>20</sup>.

We'll consider all stages of the preparing cash flow statement in accordance with the International Accounting Standard (IAS 7) as the object of the research of JV «KULTAKNEFTGAZ» LLC.

The direct method is often considered more descriptive and potentially a more useful source of information about the cash flow of a company than the indirect method. Only the operating section of the statement of cash flows differs between the direct method and the indirect method.

The indirect method is commonly used by corporations. This method begins with net income from the income statement. This method takes net income as a starting estimate for changes in cash position and makes adjustment to incorporate reasons why net income does not correspond to cash flow. The first adjustment adds back expenses that reduced net income but did not require cash. For most companies, the largest expense added back to income is depreciation.

In addition, the indirect method accounts for changes on the balance sheet to document cash flows. For example, if our accounts receivables account increases from one year to the next, we are net lending more money to customers. The cash flow predicted from adjusted net income is further reduced by the increase in these trade credits.

Conversely, if a company owes additional money to suppliers from one year to the next, the company is, in effect, borrowing from suppliers. This trade credit is generally included in the operating section of the statement. If the company

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<sup>20</sup> "Financial accounting" ACCA F3. 2013

increases (decreases) its investment in operating assets such as inventory, the use of cash is recorded in the operating section of the statement of cash flows.

The indirect method begins with net income and makes adjustments for noncash items on the income statement. Then, changes in balance sheet accounts will explain other changes in the operating section. Changes in balance sheet accounts will be used to measure cash in the investing and financing sections. A line-by-line explanation of the calculations follows Table 2.6.

The indirect method begins with net income of UZS 314,000. This value comes directly off the bottom line of the «KULTAKNEFTGAZ» income statement. Next, noncash expenses are added back. Depreciation of UZS 18 million is identified on the «KULTAKNEFTGAZ» income statement. Other noncash accrued expenses, such as accrued write-offs held in allowance for uncollectibles (not indicated on these statements) would also be added back.

The statement next adds back losses that were recognized on the income statement because they reduce reported income but not cash. The company reported a loss of UZS 6 million on the sale of equipment. Similarly, gains that might appear on the income statement would be subtracted because they do increase reported income but produce no cash.

Next, a series of changes in operating assets and liabilities are included. «KULTAKNEFTGAZ» reduced the amount it owed suppliers by UZS 10 million (comparing accounts payables in 2014 versus 2013), which required UZS 10 million in cash not included in the income statement. According to its balance sheet, «KULTAKNEFTGAZ» also increased merchandise inventory.

The statement subtracts the UZS 10 million paid to purchase additional inventory. For example, prepaid expenses on the balance sheet rose by UZS 3 million, from UZS 2 million to UZS 5 million. The increase required UZS 3 million in cash and is subtracted from the adjusted cash balance. «KULTAKNEFTGAZ» increased the amount of money owed to suppliers (accounts payable) by UZS 32 million, from UZS 24 million to UZS 56 million as reported on the «KULTAKNEFTGAZ» balance sheet. Finally, the company

reduced the stated liability for taxes on its balance sheet by UZS 4 million (from UZS 16 million to UZS 12 million) presumably by paying UZS 4 million more in cash than income tax expenses reported on the income statement.

The impact of operating activities on cash equals net income of UZS 314 million plus UZS 18 million noncash depreciation expense plus an additional UZS 29 million in cash generated by changes in operating assets and liabilities, for a net contribution of UZS 343 million cash.

The second section of the indirect statement of cash flows lists investing activity for «KULTAKNEFTGAZ». The company used UZS 190 million to purchase a new building or buildings. The balance sheet shows the investment because the amount in the buildings account rose from UZS 130 million to UZS 320 million. The company also spent UZS 50 million on equipment, although the value of equipment on the balance sheet rose by only UZS 34 million from UZS 20 million to UZS 54 million because of other equipment sold and retired. Likewise, we rely on other information to know that the sale of other equipment generated UZS 8 million. Finally, the balance sheet documents the purchase of land costing UZS 100 million because the company carried UZS 100 million in land in 2013 and UZS 200 million in land in 2014.

The financing section documents that «KULTAKNEFTGAZ» issued UZS 55 million in common stock, as the balance sheet amount of paid-in common rose from UZS 125 million to UZS 180 million. The cash produced is included as a source of cash. The company also issued debt for proceeds of UZS 35 million (UZS 125 million in debt on the balance sheet for 2013 rose to UZS 160 million for 2014). The company must have paid UZS 34 million in dividends because the retained earnings rose from UZS 96 million to UZS 376 million, UZS 34 million less than the net income of UZS 314 million.

The balance sheet cash balance increased by UZS 67 million, from UZS 66 million at year-end 2013 to UZS 133 million at year-end 2014. The net cash provided by operations (UZS 343 million) plus the net cash used by investing

activities (UZS 332 million) plus net cash flow from investing also totaled UZS 67 million. Table 2.4 shows a classified balance sheet for «KULTAKNEFTGAZ».

**Table 2.4**

**Balance Sheet: «KULTAKNEFTGAZ»<sup>21</sup>, December 31, 2014**

(in thousand of Uzbekistan soums)

| <b>Assets</b>                                     | <b>2013</b>   | <b>2014</b>   | <b>Difference</b> |
|---|---------------|---------------|-------------------|
| Cash  | 133000        | 66000         | 67000             |
| Accounts receivable                               | 70000         | 60000         | 10000             |
| Merchandise inventory                             | 30000         | 20000         | 10000             |
| Prepaid expenses                                  | 5000          | 2000          | 3000              |
| Land  | 200000        | 100000        | 100000            |
| Buildings   | 320000        | 130000        | 190000            |
| Accumulated depreciation bldg                     | (22000)       | (10000)       | (12000)           |
| Equipment   | 54000         | 20000         | 30000             |
| Accumulated depreciation equipment                | (6000)        | (2000)        | (4000)            |
| <b>Total assets</b>                               | <b>784000</b> | <b>386000</b> |                   |
| <b>Liabilities and Shareholders' equity</b>       |               |               |                   |
| Accounts payable                                  | 56000         | 24000         | 32000             |
| Income tax payable                                | 12000         | 16000         | (4000)            |
| Bonds payable                                     | 160000        | 125000        | 35000             |
| Common stock                                      | 180000        | 125000        | 55000             |
| Retained earnings                                 | 376000        | 96000         | 280000            |
| <b>Total liabilities and Shareholders' equity</b> | <b>784000</b> | <b>386000</b> |                   |

Table 2.5 shows a classified income statement for «KULTAKNEFTGAZ».

**Table 2.5**

**Income Statement: «KULTAKNEFTGAZ»<sup>22</sup> for the Year Ending 2014**

(in thousand of Uzbekistan soums)

|   |               |
|---|---------------|
| Revenues  | 1014000       |
| Interest income                                       | 24000         |
| Cost of goods sold                                    | 300000        |
| Operating expenses (includes UZS 18,000 depreciation) | 24000         |
| Interest expense                                      | 84000         |
| Loss on sale of equipment                             | 6000          |
| Income before income taxes                            | 408000        |
| Income tax expense                                    | 94000         |
| <b>Net income</b>                                     | <b>314000</b> |

The balance sheet amounts, changes in the balance sheet amounts, and values off the income statement will be used to generate a statement of cash flows using both the indirect method and the direct method.

<sup>21</sup> Made by author, according to the information of the JV «KULTAKNEFTGAZ» LLC.

<sup>22</sup> Made by author, according to the information of the JV «KULTAKNEFTGAZ» LLC.

The two major sections of the operating section of the cash flow statement in direct method are cash receipts and cash payments. As with the indirect method described above, the direct method measures the cash flow from the business. The major receipts are payments received from customers. The starting amount for the cash received is generally sales (revenues). In fact, revenues must be reduced by the increase in accounts receivables, bad debt expense, and the increase in bad debit, allowance. Table 2.6 shows a Statement of Cash Flows (Indirect Method) for «KULTAKNEFTGAZ».

