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CURRENT STATE OF INTERNAL AUDIT ORGANIZATION IN COMMERCIAL BANKS AND THE KEY CHALLENGES AFFECTING ITS EFFECTIVENESS

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Abstract
This thesis analyzes the current state of the organization and implementation of internal audit processes in commercial banks of Uzbekistan. Six major groups of factors reducing the effectiveness of internal audit activities are systematized, and their cause-and-effect relationships are identified and explained.

Keywords: internal audit service, audit plan, human resource capacity, recommendation monitoring, audit effectiveness, digitalization, independence.

Introduction

The regulatory requirements governing internal audit in Uzbekistan were substantially updated in 2021. The Regulation "On the Requirements for Internal Audit in Commercial Banks" was approved by Resolution No. 3/2 of the Board of the Central Bank of the Republic of Uzbekistan dated 16 April 2021 and entered into force on 8 August 2021 [1]. The Regulation establishes requirements regarding the independence and objectivity of internal audit, governance of the internal audit function, audit procedures, and interaction with the Central Bank. Nevertheless, the existence of a comprehensive legal framework does not necessarily guarantee the effective functioning of the internal audit function in practice.

General Overview of the Current Situation

The level of development of internal audit functions varies considerably across commercial banks. Broadly, banks can be classified into three groups:

Group 1 – foreign-owned banks and large banks undergoing transformation: these institutions generally employ risk assessment matrices, internal audit methodology manuals, certified internal auditors, and automated systems for monitoring audit recommendations.

Group 2 – large banks with significant state ownership: these banks possess formal internal audit structures and annual audit plans; however, their methodologies remain largely based on traditional compliance-oriented inspection approaches.

Group 3 – small and regional banks: internal audit units are relatively small, staff competencies are limited, and audit activities primarily focus on verifying compliance with regulatory requirements.

Systematic Analysis of Existing Challenges

Although internal audit departments formally report to the Supervisory Board, they frequently remain dependent on executive management with respect to budget allocation, staffing decisions, and employee incentives. The Basel Committee on Banking Supervision emphasizes that internal audit functions must possess adequate authority, organizational status, independence, and resources [2]. In practice, however, economic dependence often undermines organizational independence.

The number of internal auditors is often disproportionate to the size of banks' assets and branch networks. Furthermore, the proportion of specialists holding internationally recognized certifications such as CIA, CISA, CRMA, and ACCA remains relatively low. Significant competency gaps are particularly evident in the following areas:

Information technology and cybersecurity auditing;

Model validation and auditing (including IFRS 9 Expected Credit Loss models);

Treasury and derivative operations;

Data analytics and digital auditing techniques.

Annual audit plans are frequently developed according to a cyclical coverage approach, whereby each organizational unit is audited at predetermined intervals regardless of its risk profile. Consequently, risk assessment often becomes a secondary criterion, leading to the inefficient allocation of audit resources toward low-risk areas.

Common deficiencies observed in practice include:

- repeated extensions of implementation deadlines;
- recommendations reported as "implemented" while underlying root causes remain unresolved;
- a high recurrence rate of previously identified deficiencies.

Considering that the implementation of audit recommendations represents one of the primary indicators of internal audit effectiveness, these shortcomings have significant systemic implications.

Internal audit activities continue to rely predominantly on manually performed sample-based testing. In many banks, internal auditors either lack direct read-only access to Automated Banking System (ABS) databases or have only limited access. This issue is primarily organizational rather than technological in nature.

Many commercial banks have not fully developed essential methodological documents, including internal audit manuals, standardized working paper templates, and Quality Assurance and Improvement Programs (QAIP). The Global Internal Audit Standards issued by the Institute of Internal Auditors require both an effective QAIP and periodic independent external quality assessments [3].

Cause-and-Effect Relationships Among the Challenges

The above-mentioned problems should not be viewed as isolated issues. Rather, they originate from a common underlying perception that internal audit is merely a mandatory regulatory requirement rather than a strategic management function. This perception generates the following chain of negative consequences:

Low strategic importance of the internal audit function → Limited budget and staffing → Weak human resource capacity → Superficial audit procedures → Low-value audit findings → Reduced management confidence in internal audit → Further decline in the strategic importance of the internal audit function.

Breaking this negative self-reinforcing cycle requires intervention at its root. Strengthening the organizational and financial independence of the internal audit function is likely to be the most effective solution because it directly addresses the initial link in the chain.

Conclusions and Recommendations

1. The budget of the internal audit department should be approved by the Supervisory Board as a separate budget item and should not be subject to unilateral reductions by executive management.

2. A comprehensive competency framework together with a mandatory professional certification roadmap (covering a period of 3–5 years) should be introduced for internal auditors.
3. Audit recommendations should be monitored through an automated issue-tracking system, with automatic escalation mechanisms established for critical recommendations.
4. Internal audit departments should be granted regulatory guaranteed read-only access to Automated Banking System (ABS) databases to improve audit efficiency and evidence collection.

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