



International Journal of Financial Management and Economics

P-ISSN: 2617-9210
E-ISSN: 2617-9229
www.theeconomicsjournal.com
IJFME 2021; 4(1): 41-45
Received: 10-10-2020
Accepted: 19-11-2020

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Analytical procedure in an audit of fixed assets

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Abstract

The article describes the content of analytical procedures, stages and methods of their implementation when planning an audit of fixed assets. Areas of potential risk were identified in terms of equipment, condition, movement, use of fixed assets and investment activity of the organization. Additional analytical procedures in the audit of fixed assets are indicated.

Keywords: Fixed assets, materiality, planning, stage, methodology, analytical procedures

Introduction

Analytical procedures play a significant role in the theory and practice of audit, as a result of their application, the features of the audited entity's activity are revealed, and the risks of potentially dangerous areas of the accounting process are assessed.

Analytical procedures help to identify unusual transactions, as well as coefficients and trends that indicate possible problems that are relevant to the financial (accounting) statements of the audited entity. A properly organized preliminary review of the organization's financial condition reduces the auditor's risk during the audit.

In accordance with the National Audit Standard Activity No. 20 "Analytical procedures", these procedures include:

- a. Study of financial and other information about the audited entity in comparison with:
 - With comparable information for previous periods;
 - With the expected performance of the audited entity, such as estimates or forecasts, as well as the auditor's assumptions;
 - With information about the performance of organizations in the same industry;
- b. Comparison of the methods established in the accounting policy with those actually applied in the organization;
- c. Comparison of balances and turnovers on the accounts of the analytical account with the data of synthetic accounting;
- d. Analysis of factors that affect the reduction of financial and economic indicators of the organization;
- e. Consideration of relationships:
 - Between elements of information that are supposed to correspond to the Pro.
 - Based on the experience of the audited entity;
 - Between financial information and other information.

The use of analytical procedures at the planning stage allows the auditor to analyze the results obtained when comparing the expected values of economic indicators of the organization with the recorded values or coefficients calculated on their basis. These results serve as the primary indicator of whether the financial (accounting) statements contain material misstatements to assess audit risk.

The information base of analytical procedures is: macroeconomic indicators; indicators of the organization according to financial (accounting) statements, regional and industry indicators.

Analytical procedures can be performed using different methods

- Comparison (including horizontal and vertical comparative analysis);
- Carrying;
- Coefficient;
- Deterministic factor analysis;

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- Expert evaluation;
- Situational analysis and forecasting.

Let's consider the stages and methods of conducting analytical procedures when planning an audit of fixed assets. As irreplaceable means of production, fixed assets are the core item of the balance sheet. Their growth positively characterizes the investment and economic development of the business, its reliability and long-term viability.

Phase one. During pre-planning, the auditor gets to know the client's business. To do this, it conducts a rapid analysis of the organization's performance. These include:

- The amount and growth rate of revenue from the sale of products (goods, works, services);
- Profit from the sale of products (goods, works, services);
- Profit before tax;
- Annual labor productivity;
- The level of the average annual salary of the employee;

- Capital productivity;
- Working capital turnover ratio;
- Materials consumption;
- Cost recovery;
- Profitability of sales;
- Return on assets and equity.

Table 1 shows the estimated data of Gulom Polvon LLC (Surkhandarya region, Uzbekistan).

The calculated data show that the organization's performance has improved (table 1). Revenue from product sales increased by 67.14% due to both increased sales volume and higher sales prices. This had a positive effect on the change in profit from sales-2.2 times. This significant increase is also due to the faster growth rate of revenue relative to cost. This is evidenced by the decrease in material consumption.

Profit before tax increased more than three times, therefore, the organization has a positive balance from other activities.