**Table 2.6**

**Statement of Cash Flows (Indirect Method): «KULTAKNEFTGAZ»<sup>23</sup>**  
for the Year Ending 2014 (in thousand of Uzbekistan soums)

|  |                        |
|--|------------------------|
| <b>Cash Flow from Operating Activities</b>       |                        |
| Net income                                       | 314000                 |
| Adjustments:                                     |                        |
| Depreciation expenses                            | 18000                  |
| Loss on sale of equipment                        | 6000                   |
| Decrease in accounts receivables                 | (10000)                |
| Increase in merchandise inventory                | (10000)                |
| Increase in prepaid expenses                     | (3000)                 |
|  | 32000                  |
| Increase in accounts payable                     | 29000                  |
| Decrease in income tax payable                   | (4000)                 |
| <b>Net Cash Provided by Operating Activities</b> | <b><u>343000</u></b>   |
| <b>Cash Flows from Investing Activities</b>      |                        |
| Purchase of Building                             | (190000)               |
| Purchase of Equipment                            | (50000)                |
| Sale of Equipment                                | 8000                   |
| Purchase of Land                                 | (100000)               |
| <b>Net Cash Used by Investing Activities</b>     | <b><u>(332000)</u></b> |
| <b>Cash Flows from Financing Activities</b>      |                        |
| Issuance of Common Stock                         | 55000                  |
| Issuance of Debt                                 | 35000                  |
| Payment of Cash Dividends                        | (34000)                |
| <b>Net Cash Used by Financing Activities</b>     | <b><u>56000</u></b>    |
| Net Increase in Cash                             | 67000                  |
| <b>Cash at the Beginning of the Period</b>       | <b>66000</b>           |
| <b>Cash at the End of the Period</b>             | <b>133000</b>          |

A second cash receipt includes interest and dividends received. Because most companies accrue income, it may be necessary to adjust the interest income

<sup>23</sup> Made by author, according to the information of the JV «KULTAKNEFTGAZ» LLC.

account on the income statement downward (upward) by the increase (decrease) in accrued interest appearing on the balance sheet at the end of the year compared to the beginning of the year.

Cash receipts are summarized in Equation 2.1:

$$\text{Cash receipts} = \text{Revenues} + \text{Accounts receivable} - \text{Uncollectible expense} + \text{allowance for uncollectibles} + \text{Interest and dividends received} \quad (2.1)$$

In addition to receipts, the operating section of the statement of cash flows calculated using the direct method must account for payments. For most businesses, the major payments are made to suppliers. The statement of cash flows for companies using the direct method lists these just after receipts. The direct method begins with cost of goods sold expense from the income statement. Most of the cash actually paid to suppliers is first recorded as inventory (including raw materials and finished goods), so the actual amount is not recognized on the income statement directly.

Cash payments are summarized in Equations 2.2 through 2.4:

$$\text{Cash Payments to Suppliers} = \text{Cost of goods sold} + \text{Inventory} - \text{Accounts payable} \quad (2.2)$$

$$\text{Cash Payments for Operating Expenses} = \text{Operating expenses} + \text{Prepaid expenses} - \text{accrued expenses payable} \quad (2.3)$$

$$\text{Cash Payments for Income Taxes} = \text{income tax expense} - \text{income tax payable} \quad (2.4)$$

The direct statement of cash flows begins with revenues and subtracts off cost of goods sold. Although this sounds similar to the indirect method, the direct method combines information from individual income and balance sheet items to construct sources and uses of cash. A line-by-line explanation of the calculations follows Table 2.7.

The largest source of cash for most companies is sales or service revenue. «KULTAKNEFTGAZ» produces UZS 1.004 billion receipts from customers. The company recognized UZS 1.014 billion of revenue on the income statement. However, the company's accounts receivable rose by UZS 10 million, indicating that the company actually collected UZS 1,004 billion.

«KULTAKNEFTGAZ» also received interest income of UZS 24 million. Perhaps the company earned accrued income that differed slightly from actual interest paid. However, the company shows no interest accruals, so the accrued interest is apparently not material.

«KULTAKNEFTGAZ» paid suppliers UZS 278 million. The direct method begins with the cost of goods sold of UZS 300 million from the income statement and subtracts the UZS 32 million increase in accounts payable shown on the balance sheet and adds the additional UZS 10 million in merchandise inventory also documented on the balance sheet.

A second use of cash on the direct statement is a category that begins with operating expenses of UZS 240 million, as reported on the «KULTAKNEFTGAZ» income statement. Those operating expenses include UZS 18 million of depreciation expense. The noncash depreciation expense is subtracted from the UZS 240 million reported number. «KULTAKNEFTGAZ» also prepaid UZS 3 million in expenses as the balance in prepaid expenses rose from UZS 2 million in 2013 to UZS 5 million in 2014. The direct statement of cash flows includes this use of cash in this section of payments for operating expenses.

The next use of cash on the operating section of the direct statement of cash flows is interest expense. The income statement reports UZS 84 million of interest expense. No information is available about interest accrued but not paid. If the company accrued a material amount of interest expense, the cash payment would be reduced by the change in the accrual carried on the balance sheet.

The final use of cash in the operating section of the direct statement of cash flows is income tax expense. The income statement reported income tax expense of UZS 94 million. However, the balance sheet reveals that income tax payable declined by UZS 4 million from UZS 16 million in 2013 to UZS 12 million in 2014. Therefore, the company used UZS 98 million for income taxes in the year 2014.

The cash flow from operations equals UZS 343 million. Table 2.7 shows that the company received UZS 1.028 billion in cash payments from customers and



made UZS 685 million payments. The cash flow from operations section using the indirect method in Table 2.6 and the direct method in Table 2.7 document the same UZS 343 million cash supplied by operations.

**Table 2.7**

**Statement of Cash Flows (Direct Method): «KULTAKNEFTGAZ»<sup>24</sup>**  
for the Year Ending 2014 (in thousand of Uzbekistan soums)

|  |                        |
|--|------------------------|
| <b>Cash Flow from Operating Activities</b>       |                        |
| Sources of Cash:                                 |                        |
| Cash Receipts from Customers                     | 1004000                |
|  | 24000                  |
| Interest Received                                | 1028000                |
| Uses of Cash:                                    |                        |
| To Suppliers                                     | 278000                 |
| For Operating Expenses                           | 225000                 |
| For Interest                                     | 84000                  |
|  | 98000                  |
| For Income Taxes                                 | 685000                 |
| <b>Net Cash Provided by Operating Activities</b> | <b><u>343000</u></b>   |
| <b>Cash Flows from Investing Activities</b>      |                        |
| Purchase of Building                             | (190000)               |
| Purchase of Equipment                            | (50000)                |
| Sale of Equipment                                | 8000                   |
| Purchase of Land                                 | (100000)               |
| <b>Net Cash Used by Investing Activities</b>     | <b><u>(332000)</u></b> |
| <b>Cash Flows from Financing Activities</b>      |                        |
| Issuance of Common Stock                         | 55000                  |
| Issuance of Debt                                 | 35000                  |
| Payment of Cash Dividends                        | (34000)                |
| <b>Net Cash Used by Financing Activities</b>     | <b><u>56000</u></b>    |
| Net Increase in Cash                             | 67000                  |
| <b>Cash at the Beginning of the Period</b>       | <b>66000</b>           |
| <b>Cash at the End of the Period</b>             | <b>133000</b>          |

The section documenting cash flows from investing activities and the section documenting cash flows from financing activities are identical to the investing and financing sections using the indirect method. Those sections are printed in Table 2.6 and repeated in Table 2.7. The calculations are described for Table 2.6.

Likewise, the reconciliation of beginning cash to ending cash and the cash reported on the balance sheet is identical on both the direct method in Table 2.7

<sup>24</sup> Made by author, according to the information of the JV «KULTAKNEFTGAZ» LLC.

and the indirect method in Table 2.6 because the cash documented in each of the three sections is equal.

All of the accounting entries made by a company enter either the income statement or the balance sheet. Because these two financial statements already tally up all the transactions that affect cash, accountants rely on values published in these two financial statements to document cash flows in the statement of cash flows. The statement of cash flows documents how cash is generated and how it is used for current operations, because of investments made or redeemed or because of financing activities.

### **2.3. The procedure of auditing cash flow statement in accordance with the requirements of the International Standards on Auditing**

In order to provide direct mobilization of foreign investments, enhance efficiency of performance of joint-stock companies, provide their openness and attractiveness for potential investors, apply modern corporate governance methods and enhance the role of stock holders in strategic management of stock holders President's Resolution № PF-4720 dated by April 24, 2015 was issued.

