

INTERNATIONAL REQUIREMENTS FOR THE ORGANIZATION OF INTERNAL CONTROL

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A series of international scandals related to the unfair work of external auditors and the issuance of knowingly false reports on the financial statements of bankrupt companies has led to an increase in the relevance of the problem of organizing internal audit and other forms of control. Despite the fact that the internal control system (ICS) is an integral part of the management system of any company, there were no regulatory requirements for its organization until the end of the 20th century.

Thus, in accordance with the requirements of the Sarbanes-Oxley Act and other regulations issued or approved by the U.S. Securities and Exchange Commission or the Corporate Accounting Oversight Board, company management must annually assess the effectiveness of internal control over the financial reporting process, report the results of the assessment, and engage independent auditors to audit the assessment. These requirements apply to companies that hold shares or debt securities registered with the U.S. Securities and Exchange Commission under the Securities Exchange Act of 1934 and whose shares are traded on U.S. stock exchanges. Roughly the same requirements apply if a company lists its shares on the London Stock Exchange. To issue and list on the London Stock Exchange, the issuing company must meet a number of corporate governance and internal control requirements.

These requirements are set out in the Combined Code of Corporate Governance (*Combined Code of Corporate Governance*) in the form of best practice principles that a company must meet. Each year, in its annual report, the issuing company discloses its compliance with the Code's requirements , including how it implements individual principles or the reasons why such principles are not met.

At the end of the 20th century, the need to reduce the risk of investors investing in corporate financial assets led to the fact that in 1985 in the United States, with the participation and funds of five professional self-regulatory organizations:

- American Institute of Certified Public Accountants;
- American Accounting and Reporting Association;
- *Institute of Financial Managers*;
- *Institute of Internal Auditors*;
- Institute of Management Accounting

The result of this commission's work was presented to the public in 1992 under the title "Integrated Control Concept" (*Internal Control - Integrated Framework*), which is usually named after the organizing committee - the Committee of Sponsoring Organizations of the Treadway Commission .

COSO model was particularly important because it emphasized the responsibility of company management for the state of internal control. According to COSO, internal control is a process implemented by the highest policy-making body of the company (e.g., the board of directors, which represents the company's owners), its top-level management personnel (management), and all other employees, which sufficiently and justifiably ensures the company achieves the following objectives:

- feasibility and financial efficiency of activities (including the safety of assets);

- reliability of financial statements;
- compliance with the requirements of legislation and regulatory authorities.

One of the main tenets of the COSO is the direct responsibility of both the board of directors and management for the creation and ensuring the effective implementation of risk-oriented internal control of the enterprise.

Previously, management was tasked with ensuring the corporation's owners could achieve its goals; there were no specific internal control requirements. The company was required to ensure the following three objectives:

- cost-effectiveness and efficiency of operations;
- reliability of financial statements;
- compliance of activities with legislation and regulatory bodies.

Thus, now, when developing an internal control system (hereinafter referred to as ICS), companies need to be guided by the CO S O methodology, the main requirements of which boil down to the following theses:

- The ICS must be documented in a format understandable to auditors;
- The SVK must function effectively;
- procedures for assessing the effectiveness of the internal control system should be in place in the company on a regular basis.

The internal control system operates regularly, not sporadically, whereas the audit commission conducts audits annually on a mandatory basis, as well as at any time at the initiative of the company's audit commission (auditor), by decision of the general meeting of shareholders, the board of directors (supervisory board), or at the request of a shareholder(s) of the company who collectively own at least 10 percent of the company's voting shares. The absence of a comprehensive internal control system means that performance reviews are conducted either as part of an audit or as part of an annual review of the company's financial and economic activities by the audit commission. It is no longer sufficient for owners to receive information on the company's state of affairs from time to time. It is far more important to have up-to-date information on deviations from established goals and respond to them promptly. This is why, regardless of legal requirements, many companies create their own internal control systems.

The principles of COSO formed the basis for the new edition of International Standards on Auditing (ISAs) issued after 2001. The initial, inevitable reaction of Western auditors to the increased demands placed on them was an increase in the cost of audit services. Amendments to the standards were necessary to improve auditor efficiency and reduce their labor costs without compromising the quality of their work, thereby avoiding an excessively sharp increase in audit fees.

The implementation of such measures within the ISAs has resulted in the development of standards that should ensure consideration of the economic entity and its environment and the assessment of the risks of material misstatement. ISA 330, "Audit Procedures Responsive to Assessed Risks," links the assessment of audit risks and audit procedures for those assessed risks with an analysis of the reliability of the audited entities' internal control systems for potential misstatement of the financial statements. The International Federation of Accountants (IFAC) has made these ISAs effective for audits of reporting periods beginning after December 15, 2004. The adoption of these standards has resulted in additions and amendments to virtually all ISAs.

It can be seen that while the "old" standards defined the ICS as a set of activities in which, first and foremost, the economic entity itself is interested, the new version places emphasis on the continuity of the process, as well as the reliability of the financial statements prepared by the client and their compliance with applicable laws and regulations, as well as the ability of enterprise managers to reduce business risks with the help of the ICS.

The new ICS considers five components of the ICS; the names of the previously existing components have also changed. This change in classification is due to the significant influence of

the US auditing system on the development of ISAs, and it was the US auditing standards that provided for this classification of the ICS components.

Let's take a closer look at the components of the internal control system in the order they are mentioned in ISA 315 and the new features introduced by the latest version of the standard. The control environment, according to paragraph 2 of Appendix 2 of ISA 315, includes the attitude, awareness, and actions of management and those charged with governance regarding the entity's internal control and its importance to that entity.

The control environment also includes management and administrative functions and shapes the internal culture of the enterprise, influencing the awareness of its employees regarding control (in the original - control consciousness). The control environment is the basis for effective internal control; it ensures discipline and structure.

The risk assessment process is understood by the audited entity as the process of identifying business risks, their potential consequences, and responding to them (paragraph 5 of Appendix 2 to ISA 315). For financial reporting purposes, the risk assessment process includes:

- identification of risks associated with the preparation of true and reliable financial statements in accordance with the applicable principles of their preparation (i.e. in accordance with the standards and approaches established in the country, in our case – National Accounting Standards), and the management's response to these risks;
- assumptions about the importance of risks;
- assessment of the probability of occurrence of the corresponding adverse consequences;
- deciding on the measures to be taken to manage risks.

Please note that the new ISAs now require audited entity managers to independently assess the risks associated with their company's operations. There is a possibility that these international auditing standards will be recognized and adopted for use in the Republic of Uzbekistan. National public associations of auditors are working to translate the ISAs into Uzbek. Therefore, the subsequent application of the new standards in Uzbekistan will likely require amendments to the regulatory framework (for example, an updated accounting law) requiring managers not only to maintain records, prepare reports, and conscientiously calculate taxes, but also to assess the risks associated with their business activities. This is of particular importance in a developing economy.

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