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IMPROVING THE SYSTEM OF INTERNAL AUDIT IN BANKS

Oromidinov Muzaffar Pardabayevich*

*Scientific Researcher,
UZBEKISTAN

Email id: moptermiz@bk.ru

ABSTRACT

This article analyzes ways to improve internal audit in banks. The experience of Uzbekistan and international experience in internal audit are considered. The importance of internal audit in banks and the role of the bank in the sustainable operation are also mentioned. The article also examines various international research on internal audit. Based on the research and analysis, scientific conclusions and recommendations have been developed. This division of the banking system primarily determines the goals, objectives and position of the Central Bank and commercial banks. Commercial banks provide services to individuals and legal entities on a commercial basis. Internal audit is part of the ongoing monitoring of the bank's system of internal controls and of its internal capital assessment procedure. Internal audit provides an independent assessment of the adequacy of, and compliance with, the bank's established policies and procedures. It may help an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

KEYWORDS: *Audit, Internal Audit, Banking, Commercial Banks, Central Bank, Audit Functions, Management, Internal Policy, External Audit, Effective Operation.*

INTRODUCTION

It is known that the stability of commercial banks ensures the inviolability of deposits of individuals and legal entities, the continued inflow of additional funds into the national economy, and on this basis, the smooth development of the macroeconomy. By regulating the activities of commercial banks, the central bank ensures a high level of liquidity of the financial and banking system, the solvency of banks, and at the same time protects the customers of banks by creating a continuous payment system. The system of supervision over commercial banks has been formed

and is being improved in Uzbekistan. As a result, in recent years, the capital adequacy of the banking sector of the country is almost three times higher than the international standard set by the Basel Committee on Banking Supervision at 8%.

According to the experience of developed countries, without the effective functioning of the two-tier banking system, which includes a network of issuing banks and commercial banks, the state can not grow and stabilize the economy. At the forefront is the Central Bank, which regulates the country's money supply and the activities of all credit institutions. The second place is occupied by commercial banks and other credit institutions.

This division of the banking system primarily determines the goals, objectives and position of the Central Bank and commercial banks. Commercial banks provide services to individuals and legal entities on a commercial basis. The central bank will work to ensure the country's macroeconomic performance, the stability of the country's financial sector and the stability of the national currency.

In order for the banking system to continue to operate stably, it needs to be monitored. Supervision of commercial banks means the constant supervision of banks to ensure their stability. Banking supervision is divided into two types. The first is internal control, the second is external control. Internal control is carried out by the internal control department of commercial banks and internal control departments of branches. The structure of the internal control system includes the Internal Control Department of the Bank's Head Office, as well as the staff responsible for Internal Control in the bank's branches.

The internal control department of the head office and the internal control staff of the bank's branches organize their activities in close connection with all the structural units and employees of the bank. In developing the programs, the proposals of the head office structures on topical issues are taken into account. The Board ensures the quality and timeliness of the instructions, instructions, orders and directives of the Chairman of the Board of the bank within the tasks and functions assigned to it.

The internal control system cooperates with the Central Bank and the Department on the organization of internal control, prevention and elimination of violations of the legislation and internal regulations by employees.

The system of internal control in banks is called internal audit. According to the Regulation of the Central Bank of the Republic of Uzbekistan "On requirements for internal audit of commercial banks"[1], the following definition of the internal audit system of banks:

internal audit - activities related to the internal control system of the bank, including risk management and the provision of an independent assessment of the quality, consistency and effectiveness of corporate governance systems and processes;

internal audit service - an independent structural unit of the bank, which regularly conducts internal audit;

Internal Auditing Standards - Principles of Internal Auditing in Banks of the Basel Committee on Banking Supervision, International Professional Standards on Internal Audit of the Institute of Internal Auditors, International Standards on Auditing of the International Federation of Accountants.

Internal audit is part of the ongoing monitoring of the bank's system of internal controls and of its internal capital assessment procedure. Internal audit provides an independent assessment of the adequacy of, and compliance with, the bank's established policies and procedures. As such, the internal audit function assists senior management and the board of directors in the efficient and effective discharge of their responsibilities.