In the Decree of the President of Republic Uzbekistan № PF-4720 dated by April 24, 2015 «On measures for the introduction of modern methods of corporate governance in joint stock companies» it is defined «All joint stock companies shall be transferred to the publication of the annual financial statements and conduct of its external audit in accordance with International Standards on Auditing and International Financial Reporting Standards during 2015-2018»<sup>25</sup>.

In this connection, there is a necessity of drawing cash flow statement and its audit according to the International Standards. Thus, the statement of cash flows should be objective, bear the general information in interests of users, give only the necessary information and to be clear to foreign founders, to co-ordinate the cash flow statement to requirements of the International Standards.

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<sup>25</sup> The Decree UP-4720 of the President of Uzbekistan «On measures for the introduction of modern methods of corporate governance in joint stock companies» from April 24, 2015. [www.lex.uz](http://www.lex.uz)

Audit of financial statements is also known as financial audit. It is a verification of the financial statements of a legal entity with a view to express an audit opinion. To be more clearly, audit of financial statements is the process of determining whether all financial statements of an organization which have been announced are accordance with specific standard or not. This is a process of checking the level of trustworthy of the announced financial statement. The main statement that financial audit will concern are balance sheet, income statement, statement of cash flows.

The purpose of cash flow statement audit is to provide reasonable assurance that the cash flow statement is presented fairly, in all material respects or give a true and fair view in accordance with the International Standard on Auditing.

Under the principles of International Standards on Auditing (ISA) 200, the objective of an audit of cash flow statements is to enable the auditor to express an opinion on whether the cash flow statement are prepared, in all material respects, in accordance with an applicable financial reporting framework. The objective applies to a full scope audit of any entity's financial statement, whether or not the entity is profit oriented or the assignment is a non-statutory audit<sup>26</sup>.

Stages of the audit process can be summarised in five phases (Figure 2.1).



**Figure 2.1 Stages of the Audit Process<sup>27</sup>**

<sup>26</sup> International Standards on Auditing (ISA) 200 “Overall objectives of the independent auditor and the conduct of an audit in accordance with International Standards on Auditing”

<sup>27</sup> Prepared by author according to the information of International Standards on Auditing (ISA) 200

1. Planning — Initial planning activities include formal acceptance of the client by the audit firm, verifying compliance with independence requirements, building the audit team and performing other procedures to determine the nature, timing and extent of procedures to be performed in order to conduct the audit in an effective manner<sup>28</sup>.

ISA 300 requires the auditor to plan the audit so that the engagement is performed in an effective manner. Planning also helps the firm perform the engagement efficiently. Planning involves establishing and documenting the overall audit strategy for the engagement and developing and documenting an audit plan, in order to reduce audit risk to an acceptably low level.

2. Risk assessment — Auditors use their knowledge of the business, the industry and the environment in which the company operates to identify and assess the risks that could lead to a material misstatement in the financial statements<sup>29</sup>.

ISA 315 requires the engagement team to identify and assess the risks of material misstatement at the financial statement level, and at the assertion level for classes of transactions, account balances, and disclosures. Obtaining an understanding of the entity and its environment establishes a frame of reference within which the engagement team plans the audit and exercises professional judgment about assessing risks of material misstatement and responding to those risks throughout the audit. The engagement team is also required to assess the risks of material misstatement due to fraud. The engagement team at the planning stage should summarize the key risks attached to the entity and factors that may minimize or eliminate those risks.

3. Audit strategy and plan of cash flow statement — Once the risks have been assessed, auditors develop an overall audit strategy and a detailed audit plan to address the risks of material misstatement in the financial statements. Among other things, this includes designing a testing approach to various financial statement items, deciding whether and how much to rely on the company's internal

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<sup>28</sup> International Standard on Auditing 300 “Planning an Audit of Financial Statements”

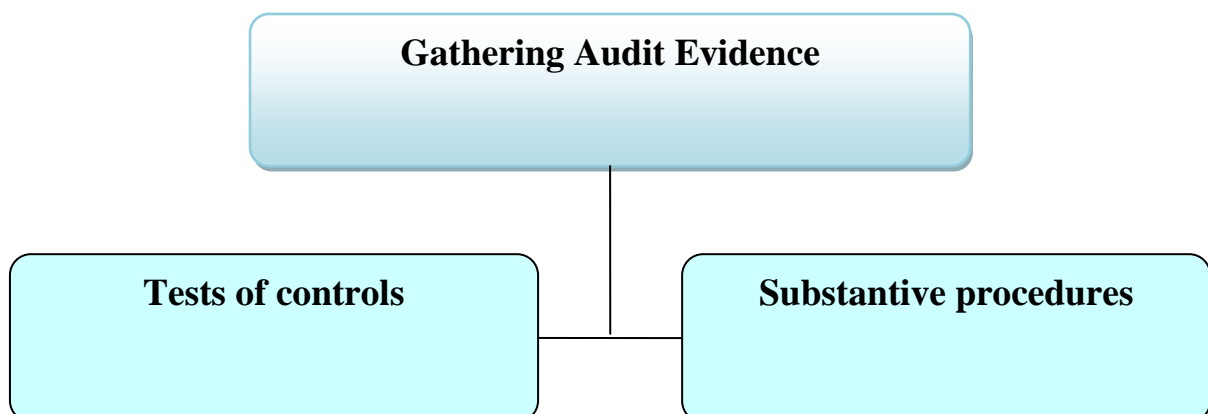
<sup>29</sup> International Standard on Auditing 315 “Identifying and assessing the risks of material misstatement through understanding the entity and its environment”

controls, developing a detailed timetable, and allocating tasks to the audit team members. The audit strategy and plan is continually reassessed throughout the audit and adjusted to respond to new information obtained about the business and its environment.

4. Gathering Audit Evidence. After the auditor has planned the audit the auditor needs to gather sufficient appropriate audit evidence on which to base his audit opinion. Auditors apply professional scepticism and judgement when gathering and evaluating evidence through a combination of testing the company's internal controls, tracing the amounts and disclosures included in the financial statements to the company's supporting books and records, and obtaining external third party documentation. This includes testing management's material representations and the assumptions they used in preparing their financial statements. Independent confirmation may be sought for certain material balances such as cash.

ISA 500 defines Audit Evidence as "All the information used by the auditor in arriving at the conclusions on which the audit opinion is based, and includes the information contained in the accounting records, underlying the financial statements and other information"<sup>30</sup>.

The auditor gathers evidence by performing audit procedures (Figure 2.2). These audit procedures consists of test of controls and substantive procedures.



**Figure 2.2 Gathering Audit Evidence<sup>31</sup>**

<sup>30</sup> International Standard on Auditing 500 "Audit evidence"

<sup>31</sup> Made by author

Tests of controls. As businesses have grown more complex and sophisticated, and the costs of labour have risen, automated systems and processes have necessarily become much more prevalent. A well-run business will have its own systems and controls in place to operate efficiently, safeguard its assets, and to provide reasonable assurance that its transactions are properly reported and that its financial statements are complete and accurate. “The auditors assess the effectiveness of these controls in preventing and mitigating the possible risk of material misstatement in those areas where the auditor plans to use such controls to adjust the nature, timing and extent of their testing”<sup>32</sup>. If they believe the controls are effective, and they have tested that they operated reliably throughout the year, then the level of substantive audit evidence needed to give an opinion may be reduced. Even if the controls are reliable, varying degrees of substantive audit evidence will still always need to be gathered.

Substantive procedures. In addition to testing controls, the auditor is required to perform further procedures to gather evidence from substantive procedures (substantive audit evidence), which can include a combination of the following:

- Physically observing or inspecting assets (such as inventory or property, plant and equipment);
- Examining records to support balances and transactions;
- Obtaining confirmations from third parties the company does business with (such as its suppliers, customers and in particular the banks it uses);
- Checking elements of the cash flow statement by comparison to relevant external information and investigating any differences;
- Checking calculations.
- Agreeing the financial statements to the underlying records.
- Examining the journal entries passed while preparing the financial statements.

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<sup>32</sup> International Standard on Auditing 330 “The auditor’s responses to assessed risks”

□ Evaluation of whether the overall presentation of the cash flow statement, including disclosures, is in accordance with International Financial Reporting Standards (IFRS).

