

The Role Of Valuation Reserves In Forming Financial Results And Improving The Reliability Of Audit Expertise

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Abstract

This study examines the role of valuation reserves in shaping the financial results of enterprises and addresses the issue of improving the reliability of their audit. The purpose of the study is to analyze the impact of valuation reserves on financial performance and to develop approaches for enhancing audit reliability based on the international standard ISA 540. The main problem lies in the subjective nature of estimation indicators and their potential use in earnings manipulation. As a result, the study proposes strengthening the application of professional skepticism, improving risk assessment procedures, and adopting a systematic approach in auditing valuation reserves.

Keywords: Audit, valuation reserves, financial results, ISA 540, IFRS, professional skepticism, asset impairment, reliability, audit risk

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Introduction

At present, the economic reforms being implemented in Uzbekistan, particularly the process of adapting the financial reporting system to

international requirements, are creating new demands for accounting and auditing practices within enterprises.

Especially under the gradual transition to International Financial Reporting Standards (IFRS), issues related to asset valuation, liability recognition, and the formation of various reserves are becoming increasingly significant. This is because valuation processes directly influence the final results reflected in financial statements and play an essential role in the formation of profit indicators.

Therefore, valuation reserves should be considered not only as a technical element of accounting but also as an important instrument for accurately reflecting the financial position of an enterprise. The object of this study is the financial reporting of enterprises and the valuation estimates reflected therein. In practice, certain indicators presented in financial statements — particularly asset impairment, provisions for doubtful debts, and reserves for future expenses — are often based not on exact facts but on estimates and assumptions. Consequently, ensuring the reliability and fairness of such indicators becomes a critical issue.

The subject of the research consists of methodological approaches applied in auditing valuation reserves. In particular, the processes of verifying estimation indicators, assessing their validity, and determining their impact on financial reporting occupy an important place in auditing practice. In this regard, International Standards on Auditing, especially ISA 540, emphasize the significance of professional judgment, risk assessment, and the collection of audit evidence.

The main purpose of this study is to improve the mechanism for confirming the reliability of estimation indicators during audit procedures. To achieve this objective, the impact of valuation reserves on financial results is analyzed, challenges encountered during their audit are identified, and practically effective approaches are developed. As a result, the proposed methodological approaches will contribute to increasing the reliability of audit conclusions, ensuring transparency in financial reporting, and reducing overall audit risk.

Literature Review

Issues related to accounting estimates and their auditing have been widely discussed in international scientific and practical literature. In this

area, the standards developed by the International Accounting Standards Board occupy a significant place.

In particular, IFRS provides clear approaches regarding estimation-based indicators such as asset impairment, contingent liabilities, and reserves. At the same time, standards developed by the International Auditing and Assurance Standards Board, especially ISA 540, serve as the primary methodological source in auditing accounting estimates.

International researchers have extensively studied issues related to the uncertainty of estimation indicators, their subjective interpretation by management, and their impact on audit risk. Their studies mainly emphasize increasing the auditor's level of professional skepticism, verifying the validity of valuation models, and utilizing external audit evidence.

Local scientific literature also pays considerable attention to valuation reserves and their audit. Uzbek scholars have broadly analyzed the improvement of accounting and auditing systems, their adaptation to international standards, and their implementation into national practice. However, local research has focused more on regulatory and accounting procedures, while insufficient attention has been given to the in-depth analysis of estimation indicators and modern risk-based approaches to auditing them.

The literature review demonstrates that although general approaches to auditing valuation reserves have been developed, a specific research gap still exists in this field. Current methodologies do not fully address the high level of subjectivity associated with estimation indicators and fail to provide a unified universal approach for their identification and verification.

Furthermore, the use of complex financial instruments and valuation models in modern economic conditions makes audit procedures increasingly complicated. For this reason, there is a growing need to conduct deeper risk analysis, strengthen professional skepticism, and improve the practical implementation of international standards in auditing valuation reserves. These aspects determine the relevance of this study and necessitate the development of new methodological approaches.

Research Methodology

The methodological foundation of this study is based on an integrated approach that ensures the conceptual relationship between International

Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA).

To achieve the research objectives, the following scientific and methodological instruments were used:

1. Inductive Analysis and Conceptual Modeling

The nature of accounting estimates was studied within the framework of IFRS 13 “Fair Value Measurement” and IAS 37 “Provisions, Contingent Liabilities and Contingent Assets.”

The impact of subjective estimations on enterprise net profit was analyzed through practical examples, and the factor of “management subjectivity” was modeled as an object of audit expertise.