Table 1: Dynamics of financial and economic results of Gulom Polvon LLC in 2018-2019

Indicator	2018	2019	2019 - 2018%
Revenue from the sale of products, million sum.	74 904	125 192	167,14
Profit from the sale of products, million sum.	5 580	12 682	227,28
Profit of taxation, million sum.	3 105	10 166	327,41
Return on funds, rubles	17,33	28,99	167,28
Annual productivity of labor, million sum.	2 996	5 008	167,16
Average annual salary of one employee, million sum.	156	228	146,15
Working capital turnover ratio	2,28	5,09	223,25
Material consumption, rubles	0,44	0,19	43,18
Profitability of sales, %	7,45	10,13	2,68
Return on assets, %	10,70	28,51	17,81
Return on equity, %	22,31	46,98	24,67
Return on use of fixed assets, %	172,32	235,41	63,09

As a result, all indicators of resource efficiency have improved. Thus, the annual productivity of labor increased by 67.16%, while wages increased by 46.15%. Outpacing the growth rate of labor productivity relative to wage costs helped to increase profits and improve profitability indicators. The profitability of using fixed assets increased the most - by 63.09%, and based on 100 rubles of used fixed assets, the organization received a profit of 235.41 rubles in the reporting year. In terms of return on assets, there is an increase of 17.81%, and in terms of return on equity - by 24.67%.

As you can see, the amount of changes in indicators is significant.

With the purpose of objective assessment indicators, it is recommended to perform external environment of functioning of business entity (analysis of competitors, suppliers, customers, market, competition level, trends of industry development and foreign trade activities, segments, and market capacity, etc.).

Second stage. At this stage of audit planning, the analysis of accounting forms is performed. For fixed assets this is:

- Form № 1 "Accounting balance sheet". Fixed assets are recorded at their residual value. Additional capital can characterize the amount of revaluation (markdown) of fixed assets. Off-balance sheet accounts reflect the cost of leased fixed assets, including long-term Finance leases (leasing);
- Form № 2 "profit and loss Statement". Other income

and expenses include proceeds from the sale of property, plant and equipment, interest payable and interest received on the lease of property;

- Form № 4 "cash flow Statement". For investment activities, revenue from the sale of fixed assets and other similar property, the amount of purchased fixed assets is shown;
- Form № 5 "Appendix to the balance sheet". The initial cost of fixed assets by their types at the beginning and end of the year, the cost of retired and received objects, the amount of accumulated depreciation, the cost of transferred and leased fixed assets, the result of revaluation is reflected.

In the course of the analysis, the facts of misstatement of accounting statements are identified based on such an analytical procedure as evaluating the comparability of accounting forms.

In table. 2 presents recommended economic indicators for comparison, directly related to fixed assets, and the result of comparison for LLC "Gulom Polvon".

The third stage: Evaluating the level of materiality

According to NSA No. 9 "Materiality and risk", the auditor can consider materiality both at the level of financial (accounting) statements as a whole, and in relation to balances on individual accounting accounts, groups of similar operations and cases of disclosure of information.

Materiality may be affected by factors related to individual accounting accounts of financial (accounting) statements and the relationships between them.

The auditor can set the materiality limit as the sum of the materiality limits set for significant reporting items (those reporting items that make up at least 1% of the total share

are considered significant).

However, it is not quite correct to determine the level of materiality for the balance sheet item "Fixed assets", since this group of assets is recorded at residual value, and the amount of depreciation accrued on them may distort the calculated value.

Table 2: Comparability of economic indicators in terms of the audit of fixed assets

Indicator	Basic indicator (line and reporting form)	Comparable indicator (line and reporting form)	Conclusion
Residual value of fixed assets	Page 120 f. no. 1	Page 130 f. № 5; Page 140 f. № 5	Respond
Initial cost of fixed assets at the end of the year	Page 130gr. 6F. no. 5	Page 130 f. no. 5; page 140 f. no. 5	Respond
Accumulated depreciation for the year	Page 140 gr. 4 f. no. 5; page 140gr. ZF. no. 5	Page 130 f. no. 5; Page 140 f. no. 5	Respond