In auditing cash transactions, an auditor would consider intentional and unintentional possible misstatements in the cash-related processes, whether the likely effect was an overstatement or an understatement. The auditor should obtain an understanding of internal control relevant to the cash transactions, and possibly test these controls, then select substantive tests for cash processes (Stuart, 2012).

Taking into consideration, the information presented in the balance sheet and in the income statement, there is a six-step process in auditing the statement of cash flows. These steps consist of:

1. Compute the change in the cash and cash equivalent accounts for the period of the statement. Seldom is one handed a check figure in real life, but such is the case when preparing a statement of cash flows. The statement of cash flows is not complete until it is explained the change from the beginning balance in the cash account to the balance at year-end.

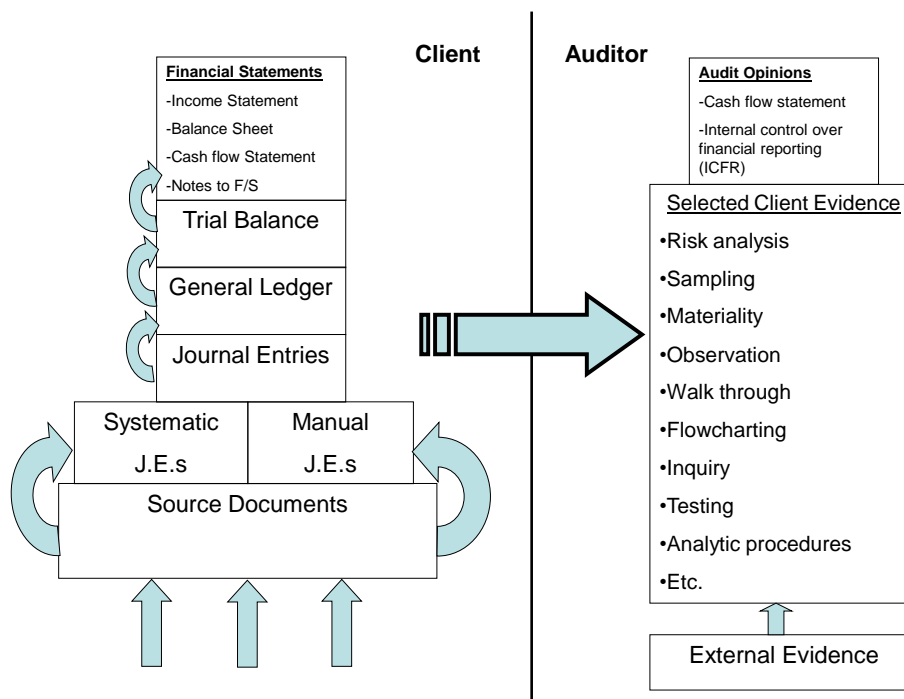
2. Convert the income statement from an accrual-basis to a cash-basis summary of operations. This is done in three steps, namely: eliminate from the income statement those expenses that don't involve cash (such non cash items would include depreciation expense that does not involve an outflow of cash in the current period even though income was reduced); eliminate from the income statement the effects of non operating activity items (such items include gains and losses associated with the retirement of debt); identify those current assets and current liability accounts associated with the income statement accounts and adjust those income statement accounts for the changes in the associated current assets and current liabilities. For example, sales will be adjusted for the change between the beginning and ending balance in accounts receivable to derive the cash collections for the period. The final result will be cash flows from operating activities.

3. Analyze the long-term assets to identify the cash flow effects of investing activities. Changes in property, plant and equipment and in long-term investments may indicate that cash has either been spent or been received.

4. Analyze the long-term debt and stockholders' equity accounts to determine the cash flow effects of any financing transactions. These transactions could be borrowing or repaying debt, issuing or buying back stock or paying dividends.

5. Audit preparing the formal statement of cash flows by classifying all cash inflows and outflows according to operating, investing and financing activities. The net cash flows provided by (used in) each of the three main activities of an entity should be highlighted. The net cash flows amount for the period is then added from the beginning cash balance to report the ending cash balance.

6. Report any significant investing or financing transactions that did not involve cash in a separate schedule to the statement of cash flows. This would include such transactions as the purchase of land by issuing stock or the retirement of bonds by issuing stock.



**Figure 2.3 Procedure of auditing cash flow statements<sup>33</sup>**

<sup>33</sup> Made by author



5. Finalisation — Finally, the auditors exercise professional judgement and form their overall conclusion, based on the tests they have carried out, the evidence they have obtained and the other work they have done. This conclusion forms the basis of the audit opinion. Auditors interact with the company during all the phases of the audit process listed above. There will be continuing discussions and meetings with management, both at operational and senior executive levels, and with those charged with governance. Using their professional scepticism and judgement, auditors challenge management's assertions regarding the numbers and disclosures in the financial statements.

Audit opinion. The management of a company is responsible for preparing the financial statements. The auditor is responsible for expressing an opinion indicating that reasonable assurance has been obtained that the financial statements as a whole are free from material misstatement, whether due to fraud or error, and that they are fairly presented in accordance with the relevant accounting standards (e.g., International Financial Reporting Standards). There are clear frameworks from independent auditing standard setters which provide rules and guidelines for how an audit should be carried out and the level of assurance obtained. It is the auditor's responsibility to plan and conduct the audit in such a way that it meets the applicable auditing standards and sufficient appropriate evidence is obtained to support the audit opinion. However, what constitutes sufficient appropriate evidence is ultimately a matter of professional judgement. The auditor considers a number of factors in determining whether financial statements are free of material misstatement, and in evaluating any misstatements identified. These factors require professional judgement, where auditors use their skill and experience to form a view based upon the evidence gathered on the financial statements taken as a whole.

ISA 700 requires from the audit report to give explicit information concerning the auditor's responsibility and to express an opinion on the financial

statements based on the conducted audit<sup>34</sup>. Included in the auditor's responsibility section is an explanation of the audit procedures and scope to ensure the user understands the extent and scope of an audit.

ISA 700 "Forming an opinion and reporting on financial statements", the form and content of an audit report (audit report for audits conducted in accordance with ISA) is as follows:

Title. The audit report has a title that clearly indicates that it is the report of an independent auditor.

Addressee. The audit report has addressed as required by the circumstances of the engagement.

Introductory paragraph. The introductory paragraph in the audit report:

- a) identifies the entity whose financial statements have been audited;
- b) states that the financial statements have been audited;
- c) identifies the title of each statement that comprises the financial statements, for example a balance sheet, an income statement, a statement of changes in equity and a cash flow statement;
- d) refers to the summary of significant accounting policies and other explanatory information; and
- e) comprising the financial statements specifies the date or period covered by each financial statement comprising the financial statements.

Management's responsibility for the financial statements. This section of the audit report describes the responsibilities of those in the organization that are responsible for the preparation of financial statements. The audit report uses the term, for example 'management' or 'those charged with governance', that is appropriate in the context of a particular legal framework.

The audit report describes management's responsibility for the preparation of the financial statements: 'the preparation and fair presentation of financial statements'. The description includes an explanation that management is responsible for the preparation of the financial statements in accordance with the

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<sup>34</sup> International Standard on Auditing 700 "Forming an opinion and reporting on financial statements"

applicable reporting framework, and for such internal control as it is necessary to enable the preparation of financial statements that are free from material misstatement.

Auditor's responsibility. The audit report states that the responsibility of the auditor is to express an opinion on the financial statements based on the audit and refers to the conduction of the audit in accordance with International Standards on Auditing (ISA). The audit report explains that the auditor is required to comply with ethical requirements and that the auditor plans and performs the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. The audit report describes an audit by stating that an audit involves performing procedures to obtain audit evidences about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of risks of material misstatements of the financial statements. In order to design audit procedures that are appropriate in the circumstances, but not concerning the purpose of expressing an opinion on the effectiveness of the entity's internal control, the auditor considers internal control. The audit report describes that an audit includes evaluating the appropriateness of the accounting policies used and the reasonableness of accounting estimates made by management. The last phrase of this section of the audit report states whether the auditor believes that the audit evidence as obtained by the auditor is sufficient and appropriate to provide a basis for the auditor's opinion.