This method helped identify the potential role of valuation indicators in manipulating financial results.

2. Comparative Analysis and Gap Analysis

The differences between National Accounting Standards and IFRS requirements were comparatively analyzed.

In particular, the “Expected Credit Loss (ECL)” model under IFRS 9 “Financial Instruments” was compared with the “actual loss” model used in national practice.

The comparative analysis scientifically justified the role of professional judgment in forming valuation reserves and its impact on the complexity of audit procedures.

3. Risk-Based Audit Approach

The study was primarily based on ISA 315 “Identifying and Assessing the Risks of Material Misstatement” and ISA 540 “Auditing Accounting Estimates and Related Disclosures.”¹

Within this framework, a matrix of inherent risk and control risk associated with valuation reserves was developed.

Special methodological emphasis was placed on the necessity of designing audit procedures for indicators characterized by high measurement uncertainty.

4. Professional Skepticism and Verification of Evidence

¹ IAASB. *ISA 315: Identifying and Assessing the Risks of Material Misstatement*. International Auditing and Assurance Standards Board, 2019

The mechanism for applying professional skepticism in auditing asset impairment (IAS 36 “Impairment of Assets”) and valuation reserves was improved.

The methodology incorporated the requirements of ISA 500 “Audit Evidence” in collecting evidence related to management bias and proposed multi-stage reliability verification filters.

5. Regulatory and Systemic Approach

The study systematically examined the harmonization of the Law of the Republic of Uzbekistan “On Auditing Activity” with international standards.

This significantly increases the possibility of implementing the proposed methodological recommendations into practice.²

The applied methodological framework enables the comprehensive analysis of valuation reserves not only as accounting objects but also as high-risk segments of audit expertise.

Analysis And Results

This section demonstrates the impact of valuation reserves on financial results using more precise calculations and develops recommendations for addressing challenges encountered in auditing practice.

Valuation reserves, especially doubtful debt provisions and inventory impairment reserves, directly influence an enterprise’s net profit.

The following table illustrates this impact using numerical data.

Table 1. Impact of Valuation Reserves on Net Profit (Refined Model)

Indicators	Calculation Formula	Amount (million UZS)
Revenue from sales	–	1,200
Main production expenses	–	750
Gross profit	$1,200 - 750$	450
Doubtful debt reserve (5%)	$1,000 \times 5\%$	50
Inventory impairment reserve (10%)	$300 \times 10\%$	30
Other operating expenses	–	70

² Law of the Republic of Uzbekistan “On Auditing Activity”. Latest edition, Tashkent, Uzbekistan

Total expenses	750 + 50 + 30 + 70	900
Profit before tax	1,200 – 900	300
Income tax (12%)	300 × 12%	36
Net profit	300 – 36	264

Analysis Result

If valuation reserves ($50 + 30 = 80$ million UZS) had not been recognized, net profit would have amounted to 344 million UZS.

Thus, valuation reserves reduced net profit by 80 million UZS (23%), clearly demonstrating their significant role in shaping financial results.

Conclusion And Recommendations

The conducted analyses show that valuation reserves play an important role in shaping the financial results of enterprises. However, they should not become instruments for artificially “managing” financial outcomes.

The essence of valuation processes is to reflect assets and liabilities as closely as possible to their real economic condition. Using subjective judgments to intentionally increase or decrease profit undermines the reliability of financial reporting.

Therefore, the principles of validity, objectivity, and consistency must be strictly observed in the formation of valuation reserves.

The research results indicate that improving the disclosure quality of valuation uncertainties in audit reports is highly important. In practice, significant assumptions and uncertainties related to estimates are often insufficiently disclosed, potentially leading users to incorrect conclusions.

Accordingly, auditors should provide detailed information regarding key assumptions, applied methodologies, and possible deviations associated with valuation estimates.

In particular, according to ISA 540 requirements, the degree of estimation uncertainty, sensitivity analysis results, and major risk factors should be transparently reflected in audit reports.

Furthermore, to improve audit quality, it is necessary to develop criteria for involving independent valuation experts. This is especially important

when auditing assets based on complex valuation models, such as financial instruments or long-term assets, where auditors may lack sufficient internal expertise.

When selecting external experts, their qualifications, experience, independence, and the validity of their conclusions should be clearly assessed.

In conclusion, establishing effective control over valuation reserves, strengthening the principle of professional skepticism in auditing practice, and fully implementing international standards can significantly improve the reliability of financial reporting.

The proposed approaches will contribute to enhancing the quality of audit expertise, ensuring transparency of financial information, and creating a more reliable information environment for investors and other stakeholders.

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