From the above it follows that internal audit is very important in the banking system. An effective internal audit is required for the Bank to operate stably, generate revenue and provide timely and quality customer service. Therefore, our research is aimed at improving the internal audit system in banks.

LITERATURE REVIEW

According to international experience, internal audit of banks is described as follows. Internal audit is part of the ongoing monitoring of the bank's system of internal controls and of its internal capital assessment procedure. Internal audit provides an independent assessment of the adequacy of, and compliance with, the bank's established policies and procedures[2].

Internal Audit evaluates the adequacy, effectiveness and efficiency of the systems of control within the bank and the quality of ongoing operations. Audits are financial, compliance, operational and systems oriented. The incumbent reports to the General Auditor in the performance of all assigned duties.

An internal audit helps a company ensure it has the proper controls, governance and risk management processes in place, according to the Institute of Internal Auditors. By nature, it's an independent activity by a person or team that can present objective findings and make recommendations for corrective measures.

Many scientists have conducted research on internal audit of banks. Among them are Saddam A. HAZAEA, Mosab I. TABASH, Saleh F.A. KHATIB, Jinyu ZHU, Ahmed A. AL-KUHALI in their article "The Impact of Internal Audit Quality on Financial Performance of Yemeni Commercial Banks: An Empirical Investigation"[3] on the Financial Performance of Internal Audit Banks effects were analyzed.

Scholars Zaroug Mohamed, Omar Tawfic, Anaam Khamis Bakhit analyzed the role of internal audit in shaping effective corporate governance in their article "The Influence of Internal Auditing on Effective Corporate Governance in the Banking Sector in Oman"[4].

In addition, many other scientists could conduct research in this area such as Mahmoud Al-Akra, Waleed Abdel-Qader, Mamun Billah in their article "Internal auditing in the Middle East and North Africa: A literature review"[5], Sudipto Bhattacharya, Manfred Plank, Günter Strobl and Josef Zechner in their article "Bank capital regulation with random audits"[6], Drew Dahl in his article "Bank audit practices and loan loss provisioning"[7], Dov Eden and Leah Moriah in their article "Impact of Internal Auditing on Branch Bank Performance: A Field Experiment"[8] and Dije Muhammad Suleiman, Kabiru Isa Dandago in their article "The Extent of Internal Audit Functions Outsourcing by Nigerian Deposit Money Banks" conducted a research about internal audit in banking system.

Data and methodology

The article mainly used the method of scientific abstraction. This method focuses on the main points of the data being analyzed and ignores relatively unnecessary data. Methods such as analysis was also used. The scientific conclusions were drawn from the analysis of statistical data. Research work in this area has been studied. International experience in internal audit of banks has been studied from various official sources. Since such research is directly related to the wishes of customers, it is advisable to conduct a survey on the quality of banking services.

Internal auditing is an independent, objective assurance and consulting activity designed to add value to and improve an organization's operations. It may help an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes. Internal auditing might achieve this goal by providing insight and recommendations based on analyses and assessments of data and business processes. With commitment to integrity and accountability, internal auditing provides value to governing bodies and senior management as an objective source of independent advice. Professionals called internal auditors are employed by organizations to perform the internal auditing activity.

An internal audit function provides vital assurance to a bank's board of directors and senior management (and bank supervisors) as to the quality of the bank's internal control system. In doing so, the function helps reduce the risk of loss and reputational damage to the bank[10].

The term audit usually refers to a financial statement audit. A financial audit is an objective examination and evaluation of the financial statements of an organization to make sure that the financial records are a fair and accurate representation of the transactions they claim to represent. The audit can be conducted internally by employees of the organization or externally by an outside Certified Public Accountant (CPA) firm[11].

- There are three main types of audit: external audit, internal audit, and Internal Revenue Service (IRS) audit.
- An external audit is usually performed by certified public accounting companies and the audit report is included in the audit report.
- An unqualified or pure audit opinion means that the auditor has not identified any material misstatements as a result of reviewing the financial statements.
- An external audit may include both the review of the financial statements and the internal control of the company.
- Internal audit serves as a management tool to improve processes and internal control.