Auditor's opinion. Expressing an unmodified opinion on the financial statements, the auditor's opinion is that the financial statements are prepared, in all material aspects, in accordance with (the applicable reporting framework). If the reference to the applicable reporting framework is no to International Financial Reporting Standards (IFRS), the auditor's opinion identifies the jurisdiction of origin of the framework.

Other reporting responsibilities. If the auditor addresses other reporting responsibilities in the audit report on the financial statements, these other reporting responsibilities need to be addressed in a separate section in the audit report.

Signature of the auditor. The auditor's signature is either in the name of the audit firm, the personal name of the auditor or both, as appropriate for the particular jurisdiction.

Date of the audit report. The audit report is dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements.

Auditor's address. The audit report names the location in the jurisdiction where the auditor practices.

## **Summary of Chapter II**

This chapter has provided the practical aspects of auditing cash flow statement also this chapter included a description of the procedure of auditing cash flow statement in accordance with the requirements of the National Standards on Auditing and the methods of preparing cash flow statement in accordance with the International Accounting Standards and the procedure of auditing cash flow statement in accordance with the requirements of the International Standards on Auditing.

Chapter two contains an overview of existing practical explanations of auditing. In this chapter, the procedure of auditing cash flow statement as the object of the research of JSC «CHIRCHIQSELMASH» have been described in accordance with the requirements of the National Standards on Auditing (NSA).

Also, the preparing cash flow statement as the object of the research of JV «KULTAKNEFTGAZ» LLC have been described in accordance with the International Accounting Standards (IAS) and International Financing Reporting Standards (IFRS) and highlighted the practical aspects of procedure of auditing cash flow statement in accordance with the requirements of the International Standards on Auditing (ISA).

Based on a practical framework, the practical aspects of auditing cash flow statement have been discussed.

## **CHAPTER III. IMPROVEMENT OF AUDITING CASH FLOW STATEMENT IN ACCORDANCE WITH THE INTERNATIONAL STANDARDS**

### **3.1. Improvement of analyzing cash flow statement**

Financial statement analysis is the process of reviewing and analyzing a company's financial statements to make better economic decisions. Financial statement analysis is a method or process involving specific techniques for evaluating risks, performance, financial health, and future prospects of an organization.<sup>35</sup>

Financial statement analysis is a company's fundamental performance that is aimed to provide essential information about its financial position in the form of financial statements.

It is used by a variety of shareholders, such as credit and equity investors, the government, the public, and decision-makers within the organization. These shareholders have different interests and apply a variety of different techniques to meet their needs. For example, equity investors are interested in the long-term earnings power of the organization and perhaps the sustainability and growth of dividend payments. Basically, it is valuable for company's internal as well as external users to make a decision. They focus on three characteristics of a company: solvency, profitability and liquidity. Therefore, creditors concentrate on the liquidity of the borrower before lending money. Comparability refers to the ability to make relevant comparisons between two or more companies in the same industry at a point in time. Consistency refers to the ability to make relevant comparisons within the same company over a period of time.

Analysis will be taken from the statement of cash flows through the following points:

- a. the concept of the statement of cash flows and their development.

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<sup>35</sup> White, Gerald I.; Sondhi, Ashwinpaul; Fried, Dov (1998). *The Analysis and Use of Financial Statements*. John Wiley & Sons, Inc.

b. the importance and objectives of the statement of cash flows and their uses.

c. analysis of the statement of cash flows.

a-The concept of the statement of cash flows and their development:

Before we know the statement of cash flow must be starting to say that this statement settled the matter after a relatively long period of time, which happened to her evolution in terms of form and content during this period. Three phases can be essential to this development, which took place at each stage including a commensurate with the needs of business as follows.

1. Statement of funding sources and uses, this statement required by Accounting principle Board (APB) opinion No(3) ,issued from the A.I.C.P.A in 1963.

2. Statement of changes in financial position, this statement required by opinion No(19) of the FASB in 1971.

3. Statement of cash flows that required by the standard No(95) adopted by FASB in 1987 as well as IAS (7) adopted by the IASC in 2000.

Can be defined cash flow statement as a list that displays the cash receipts and cash payments and net change in cash from three main activities are operating activities, investing activities and financing activities for the economic during a specific period, to bring the cash balance in the first period and another period. Cash refers to cash here in its comprehensive either in banks, this concept also introduces what is the rule of cash such as short-term investments with high liquidity that can be easily converted to cash and risk a small change such as short-term deposits which are in a period of three months.

**b-the importance and objectives of the statement of cash flows:**

The importance of the statement of cash flows of its role in providing information cannot be provided through any of the income statement or balance sheet. Where is this statement link between these two statements. In addition to being more convenient than both in identifying strengths and weaknesses in the activity of the facility, where the form with all its information and what can be

derived from the quantitative indicators of an effective tool to assess the efficiency of the policies adopted by the Administration in the field of finance and investment, as well as in discovery of plans future expansion. This will assist the Audit Committee in carrying out some of the core activities, which in turn help to improve financial reports indicating Auditors definitely improve his report. With regard to the objectives of the cash flow it can be summarized in:

1. Provide information on cash receipts and cash payments for a specific period.
2. To provide information in accordance with the basis of cash from operating activities, investing and financing.

And information provided by the statement of cash flow if used and linked with other information provided by the other financial statements, it will help the auditors, investors, creditors and others in:

1. Assess the enterprise's ability to generate positive cash flows in the future.
2. Assessment of the enterprise's ability to meet its obligations and its ability to distribute profits, and the need for external financing.
3. Evaluation of the reasons for the difference between the net income and cash inflows and outflows.
4. Evaluation of the impact on the financial position of each of the enterprise investment and financing operations of monetary and non-monetary.

And from the above, information identified in the cash flow statement should help:

1. Measurement of the enterprise ability to generate cash flows in the future. Since the primary objective of financial statements is to provide information makes it possible to predict the value of the timing and the uncertainty of the cash flows future by examining the relationship between some of the items such as sales and net cash flow from operating activities or net cash flows from operating activities and the increase or decrease in cash.

2. Determine the enterprise's ability to conduct economic dividend and payment liabilities.

3. Determine the reasons for the difference between net income and net cash flow from operating activities, is net income is an important number because it provides information about the success or failure of the company from time to time, some reticent on the net income derived in accordance with the accrual basis because access to this number requires some estimates of the reliability of this figure is controversial, however, is for cash, many users wish to financial causes the difference between net income and net cash flows and thus can determine the extent of relying on net income.

4. Evaluation of liquidity and financial flexibility, which refers liquidity to the approach of monetary assets and liabilities (i.e. the length of time it takes the assets turn into cash, and the length of time required to provide the cash necessary for the payment of liabilities), and is intended to ease the financial company's ability to pay its debts and meet their payments at maturity, either the financial flexibility refers to the ability to respond and adapt to unfavorable financial conditions and needs sudden and unexpected opportunities.

c-analysis of the statement of cash flows (Table 3.1).

Can analyze the statement of cash flow to detect important relationships and classification can analyze this statement to achieve this goal as follows:

a. to assess the quality of the company's profits: the statement provides information with which to distinguish between net income and net cash flow and on the based that net income is determined under the accrual basis, while net cash flow determined under the cash basis. Thus, the investigation established for the a high number of net income does not necessarily mean they make high cash flows and vice versa. And it is recognized that the higher the number of net operating cash flow achieved by established during the year, the higher the quality of profits generated and vice versa.



