

IMPROVING THE METHODOLOGY FOR DETECTING AND ASSESSING FINANCIAL ERRORS AND IRREGULARITIES IN BUDGET ORGANIZATIONS THROUGH INTERNAL AUDIT

Mulayev Farkhod Alisherovich

Independent Researcher,

Tashkent State University of Economics

E-mail: farhodmulaev@gmail.com

ORCID: 0009-0002-9268-6603

Abstract

The thesis addresses the improvement of the methodology for detecting and assessing financial errors and irregularities in budget organizations through internal audit. The stages of the detection process are examined, the weaknesses of current practice are identified at each stage, and a structured multi-dimensional assessment procedure linking severity, recurrence and consequence to a predetermined audit response is proposed and presented in tabular form.

Keywords: Internal audit, detection methodology, assessment, materiality, audit sampling, audit evidence, prioritisation, budget organization, control weakness, public financial management.

The detection of financial errors and irregularities is the operational core of internal audit in budget organizations. Everything that precedes it — planning, risk assessment, programme design — exists to make detection possible, and everything that follows it — reporting, recommendations, follow-up — depends on how reliably it has been performed. Yet detection is the stage least covered by formal methodology in current practice, and it is frequently treated as a matter of professional experience rather than of documented procedure.

The detection process can be decomposed into four stages. The first is the definition of criteria: the auditor must establish, before examining any transaction, what the transaction ought to look like. In budget organizations these criteria are drawn from legislation, the budget estimate, the staffing schedule, procurement rules and contractual terms. The second stage is the

selection of items for examination. The third is the application of audit procedures. The fourth is the evaluation of the deviations identified.

Current practice exhibits characteristic weaknesses at each stage. Criteria are frequently left implicit, which makes the resulting finding difficult to defend when challenged by the auditee. Selection is described in working papers by the phrase that the population was examined on a sample basis, without any statement of the sample size or the basis of its determination, contrary to the requirements of ISA 530. Procedures are applied uniformly regardless of the nature of the process being examined. Evaluation is limited to recording the monetary amount of the deviation, so that findings of very different gravity appear in the report with equal weight.

The improvement of the methodology therefore begins with the explicit documentation of criteria. Each engagement programme should state, for every process examined, the specific normative provision against which conformity will be assessed, together with the version of that provision in force during the period under audit. This requirement follows directly from the compliance auditing standards of the ISSAI 4000 series, which define non-compliance as a deviation from identified criteria and consequently make the identification of criteria a precondition of any conclusion.

The second element concerns sampling. The sample size should be derived from the assessed risk of the process rather than from convenience. For processes assessed as high risk, extended or full examination is appropriate; for moderate risk, a statistical sample with a documented confidence level; for low risk, analytical procedures on aggregate data. The basis of selection — the population, the sampling unit, the method and the treatment of items examined in full — must be recorded so that an independent reviewer can reconstruct it, in accordance with the documentation requirement of ISSAI 100.

The third element concerns the matching of procedures to the type of deviation sought. Errors of classification are efficiently detected by analytical review of account movements; irregularities in procurement require the direct examination of contract files and comparison of contract values against thresholds; payroll irregularities are detected by reconciling payments against the staffing schedule and attendance records; asset irregularities require physical observation and reconciliation with the

register. A uniform programme applied to all processes systematically fails to detect several of these categories, and the failure is invisible in the working papers because no procedure was designed to find them.

The availability of transaction-level data in electronic form makes it possible to extend this element further. Analytical routines applied to the full population — identification of duplicate payments, of transactions recorded outside working hours, of contract values placed immediately below a procurement threshold, of round-sum entries — can be run before sampling and used to direct the manual examination. This does not replace sampling, but it changes its function: the sample is drawn to estimate the frequency of deviations in the remainder of the population rather than to search for deviations blindly.

The fourth and most substantial element concerns assessment. It is proposed that every deviation identified be assessed against four dimensions: quantitative severity, measured against the established materiality threshold; qualitative severity, measured by the legal force of the provision breached; probability of recurrence, established by comparison with the results of previous audit cycles; and consequence, covering the effect on the organization's activity, on disciplinary or legal exposure and on public confidence. The composition of the assessment is set out in Table 1.

Table 1. Structure of the multi-dimensional assessment of an identified deviation

Assessment dimension	Basis of measurement	Scale	Indicative weight
Quantitative severity	Amount of the deviation in relation to the established materiality threshold for the process	1 to 5	0.30
Qualitative severity	Legal force of the provision breached: internal rule, by-law, law or code	1 to 5	0.30
Probability of recurrence	Frequency of the same deviation in previous audit cycles and in comparable units	1 to 5	0.20
Consequence	Effect on the activity of the organization, disciplinary or legal exposure, public confidence	1 to 5	0.20

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The weighted score determines the priority of the finding: 4.0 and above — critical, 3.0 to 3.9 — high, 2.0 to 2.9 — moderate, below 2.0 — low.

Each priority level is linked in advance to a remediation deadline and a level of management responsibility, so that the classification of a finding automatically determines the response it requires. The practical significance of this arrangement is that the audit report ceases to be an undifferentiated list of observations and becomes an ordered agenda for management action. It also removes the discretion that currently allows findings of equivalent gravity to be treated differently in different organizations, or in the same organization in different periods.

A further consequence of structured assessment is that it makes the results of internal audit aggregable. When findings are recorded with a consistent set of attributes — process, criterion breached, category, score, cause, responsible unit — they can be analysed across periods and across entities, revealing which types of deviation recur most frequently and which control weaknesses generate them. This transforms internal audit records from an archive into an analytical resource for the planning of subsequent audit cycles and for the risk assessment that precedes them.

Two limitations of the proposed approach should be acknowledged. First, the scoring of the qualitative dimensions retains an element of judgement; this is mitigated, but not eliminated, by anchoring each point of the scale to a described situation and by requiring the score to be supported by evidence in the working paper. Second, in small budget organizations with a very limited number of findings, the analytical value of aggregation is realised only at sectoral level, which presupposes a common recording format across entities.

In conclusion, improving the methodology for detecting and assessing financial errors and irregularities requires the explicit documentation of criteria, the derivation of sample size from assessed risk, the matching of procedures to the category of deviation sought, the use of full-population analytical routines to direct manual work, and the structured multi-dimensional assessment of every finding. Taken together, these measures increase both the reliability of detection and the usability of its results in management decision-making.

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