Internal auditors work for the company or organization conducting the audit, as a result of which the audit report is submitted directly to management and the board of directors. Consultant auditors, although not internally engaged, use the company standards they are auditing, as opposed to a separate set of standards. These types of auditors are used if the organization does not have internal resources to audit certain parts of its operations.

The results of the internal audit are used to change management and improve internal control. The purpose of an internal audit is to ensure compliance with laws and regulations, to assist in

the proper and timely conduct of financial reporting, and to collect data. It also benefits management by identifying deficiencies in internal control or financial reporting before they are reviewed by external auditors.

Analysis and results

Periodic internal audit is required to monitor the Bank's internal control system and procedures. A good internal audit process helps management perform its duties effectively. This gives them a guarantee of the bank's risks and operational performance. Each bank should conduct an internal audit based on the size and value of its operations to meet its obligations and achieve its objectives.

In general, the internal audit of any bank depends on the following:

- Evaluate the effectiveness of the internal control system and monitor its application;
- Review the appropriateness of risk management procedures and methodologies;
- Checking the effectiveness of regular operations of the bank;
- Evaluate the reliability and accuracy of financial statements and reports;
- Consider the effectiveness of management information systems and electronic banking services;
- Implement policies and procedures and ensure its effectiveness;
- Make sure the processes comply with legal and regulatory requirements;
- Check for fraud if necessary;
- Ensuring adequacy of bank asset protection procedures;
- Monitoring the bank's non-performing assets (NPAs) and alerting management when necessary.

Independent functions of internal audit:

- ✓ The internal audit function of the bank should be independent of other audit activities - simultaneous audit and control
- ✓ The internal audit team should be empowered to perform its duties impartially and be free to report its findings.
- ✓ The head of the internal audit team should have the right to communicate his findings to the board of directors, external auditors, the audit committee, and others.
- ✓ The internal audit function must be impartial, i.e. it must perform its functions without uncertainty and interference.
- ✓ The internal audit compensation scheme should be consistent with the audit objectives and free from conflicts of interest of the bank.

If we analyze the branches of commercial banks, then this figure is higher in Uzbekistan than in the rest of the world (figure 1). In 2016, there were 12.36 bank branches per 100,000 people in the world, but this figure has declined in recent years. In 2017, this figure was 11.89, while the

same figure was the highest in Uzbekistan. For the whole world, this figure was 11.57 in 2018 and 11.51 at the end of the period. That is, this index decreased from 28.12 at the beginning of the period to 11.51 at the end of the period.

Commercial bank branches (per 100,000 adults) [Uzbekistan and World]

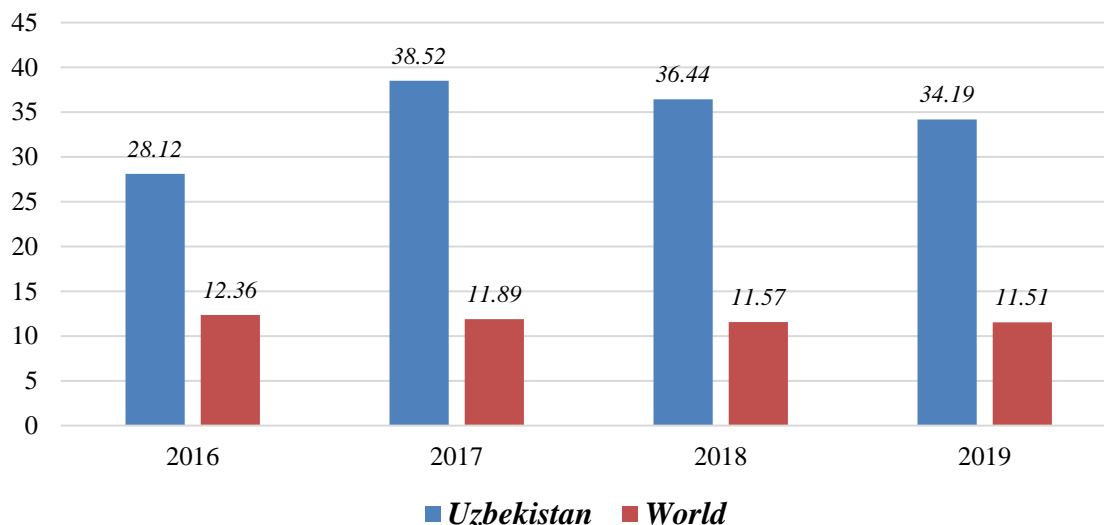


Figure 1. Commercial bank branches (per 100,000 adults)