Table 3.1

Analysis of Cash Flows Statement<sup>36</sup>

| № | General Explanation  | Cash Flows from Operating | Cash Flows from Investing | Cash Flows from Financing |
|---|--|---------------------------|---------------------------|---------------------------|
| 1 | Company is using cash generated from operations, from sale of assets and from financing to build up pile of cash possibly looking for acquisition.           | +                         | +                         | +                         |
| 2 | Company is using cash flows generated from operations to buy fixed assets and to pay down debt or pay owners.  | +                         | -                         | -                         |
| 3 | Company is using cash from operations and from sale of fixed assets to pay down debt or pay owners.  | +                         | +                         | -                         |
| 4 | Company is using cash from operations and from borrowing (or from owner investment) to expand.   | +                         | -                         | +                         |
| 5 | Company's operation cash flow problems are covered by sell of fixed assets, by borrowing or by stockholder contributions.                                    | -                         | +                         | +                         |
| 6 | Company is growing rapidly, but has shortfalls in cash flows from operations and from purchase of fixed assets financed by long-term debt or new investment. | -                         | -                         | +                         |
| 7 | Company is financing operating cash flow shortages and payments to creditors and/or stockholders via sale of fixed assets.                                   | -                         | +                         | -                         |
| 8 | Company is using cash reserves to finance operation shortfall and pay long-term creditors and / or investors.  | -                         | -                         | -                         |

Moreover, determining the value of cash flows from operating activities of the company make it possible to make a valid comparison between developed cash and cash position of the other companies in the same field different from the methods of calculating depreciation of fixed assets and the most important ratios that can be derived from the statement of cash flows and that serves the purpose of assessing the quality of corporate profits are:

a/1- adequacy ratio of operating cash flows; they illustrate the ability of the cash inflows from operating activities to cover cash needs basic and are these needs; cash outflow for operational activities, and payments of debt, and capital

<sup>36</sup> Made by author

expenditure required to maintain production capacity and repayment of outstanding debt during the year. This is calculated by the equation:

$$\frac{\text{Cash flows from operating activities}}{\text{Basic cash needs}}$$

a/2-operating cash indicator; measures the profits of the company's ability to generate operating cash flow, is calculated as follows:

$$\frac{\text{Net operating cash flow}}{\text{Net income}}$$

a/3-operational activity indicator, measures the extent to which the operational activities of the company to generate operating cash flow, calculated as follows:

$$\frac{\text{Net operational flow/operating profit before}}{\text{Benefits and taxes}}$$

b. return on assets of operating cash flow: measures the ability of the assets of the company's to generate operate cash flow, calculated as follows:

$$\frac{\text{Net operating cash flow}}{\text{Total assets}}$$

c. operating cash flow ratio: it is reflecting the efficiency of credit policies in the collecting cash, calculated as follows:

$$\frac{\text{Total cash flows from operating activities}}{\text{Net sales}}$$

d-assessment of liquidity:

Linked to the strength or weakness of the company's liquidity the availability of net cash flow from operating activities, if the net cash flow from operating activities is positive it means cash surplus the company's management can be used by either expansion or investment activities in the repayment of long-term debt. If it is negative, it means that the company search for sources to financing the deficit. In addition to the sources and uses of operating cash provides indications on how efficient the collection policies. The most useful in assessing liquidity ratios established the following:

d/1- Coverage of cash, which measure the ability of net cash flows from operating activities to cover the total cash outflow for investment activities and financing

(e.g. debt, loans payable, and leases payments for finance leases, purchase of fixed assets and dividends, calculated as follows:

$$\frac{\text{Net cash flow from operating activities}}{\text{Total cash outflow for investing activities and financing}}$$

d/2-rate payments to pay off debt interest is calculated as follows:

$$\frac{\text{The interest of debt}}{\text{Net cash flow from operating activities}}$$

And this percentage rising bad indicator, that means the company may face problems in liquidity needed to pay interest on debt. And the inverted index over the company's ability to repay debt.

d/3. with regard to the suitability of current ratio as an indicator to assess the liquidity of the financial analysts raise question marks about its validity, and suggest instead by other ratio can be termed a cash flow from operating activities (CFO) are calculated as follows:

$$\frac{\text{Net operating cash flow + cash}}{\text{Current liabilities}}$$

e/assessment funding policies: and one of the most important ratios are useful in this area:

e/1-ratio of dividends; and is providing information on the policy followed by the company's management in the area of distribution of profits and the extent and stability of this policy. It is also an indicator of the company's ability to distribute cash dividend by displaying inverted this ratio. and calculates the ratio of dividends as follows:

$$\frac{\text{Cash distribution to shareholders}}{\text{Net cash flows from operating activities}}$$

e/2-percentage interest and dividends received, a measure of the relative importance of revenues from investments in loans or securities. Is calculated as follows:

$$\frac{\text{Cash receipts from interest income and distributions}}{\text{Cash flows from operating activities}}$$

e/3. capital expenses ratio, a measure of the relative importance of external funding sources to finance capital expenditure invested in the acquisition of fixed assets, reflects the success of the company's management to follow a policy adapted to finance long-term assets of long-term funding sources. Is calculated as follows:

$$\frac{\text{Real capital spending}}{\text{Cash inflows of long-term loans and equity issues and bonds}}$$

We conclude from this that the Audit Committee can play a role in improving the external auditor's report, by improved financial statements and which are focus of the audit work. Add to that, the role that could be played by the Audit Committee in assessing the entity's ability to continuity in the conduct of economic activity, through the study of the entity's liquidity position and credit facilities, whether conferred by or granted to them. On the general we propose in this area to the means of the examination of other conduct analytical study using analysis financial statements for the purpose of extracting some of the indicators that are useful for evaluating the general situation of the enterprise.

Thus, statement of cash flows provides information that can be linked with other information derived from the financial statements, and analysis in assessing the ability of enterprises to generate positive cash flows in the future, as well as to assess their capacity to meet their obligations and their ability to profit distribution and the need for external financing. And the statement shows that the strength or weakness of liquidity in the short term is linked to the availability of net cash flow from operating activities, net cash flow from these activities is positive it means necessarily a surplus cash facility management can be used by either the expansion or investment activities in long-term debt, if the net cash flow is negative, it necessarily requires looking established sources to finance that deficit. The end result of the analysis is to assess liquidity and its ability to continuity in its activity in the future.

### **3.2. Improvement of auditing cash flow statement in accordance with the International Standards**

At the earliest stages of transition to the market economy, discussions took place on the matters related to preparation and transformation of cash flow statements in accordance with the requirements of the National Accounting Standards (NAS) or International Accounting Standards (IAS, IFRS).

In the recent years, the need has increased in commercial companies as to prepare specifically cash flow statements as per requirements of the International Accounting Standards rather than preparation of information about the various forms of providing with funds. But until now discussions keep on arising on many problems, certain aspects of methodology of making up such statements, for instance, as to their content, objective, interpretation of applied concepts, components.

Audits of cash flow statements are conducted in accordance with the International Financial Reporting Standards (IFRS), International Auditing Standards (IAS), the National Accounting Standards and the National Auditing Standards of the Republic of Uzbekistan.

If we consider these matters at international level, we find out that they have their specific aspects. They should be made up by using the standards of the group of the International Audit Standards (IAS) 700-799-“Audit conclusions and audit reports”, i.e. the standards named as 700-“Forming an opinion and reporting on Financial Statements”, 710-“Comparative information-corresponding figures and comparative financial statements”, 720-“The auditor’s responsibilities relating to other information in documents containing audited financial statements” and of the standards of the group 800-899-“Specialized spheres”, 800-“Special Considerations-Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks”, 810-“Engagements to report on summary Financial Statements. For instance, in IAS №700, certain situations have been found out that can affect formulation of opinions differing from the contents of auditors’ reports,

their components, their form, including from the clean audit opinion. Reports with changed form have been individually provided.

The International Auditing Standards serve to unify the audit system at world level. The procedure of application of the International Standards in the introduction of the National Audit Standards in our republic requires that a specific attention be paid to the level of organization of creation of audit systems in the developed countries.

In the process of international level audit, the IAS (IAS 700) is considered to be the basis for external and internal audits in accordance with the standard named as “The independent auditor’s report on the full package of the general-purpose financial statements”, the issues of the auditor’s report, its components and contents are broadly highlighted in it. The objective of the said standards is to introduce the unified procedure for making up auditor’s report and opinion of the audit of the Company conducted by external audit.

According to the International Financial Reporting Standards (IAS, IFRS), as well as to several Standards (GAAP US, GAAP UK, UZ NAS, etc.), cash flow statement as a separate statement form shall be deemed a component of the financial statement package. In order to show the significant aspects different from the other forms of the cash flow statement in the financial reporting package.

International Standards on Auditing (ISA) are professional standards for the performance of financial audit of financial information. These standards are issued by International Federation of Accountants (IFAC) through the International Auditing and Assurance Standards Board (IAASB). According to ISA guides the auditor to add value to the assignment hence building confidence of investors.

It is necessary to provide with recommendations on improvement of audit of cash flow statements based on the International Financial Reporting Standards and International Auditing Standards.

