

**Czech University of Life Sciences Prague**

**Faculty of Economics and Management**

**Department of Economics**



**Bachelor Thesis**

**Improving the Internal Audit of a Microfinance Company**

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# **BACHELOR THESIS ASSIGNMENT**

**NURALY ASANOV, BA**

Business Administration

Thesis title

**Improving the Internal Audit of a Microfinance Company**

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## **Objectives of thesis**

The main objectives of this thesis is to analyze the internal audit of microfinance companies in Kyrgyzstan.

## **Methodology**

In the practical part the existing legal and regulatory framework of the Kyrgyz Republic and research of scientists on internal audit will be studied. And also there will be an assessment of the existing system of internal audit and development of measures to improve the internal audit system. I will use descriptive and comparative methods to reach my aims.

**The proposed extent of the thesis**

30-40 pages

**Keywords**

Internal audit, microfinance company, credit operations

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**Recommended information sources**

Bulyga R.P. (2017): Audit of Business. ISBN 978-5-238-02932- 0

Galkina E.V. (2018) :Accounting and auditing. ISBN: 978-5-390-00034-2

Koroleva G. A & Novikova T. Y. (2015) Audit. ISBN 978-5-8397-1025-2

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**Expected date of thesis defence**

2022/23 WS – FEM

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## **Declaration**

I declare that I have worked on my bachelor thesis titled "**Improving the Internal Audit of a Microfinance Company**" by myself and I have used only the sources mentioned at the end of the thesis. As the author of the bachelor thesis, I declare that the thesis does not break copyrights of any their person.

In Prague on November 30,2022

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Asanov Nuraly

### **Acknowledgment**

I would like to thank prof. Ing. Mansoor Maitah, Ph.D.et Ph.D., for guidance, advices, and support during the work on my thesis.

# **Improving the Internal Audit of a Microfinance Company**

## **Abstract**

As the economy developed, there was a division of functions between owners of microfinance companies, their managers and lenders. The role of shareholders increased sharply, who needed a guarantee not only of capital preservation but also of dividends. A prerequisite for this was the proper accounting and efficient operation of the company. One of the key elements for achieving this goal is the internal audit of the company, which is conducted by the internal audit service. It makes an independent expert assessment of the internal control system, the competence of company employees, and information security.

Internal audit in Kyrgyzstan is still a new concept, abroad it has been actively used since the late 19th century. The fact that at the moment domestic companies need to improve the methodology of internal audit makes this thesis relevant

This paper consists of two parts theoretical and practical.

The theoretical part presents the history of the development of audit, the classification of audit, the analysis of the existing regulatory framework for audit. And in the practical part ,the process of internal audit in the existing microfinance companies of the Kyrgyz Republic is considered, the existing problems are identified, and the methodology for assessing the effectiveness of internal audit services is developed.

**Keywords:** Internal Audit, Microfinance Company, Internal Audit Service

# Zlepšení interního auditu mikrofinanční společnosti

## Abstrakt

S rozvojem ekonomiky došlo k rozdělení funkcí mezi vlastníky mikrofinančních společností, jejich manažery a věřiteli. Prudce vzrostla úloha akcionářů, kteří potřebovali záruku nejen zachování kapitálu, ale i dividend. Předpokladem pro to bylo řádné vedení účetnictví a efektivní fungování společnosti. Jedním z klíčových prvků pro dosažení tohoto cíle je interní audit společnosti, který provádí útvar interního auditu. Ten provádí nezávislé odborné posouzení vnitřního kontrolního systému, odbornosti zaměstnanců společnosti a bezpečnosti informací.

Interní audit je v Kyrgyzstánu stále novým pojmem, v zahraničí se aktivně používá již od konce 19. století. Skutečnost, že v současné době tuzemské podniky potřebují zdokonalit metodiku interního auditu, činí tuto práci aktuální.

Tato práce se skládá ze dvou částí teoretické a praktické.

V teoretické části je uvedena historie vývoje auditu, klasifikace auditu, analýza stávajícího právního rámce pro audit. A v praktické části je posuzován proces interního auditu v existujících mikrofinančních společnostech Kyrgyzské republiky, jsou identifikovány existující problémy a je vypracována metodika hodnocení účinnosti služeb interního auditu.