F each article depends on factors such as

- The level of risk for each reporting item (there is an inversely proportional relationship between the level of risk and the level of materiality);
- Time and money spent on checking the article (the lower the level of materiality, the more detailed the check should be);
- Requirements for the level of detail of verification of a specific article;
- Specific weight of the item in the currency.
- To determine the materiality limit for the item "Fixed assets", it is necessary to select an indicator that would most accurately characterize the significance of materiality and take into account the influence of these factors.
- Let's select the indicator that is most important for evaluating the use of fixed assets at the end of the reporting year.
- Table 3 shows the qualitative indicators of the assessment of fixed assets of LLC "Gulom Polvon".
- Since there is an inversely proportional relationship between the level of audit risk and materiality, it is necessary to determine the rate of change in quality indicators, assess their impact on audit risk, and select the optimal value from them, which is located in the zone of minimal risk. The methodology for identifying potential risk zones that characterize the security and efficiency of the use of fixed assets is presented in table 3.
- The fourth stage. Identification of potential risk zones that characterize the security and efficiency of the use of fixed assets.
- It is important to note that for joint-stock companies it is necessary to include the indicator "value of net assets", in the calculation of which fixed assets are directly involved, and a comparison of this value with the size of the authorized capital will allow us to conclude that the organization's business continuity in the short term.
- According to table 3, it can be concluded that the risk zone with the highest value is characterized by the indicator of the level of depreciation of fixed assets and the lack of a loan for updating fixed assets in 2019. The risk zone with the lowest value is the share of the active part of fixed assets (0.47). Therefore, to calculate the materiality limit for the balance sheet item "Fixed assets", this coefficient must be taken into account.
- The use of analytical procedures at the final stage of planning allows us to formulate a General conclusion about the compliance of financial (accounting)

statements with the requirements of the legislation of the Russian Federation. Undoubtedly, the main resources are the internal factors of business development. Low values of fixed asset condition coefficients are a threat to the organization's business continuity.

- Additional analytical procedures include:
- comparative analysis of the return on capital and profitability of fixed assets by competitor companies;
- Factor analysis of the use of fixed assets. For industrial enterprises, the following factor model of Fund return (FR):

$$F = \frac{\frac{x_1}{2} + x_2 + \dots + \frac{x_n}{2}}{n-1} \quad (1)$$

Where, F is the average cost of fixed assets for the period.

The measure of consumption of fixed capital is depreciation, the monetary expression of which is depreciation charges, which are a part of the cost of fixed capital transferred to the finished product (the process of commodity circulation) in each production cycle or for a certain period. In practice, depreciation amounts are calculated on a monthly basis and included in expenses. The analysis also uses the concepts of "production" and "non-production" fixed assets. Production fixed assets include objects, the use of which is aimed at systematic profit as the main purpose of activity, i.e. use in the production process, in construction, agriculture, trade and public catering, procurement of agricultural products and other similar activities. They gradually, in parts, transfer their value to the costs of production and circulation. The use of non-production fixed assets does not have the purpose of systematic profit-making. They are used for cultural and household needs of employees of the enterprise (fixed assets of housing and communal services, scientific institutions, culture, health, clubs, stadiums, kindergartens, etc.). Non-productive fixed assets are also listed on the balance sheet of the enterprise, but are concentrated in the social sphere. In addition, the active part of fixed assets is allocated, which includes working machines and equipment, devices and vehicles. The analysis of the efficiency of the use of fixed capital reflects the quality of the use of production potential, characterizes the technical level of production from the point of view of the main task of attracting capital for the production and sale of goods for profit.

To characterize the use of fixed capital, a system of indicators is used, which includes General and specific technical and economic indicators. Summary indicators reflect the use of all major production assets, while private

indicators reflect the use of certain types of assets. The most common General indicator of capital use is the return on capital calculated using the formula:

$$H = \frac{NP}{F} \quad (2)$$

Where NP is the volume of sales (in industry-manufactured products, including work in progress); F – the average cost of fixed assets for the period.

This indicator reflects the number of goods sold (output) per unit of the cost of fixed assets or the volume of turnover

(output) the company has from the use of the unit of cost of fixed assets. When calculating it from the total cost of fixed assets, it is desirable to exclude the cost of leased objects according to section 3 of the form "Appendix to the balance sheet". This exception is due to the fact that the leased fixed assets do not participate in the sale of goods. An increase in the return on funds means an increase in the efficiency of using objects and vice versa. The return on all fixed assets depends on the return on the active part of them and its share in the total cost of fixed capital. In the analysis, you can determine the impact of these factors on the return on funds using the following model.