There is some differences between IFRS and National Accounting Standards of the Republic of Uzbekistan (NAS). (Table 3.2)

**Table 3.2****Differences between IFRS and National Accounting Standards (NAS)<sup>37</sup>**

| International Financial Reporting IFRS/IAS   | National Accounting Standards (NAS)  | Comment  |
|--|--|--|
| Framework for the Preparation and Presentation of Financial Statements (Framework) | Framework for the Preparation and Presentation of Financial Statements, approved by the MF in 1998 | In general, the national framework follows the principles of the international framework. The objectives and users of financial statements are described almost identically, although there are some differences. There is no difference between underlying assumptions and qualitative characteristics, in the national framework; all are described as principles. There is no section on “Concepts of Capital and Capital Maintenance” in the national framework.   |
| IAS 1 Presentation of Financial Statements   | NAS 1 Accounting Policy and Financial Reporting  | Because NAS 1 is based on an older version of IAS 1, it focuses primarily on accounting policies, less on financial reporting. Other differences include:<br>1.Required financial statements include the report on movements of fixed assets;<br>2.Financial statements must be completed by using prescribed forms (approved by a separate regulation); the calendar year is the required reporting period; and financial statements should be prepared no later than February 15 of the following year;<br>3.NAS 1 is not applicable to banks and insurance undertakings;<br>4. NAS 1 establishes that the users of financial statements are relevant state bodies and owners, not the general public. |
|  | NAS 3 Report on Financial Results  | NAS 3 describes the income statement in detail. While the concepts are generally in line with IAS 1, there are some differences, for example, NAS 1 recognizes extraordinary items, whereas IFRS/IAS do not mention them.  |
| IAS 7 Cash Flow Statement  | NAS 9 Cash Flow Statement  | Some of its provisions are not up to date, for example:<br>1.NAS 9 still refers to the concept of extraordinary cash flows; and<br>2.NAS 9 does not contain provisions for investments in subsidiaries, associates and joint ventures.   |

If we proceed from the contents of descriptions and the above classification of movement of funds, in our opinion, there are disputed points in the current form of operations of the “Cash Flow Statement” and in the methodology of its formulation and its auditing.

It can be stated in general that classification of cash flows and terms

<sup>37</sup> Made by author, according to the information of National and International Standards

pertaining to them, the contents of the cash flow statements, the methods of formulation of audit reports on cash flow statements as per financial-economic aspects do not meet the requirements of the international standards, there are aspects different from the approaches recommended in the regulatory documents of our Republic regarding formulation of accounting statements. We shall explain this idea of ours as follows:

1. The information to be reflected as a cash flow statement has not included the full data related to cash flow statement in accordance with the International Financial Reporting Standards and are not related to other forms of financial statement.

If we consider the content of “Statement of cash flows” (Form № 4) approved under Order №140 of the Minister of Finance of the Republic of Uzbekistan dated December 27, 2002, line 110 has been assigned in the section “Financial activity” in it for reflecting received and paid interests, line 120 has been assigned in the same section for reflecting received and paid dividends. It proceeds from this that the standards specified in paragraphs 24 and 25, the National Accounting Standards, №9 – named as “Statement of cash flows” for reflecting the receipts and expenditures on received and paid interests and received dividends and clauses contained in the “Statement of cash flows” (Form №4) do not match.

It is known that received interests and dividends are deemed to be revenues from debts and investments in the form of stocks, as a results of investment activity. While the payable interests and dividends constitute the payables to business entity and are deemed to be the cost payable for financial resources attracted to private capital, as a results of the financial activity.

In order to resolve this problem, it is necessary to improve “Statement of cash flows” (Form №4) and the regulatory documents related to it. According to the Financial Reporting Standards, the received dividends will come under the investment activities, while the paid dividends will come under the financial activity. Taking into account this, in order to reflect the received dividends in the



new form, it is feasible to transfer the “Interests, dividends from the financial investments” to the Investing activities and to reflect the paid dividends to transfer “Payment of dividends” to the financial activity.

2. There is a necessity of working out new structure of cash flow statement in accordance with the International Standards. The information reflected in the cash flow statement should be as it specified in the International Standards. It is necessary to co-ordinate names of positions reflected in the cash flow statement with the International standards

3. Another problem existing in the current form of the cash flow statements is the issue of reflecting cash flows on financial leasing. Line 160 has been assigned in the “Financial activity” for receipts and expenditures from the financial lease in the “Statement of cash flows” (Form №4) approved under Order №140 of the Ministry of Finance of the Republic of Uzbekistan dated December 27, 2002. This case will lead to classification of all financial lease cash flows as coming under the financial activity. Actually, it is necessary to divide the financial lease into two parts in respect of the company:

1. Receipts from financial leasing of assets;
2. Taking assets on financial lease.

Cash flows on financial leasing also should be classified based on this. “Receipts from financial leasing of assets” should be classified as a full investment activity. Because, firstly, receipts as payment (repayment of the principal debt) for the value of the leased assets will be related to the expenses on the long-term assets such as fixed assets or capital investments. Secondly, the interests received by delayed payment of the assets value will be the investment activity derivative.

It will be correct to reflect the payments occurring in the process of “taking assets on financial lease” in the financial activity section of the cash flow statements as they occur in the process of financing the company’s business.

4. In order to reflect the receipts and expenditures in the currently effective of the cash flow statements, separate columns have been assigned. In the form that has been created in accordance with the International Financial Reporting

Standards, it is recommended to reflect the receipts and expenditures not in separate columns but on lines. Given recommendation is substantiated by the fact that the receipts and expenditures pertain to the various spheres of the business (operations, investments, finances).

5. In the form of the statement that is used now the income and the expense of money resources of the enterprise - cash flow is reflected in the form of one accounting period. However in the period of free economy, conduct analysis and to estimate various activity of the enterprise within several years.

6. There are some differences in classification of the cash flow statement according to the International Financial Reporting Standards (IFRS) and in classification of the cash flow statement that now is used in our Republic.

One of differences in a form that is used in our country "Taxation" is classified as separate subsection. In the form of the statement used in the developed countries, "Taxation" is reflected in the first section that is named cash flows in "Operating activities". Sections of cash flow statement under the International Financial Reporting Standards and the statement of cash flows under National Accounting Standards (NAS 9) of the Republic of Uzbekistan is shown three sections. But actually in practice cash flow statement's form shown four sections (Operating activities, Investing activities, Financing activities and Taxation). Therefore it is expedient to transfer "Taxation" in the first section "Operating activities".

7. In order to organize audit of cash flow statements, it is necessary to conduct the processes in this sphere in our republic by taking into account the financial, technologic and other features of each sector, and to do this it will be required to formulate guidelines for conducting audits in groups by sectors (the chemical, metallurgy services, processing cereals, food industry, consumer goods production industries, etc.). Regardless of form of ownership, all audit organizations can organize audit processes by using the said guidelines as instructions.

8. Use of modern information technologies in auditing cash flow statements will lead to auditing efficiency. Auditing process based on computer technologies will not only save funds and time but also will help in promptly obtaining the data which are difficult to obtain manually. The said data pertain to identification of the methods of improvement of a business entity's whole strategy, the financial-economic activity.

As a result of use of computers' computing potentials, it will be possible to say about the ways the business entity's management should take both during and after the reporting period based on the information of the past reports.

The programs should consist of the following components in computerization of auditing in the world practice:

- economic-mathematic, economic-organizational and information models reflecting the audit process;
- hardware, software, data and other means that provide for creation of models.

The advantage of use of information technologies in auditing cash flow statements is as follows: it is possible for audit to alter the questionnaires by way of providing with sample questionnaires for all actions and calculation practices for each audit object, as well as by taking into account the features of the business entity.

The results of calculations carried out based on the business entity's information will be automatically produced by the program with the opinion provided in the last paragraph of the documented form of each action. The found out mistakes shall be automatically made up into forms and their list will be made up. The found out mistakes will also be reflected in the document stating the breaches in the statutory acts.

The final opinion shall be formulated regarding the method of keeping the accounts system in the business entity in the audits report's final section and will be kept entered in the report in the process of formulation of the auditor's opinion.

Table 3.3 shows the procedures of auditing cash flow statement as per Audit XP “Complex Audit” program.