[Source: Data of official web site of The World Bank <https://data.worldbank.org/indicator/FB.CBK.BRCH.P5?locations=UZ>]

For Uzbekistan, this figure is much higher than the world average. This figure was 28.12 in 2016. In 2017, it reached its peak with 38.52. In recent years, this figure has been declining. In 2018, this figure was 36.44, and in 2019 it was 34.19.

There is a big difference between the results of Uzbekistan and the world in terms of the number of bank branches per 100,000 people. The biggest difference was recorded in 2017. In other periods, if we compare the result of Uzbekistan with the result of the world, the result of Uzbekistan is almost three times higher.

The increase in the number of branches of commercial banks in Uzbekistan requires a strong domestic policy. That is, there is a need to constantly strengthen internal audit. The increase in the number of branches will lead to an increase in the number of customers. This requires strengthening internal controls.

The following table shows the ratio of bank capital to assets (figure 2). This information is provided for Uzbekistan. According to him, this figure has grown steadily. This index recorded 10.68 in 2016. In the following period, it was 12.4 in 2017 and 12.44 in 2018. This figure increased from its initial 10.68 in 2016 to 18.71 in 2019.

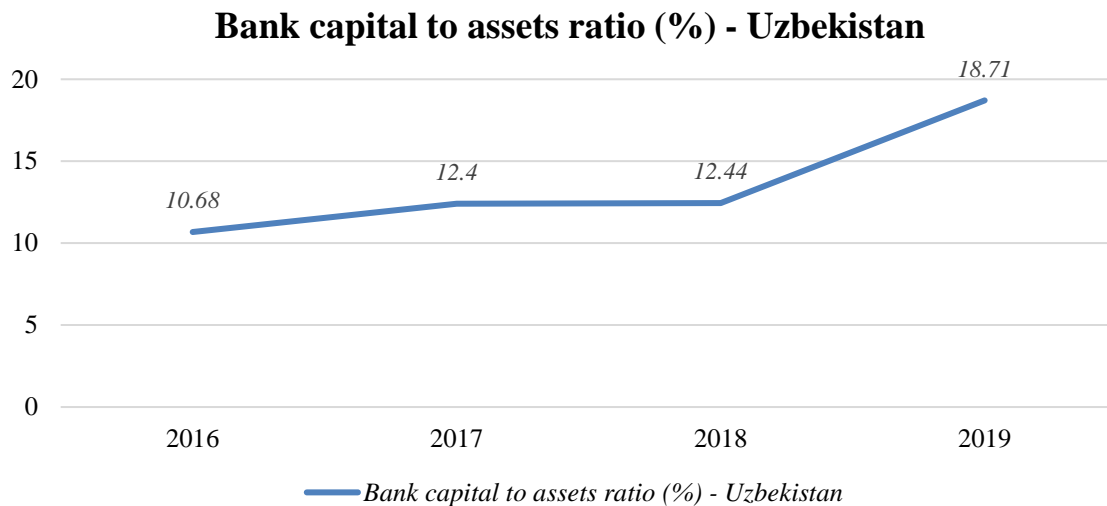


Figure 2. Bank capital to assets ratio (%) - Uzbekistan

[Source: Data of official web site of The World Bank
<https://data.worldbank.org/indicator/FB.BNK.CAPA.ZS?locations=UZ>]

From the table above, it can be seen that positive changes are being recorded. In this context, it is necessary to improve the internal audit of banks. Improving internal audit can create more opportunities for employees, improve the quality of customer service and, most importantly, increase the bank's revenue. Various emergencies that may occur on the basis of a strong internal audit will be prevented and the bank will be able to develop in the future. Therefore, it is expedient to form an internal audit of banks and adapt it to modern requirements.