Table 3: Potential risk zones in 2018 and 2019

Indicator	Criterion	2018	2019	2019-2018, +/-	The materiality of the deviations	Evaluation of deviations	Materiality of the indicator	Conclusion (Risk zone)
Equipment and structure of fixed assets								
The capitallabor ratio, sum.	Initial average annual cost of fixed assets/average Annual number of employees	173,28	172,2	-1,08	—	Low	Significant	—
Share of active part of fixed assets, %	(Machinery and equipment + Vehicles)/Initial cost of all fixed assets • 100%	45	47	2	—	Low	Significant	—
Share of non-production fixed assets, %	Cost of non-production fixed assets/Initial cost of all fixed assets • 100%	21	19	—2	—	Low	He Significant	—
Movement and condition of fixed assets								
Growth of fixed assets, %	Initial cost of fixed assets at the end of the year/Initial cost of fixed assets at the beginning of the year • 100%	98,05	99,38	1,33	—	Low	Significant	—
Disposal of fixed assets, %	Cost of disposed fixed assets/Initial cost of fixed assets at the beginning of the year • 100%	5,21	5,82	0,61	—	Low	He Significant	—
Renewal of fixed assets, %	Cost of received fixed assets/Initial cost of fixed assets at the end of the year • 100%	3,32	6,57	3,25	Significant	Positive High	Significant	—
Replacement of fixed assets, %	Cost of received fixed assets/Cost of disposed fixed assets • 100%	62,61	91,29	28,68	Significant	Positive, very high	He Significant	—
Level of depreciation of fixed assets, %	Amount of accrued depreciation/Initial cost of fixed assets • 100%	24	28,75	4,75	—	He Significant	Significant	risk zone
Investment activity of modernization and improvement of technical readiness of fixed assets								
Share of funds allocated to purchase and repair of fixed assets, %	Net cash from investing activities/Total cash receipts (cash Receipts) • 100%	15,7	28,9	13,2	Significant	Positive, very high	Significant	—
Share of credit resources allocated to purchase and repair of fixed assets, %	Amount of credit resources allocated for the purchase of fixed assets/Total amount of loans and borrowings • 100%	50	0	-50	Significant	Negative, very high	He Significant	risk zone (increased)

$$H = \frac{NP}{F_c} \quad (2)$$

Where F_c is the average value of the active part of fixed assets over the period

Table 4: Indicators of evaluation of fixed assets of LLC "Gulom Polvon" in 2019, million sum

Indicator	Value
Initial cost of fixed assets at the beginning of the year	4 332
Initial cost of fixed assets at the end of the year	4 305
Residual value of fixed assets at the beginning of the year	3 292
Residual value of fixed assets at the end of the year	3 067
Replacement cost	—
Average annual cost of fixed assets	4 318,5

Give some examples

The increase in the value of fixed assets growth rate exceeding the growth rate of working capital leads to a decrease in the liquidity of the balance and of the organization as assets belong to the fourth group of assets by degree of liquidity (illiquid). An increase in the cost of fixed assets in comparison with the amount of equity reduces the amount of own working capital, as a result, the coefficient of security of own working capital may not correspond to the standard value. In this case, the organization is recognized as insolvent.

Gratuitous receipt of fixed assets as authorized capital increases the amount of equity, which leads to an increase in the stability of the financial position. On the other hand, this leads to an increase in the share of depreciation charges and repair costs in the cost of production, which can lead to a decrease in profit and profitability if the return on capital received for free is low.

The acquisition of fixed assets requires both its own sources of financing and attracted resources (loans), which reduces the financial stability of the organization. At the same time, revaluation of fixed assets increases additional capital and increases the coefficient of financial independence. Underestimating the main this leads to an underestimation of the amount of depreciation.

If the fixed assets are leased, then the amount of cash is reduced by the amount of rent and interest for rent (when leasing). The amount of interest decreases the net profit, therefore, the amount of equity and financial independence of the organization.

Understating the value of fixed assets due to the likely underestimation of the accounting value of real estate (in order to reduce property tax) and fully amortised items of fixed assets leads to an overestimation of the return on assets. Understating the cost of fixed assets due to the lack of reflection of leased property (leasing) and, accordingly, understating the amount of lease obligations overestimate the indicators of financial stability, distort the structure of assets, thereby positively affecting the liquidity of the balance sheet.

The sale of fixed assets generates a financial result from other activities, which increases the net profit. At the same time, the cost of fixed assets decreases, capital turnover accelerates, and balance sheet liquidity increases due to structural shifts in the balance sheet asset.

Thus, analytical procedures are indispensable in an audit for evaluating the business, determining the level of materiality, identifying the continuity of the organization's activities and forming an effective system of internal control.

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