**Table 3.3**

**The sequence of the procedures of auditing cash flow statement  
as per Audit XP “Complex Audit” program<sup>38</sup>**

| <b>Name/Index</b>  | <b>Auditing procedures</b>  |
|--|---|
| Internal supervision system and accounting system assessment tests.1x01-1x02 | Testing internal control and accounting   |
| Accounting policy 1x11-1x12  | Analysis of the calculation policy in accounting and analysis of calculation policy in tax accounting   |
| Checking the procedure of formulation of cash flow statements. 1x21-1x22     | Analysis of the plan of working accounts and checking the compliance of the accounting registry indices with the statement information  |
| Auditor’s selection 1x31-1x36  | Calculation of selection scope, total selection procedure   |
| <b>Significance</b>  |   |
| Existence, law, fullness 1x41-1x43   | Taking inventory, checking agreements, net cash receipts, correct documentation of expenditures in accounts   |
| Existence, assessment 1x51-1x55  | Checking compliance of cash flows with the standard requirements. Checking correct assessment as per accounting policy and the laws. Checking correctness of cash flows by activities in accordance with the accounting policy. |
| Emergence, accuracy, assessment 1x61-1x62                                    | Checking compliance of the operations by net cash receipts and expenditures during the checked period with the said period, checking compliance of purchase and write-off prices with the accounting information.               |
| Reflection and disclosure 1x71   | Checking reflection of all important information in statements  |
| Summary for section 1x92-1x98  | The found out drawbacks and errors, systematic drawback information, analysis of random check results, list of established drawbacks, opinion of the audited section.   |

It may be stated that currently many audit programs are being developed and improved in the IT market, viz.: Audit XP “Complex Audit” program, “IT Audit”, “AuditNet, “AuditPro”, “Auditsystem/2™”. In the process of conducting IT-based audits, an auditor should focus on the following: operations are correctly

<sup>38</sup> Prepared by the author according to the information of Audit XP “Complex Audit” program

performed by the computer, operations are not lost, kept separate, kept unchanged, errors are promptly remedied, accuracy of achieved results.

Being formulated based on the comparative study of the regulatory documents that set up the procedure for formulation of the financial statements and cash flow statements in accordance with the International and National Standards, the expressed opinions serve, under the conditions of modernization of the economy, for growth in the data potentials of financial statements that is a means of communication between the state, investors, creditors, suppliers, buyers and customers and other information users and the company, further integration of the National Accounting Standards into the International Financial Reporting Standards and for coordination of the provisions of the regulatory documents that set up the procedure for formulation of cash flow statements mutually complementing each other.

### **Summary of Chapter III**

In this chapter, the results of the improvement of auditing cash flow statement have been presented. Chapter three contains the results of improvement of auditing cash flow statement in accordance with the International Standards and the aspects of improvement of analyzing cash flow statement.

It is necessary to provide with recommendations on improvement of audit of cash flow statements based on the International Financial Reporting Standards and International Auditing Standards. The International Auditing Standards serve to unify the audit system at world level. In order to fulfill these tasks, the need is believed to have arisen for organization of audit of business entities' cash flow statements according to the requirements of the national auditing standards, analysis of the statement data, improvement of the auditing process according to the experience gained in foreign countries.

## **Conclusions and recommendations**

Emergence of various forms of property ownership and introduction of the modern methods of management of businesses under the conditions of deregulation of the economy have also created certain problems in organization of audits of cash flow statements.

If we have a look from the point of view of today's requirements, the main attention is being paid to addressing the problems existing in audit of businesses and to improvement of activities in this sphere. Now, efforts are being made to bring the accounting and audit to the level of the international standards.

The attempts to organize activities in conducting audits of cash flow statements according to the modern requirements will undoubtedly serve for resolving the problems existing in this sphere. The dissertation's beginning part indicates the theoretical fundamentals and the current status of organization of auditing cash flow statements, the drawback existing in this sphere, the methods of remedying them. Proceeding from the ideas provided above, it is feasible to formulate recommendations on addressing the problems existing in the sphere of auditing cash flow statements. We have arrived at certain opinions based on aspects of study and researches into the problems of organization and conducting audits of cash flow statements.

Thus, the research scientific novelty is reflected in the following:

- ✓ the content and essence of cash flow statement audit have been disclosed;
- ✓ the main areas of study of the theoretical bases of cash flow statement audit and its development have been proved;
- ✓ the aspects of procedure of auditing cash flow statement in accordance with the requirements of the National Standards on Auditing have been proved;
- ✓ the methods of preparing cash flow statement in accordance with the International Accounting Standards have been disclosed;

✓ the aspects of procedure of auditing cash flow statement in accordance with the requirements of the International Standards on Auditing have been proved;

✓ the aspects of improvement of analyzing cash flow statement have been proved.

✓ recommendations have been formulated on improvement of auditing cash flow statement in accordance with the international standards.

My dissertation described the theoretical bases of auditing cash flow statement, and an overview of existing practical explanations of auditing cash flow statement in accordance with the requirements of the National and International Standards on Auditing, also examining the national context in an international comparison. Based on the research, I found opportunities for improvement of national regulations and practices in the following fields:

1. There is a necessity of working out new structure of cash flow statement in accordance with the International Standards. The information reflected in the cash flow statement should be as it specified in the International Standards. It is necessary to co-ordinate names of positions reflected in the cash flow statement with the International standards.

2. The information to be reflected as a cash flow statement has not included the full data related to cash flow statement in accordance with the International Financial Reporting Standards and is not related to other forms of financial statement.

It is necessary to improve “Statement of cash flows” (Form №4) and the regulatory documents related to it. According to the International Financial Reporting Standards, the received dividends will come under the investment activities, while the paid dividends will come under the financial activity. Taking into account this, in order to reflect the received dividends in the new form, it is feasible to transfer the “Interests, dividends from the financial investments” to the Investing activities and to reflect the paid dividends to transfer “Payment of dividends” to the financial activity.

3. Cash flows on financial leasing also should be classified based on this. “Receipts from financial leasing of assets” should be classified as a full investment activity. Because, firstly, receipts as payment (repayment of the principal debt) for the value of the leased assets will be related to the expenses on the long-term assets such as fixed assets or capital investments. Secondly, the interests received by delayed payment of the assets value will be the investment activity derivative.

It will be correct to reflect the payments occurring in the process of “taking assets on financial lease” in the financial activity section of the cash flow statements as they occur in the process of financing the company’s business.

4. In order to reflect the receipts and expenditures in the currently effective of the cash flow statements, separate columns have been assigned. In the form that has been created in accordance with the International Financial Reporting Standards, it is recommended to reflect the receipts and expenditures not in separate columns but on lines. Given recommendation is substantiated by the fact that the receipts and expenditures pertain to the various spheres of the business (operations, investments, finances).

5. In the form of the statement that is used now the income and the expense of money resources of the enterprise - cash flow is reflected in the form of one accounting period. However in the period of free economy, conduct analysis and to estimate various activity of the enterprise within several years.

6. Sections of cash flow statement under the International Financial Reporting Standards and the statement of cash flows under National Accounting Standards (NAS 9) of the Republic of Uzbekistan is shown three sections. But actually in practice cash flow statement’s form shown four sections (Operating activities, Investing activities, Financing activities and Taxation). Therefore it is expedient to transfer "Taxation" in the first section "Operating activities".

7. In order to organize audit of cash flow statements, it is necessary to conduct the processes in this sphere in our republic by taking into account the financial, technologic and other features of each sector, and to do this it will be required to formulate guidelines for conducting audits in groups by sectors (the



chemical, metallurgy services, processing cereals, food industry, consumer goods production industries, etc.). Regardless of form of ownership, all audit organizations can organize audit processes by using the said guidelines as instructions.

8. Use of modern information technologies in auditing cash flow statements will lead to auditing efficiency. Auditing process based on computer technologies will not only save funds and time but also will help in promptly obtaining the data which are difficult to obtain manually. Using a computer program as per Audit XP “Complex Audit” of the procedures of auditing cash flow statement statements will lead to auditing efficiency.

9. The quality assurance review program, as well as the relevant methodology, should be strengthened. The regime should be focused on risk assessment and its objective should be to improve audit quality through identifying gaps in the implementation of auditing standards and encouraging training and improvements in methodology to address the gaps.

Based on the findings of my research, I consider that it is necessary to improvement of auditing cash flow statement in accordance with the requirements of the International Standards. I sincerely hope that my dissertation will contribute to this development.

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