CONCLUSION AND RECOMMENDATIONS

Based on the above analysis, the importance of internal audit of banks was considered. According to him, the effective functioning of the bank requires active internal audit and its constant improvement. The main purpose of this study is also to improve internal audit in banks. Accordingly and on the basis of the above analysis, several proposals have been developed.

The advantages of a good internal audit system in banks are listed below:

- ✓ The overall operating and control environment of the bank has improved
- ✓ A continuous internal audit system increases the responsibility of employees
- ✓ A strong internal audit process allows for early detection of fraud or potential fraud
- ✓ Identifies redundant procedures and recommends improvements that increase operational efficiency
- ✓ Ongoing monitoring of policies and procedures can help reduce financial risks
- ✓ Unexpected checks of cash by internal auditors ensure that all cash transactions are properly accounted for
- ✓ Ensures compliance with the requirements of legislation and regulations

- ✓ Systematic internal audit assures the head office that all banking procedures and rules are followed
- ✓ Good control over the bank's non-performing assets
- ✓ Regular internal audits of banks also provide convenience and confidence to legal auditors.

A seamless and efficient structure provides any department with the level of communication and transparency it needs. First and foremost, who your CAE (General Audit Director) reports to can play an important role in a department's high efficiency. To avoid objectivity or conflicts of interest, it is best that the CAE does not report directly to your CFO. Alternatively, the CAE must report to the Audit Committee.

Despite the phobias that revolve around the word "A," the IA department doesn't want to be a crazy uncle sitting at a corporate dinner table. IA department members need to connect with key employees of the organization to gain their trust, rather than just being a bad person who speaks up when they point out mistakes.

Indeed, when such relationships are developed and maintained, these employees may seek help from IA department members, express concerns about the design or implementation of the control, or even suspect fraud.

An open and communicative relationship with other employees makes it easier to trust you without fear of reprimand. You all play on the same team and share the overall goals and objectives of the organization.

In the IA world, the concept of less is often forgotten when audit plans are made for a fiscal year. To do this, instead of conducting multiple audits, take a strategic approach and create plans that have the greatest impact on the organization, both operational and functional, especially in any high-risk areas.

In addition, IA executives need to strike a balance between specific issues and details and the big picture. Audits should also be non-objective and not overly objective. As with any project within the organization, the audit efforts should have clearly defined parameters and deadlines so that they are not undermined and the results are not blurred from a clear scale.

Working with external auditors encourages joint efforts, while reducing the risk of inconsistencies or gaps in the scope of work performed by both parties. Establishing and maintaining healthy and communicative relationships with external auditors increases their confidence in the work that the IA function performs and ultimately eliminates the costs associated with external auditors performing the work. By agreeing with external auditors and understanding their approach, you allow yourself to gain the trust of the Audit Committee, as they often value the opinion of external auditors. Providing a united front with external auditors at an audit committee meeting will ensure that your internal audit is up-to-date, informed, and avoids missed issues.

Help the management organization achieve its goals and focus on missed or overlooked opportunities - never forget one of IA's main goals. The IA department is constantly pointing fingers and unable to identify what may be wrong. The main task of the IA department should be to add real value to the company and not primarily to identify non-significant errors.

Risk assessment can ensure that the audit activity is appropriate and minimizes the risk of not adding value to each case. As an example, Embark recently helped the company recycle its invoices rather than retain a myopic, auditory perspective. In turn, we were able to help management make invoice processing 50% more efficient and thus make their lives much easier.

Internal auditors cannot be considered one of the Four Riders who decided to dream sleepless nights, palm sweats, and fever. In other words, when going IA in the hallway, there is no reason to hide under old sawdust beds.

In order to develop healthy relationships in the organization, and the IA department, they must do their best not to give in to the vague and fanciful notion that their sole purpose is to identify any mistakes that may be wrong. Instead, the IA department should be praised when everything is going well and be a constant champion for the organization and the team.

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