**Klíčová slova:** Interní audit, mikrofinanční společnost, služba interního auditu

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## 1. Introduction

As the economy developed, there was a division of functions between owners of microfinance companies, their managers and lenders. The role of shareholders increased sharply, who needed a guarantee not only of capital preservation, but also of dividends. A prerequisite for this was the proper accounting and efficient operation of the company. One of the key elements for achieving this goal is the internal audit of the company, which is conducted by the internal audit service. It performs an independent expert assessment of the internal control system, the competence of company employees, and information security.

Internal audit in Kyrgyzstan is still a new concept, abroad it is actively used since the end of the XIX century. It is the fact that at the moment domestic companies need to improve the methodology of internal audit, which makes this thesis *relevant*.

Internal audit today is an activity to provide independent and objective assurance and consulting to improve the company's operations. Internal auditing helps the company achieve its objectives by using a systematic and consistent approach to evaluate and improve the effectiveness of risk management, control, and governance processes. The results of internal audit allow the management of the company to become familiar with the revealed irregularities in the activities of entire departments and specific employees; to develop and adopt a timely, effective and efficient plan of action to eliminate deficiencies and irregularities in the activities of the company revealed by internal audit, which is an undeniable proof of the relevance of internal auditing of microfinance companies.

Today, internal audit services have a great opportunity to prove their usefulness to both the Board of Directors and senior executives by becoming a key link in the corporate governance system.

## **2. Objectives and methodology of internal audit**

### **2.1 Objectives**

**The purpose of** this thesis is to improve the methodology of internal audit of microfinance companies in Kyrgyzstan.

In order to achieve this goal, the following **tasks** are addressed in the work:

1. Study of theoretical aspects of internal audit;
2. Review of the regulatory framework for internal audit;
3. Carrying out internal audit of credit operations and cash desk audit. Issuing recommendations based on the audits conducted;
4. Development of a methodology for assessing the effectiveness of internal audit services of microfinance companies, based on criteria, each of which is evaluated using a point system;
5. Practical application of the developed methodology at a Kyrgyz company.

### **2.2 Methodology**

In the practical part, the following research methods were used: the method of system and comparative analysis, questioning and surveying. The conclusion summarized the results of the study and made final conclusions on the topic, recommendations for improving internal audit in the KR were presented.

### **3. Literature review**

#### **3.1 The content of internal audit in microfinance company: history appearance and its essence.**

At present, a large number of financial and credit institutions have passed a long and difficult way in their formation. More than twenty years of development of the national financial and credit system in our country make us think about at least two questions: whether the financial and credit system is reliable enough and whether it contributes sufficiently to the development of the national economy? No, and here we can conclude that one of the main reasons for the unstable state of affairs in the financial and credit sphere is the low level of corporate governance in most of them.

Internal audit is one of the tools of management of the organization. Therefore, to properly understand its essence, tasks, mechanism of organization, it is possible only if to consider internal audit in the management system, in its action and interaction with other management institutions.

At the same time, however, in the issues of improving the management of financial-credit institutions not so little has been done, namely, at a sufficiently high level the issues of formation, organizational structure of management in financial-credit institutions, staff recruitment, setting up management accounting and financial analysis, information support and much more are solved. The same cannot be said, however, about the use of internal audit in financial and credit institutions. Without a well-organized internal audit, there can be no effective system of corporate governance in a financial-credit institution, and without a well-organized system of corporate governance, there is no place for internal audit in it. That is, both the internal audit and the system of corporate governance" are two interrelated elements, without one there can be no other.

The Kyrgyz legislation pays much attention to creating the necessary legal and economic environment for the development and establishment of corporate governance. Various normative documents have been adopted in different years, such as: Law "On Joint Stock Companies", Law "On Securities Market", Law "On Deposit Insurance" and a number of other legislative acts.

The Basel Committee on Banking Supervision in recent years, addressing organizational and methodological issues of improving corporate governance; has prepared and published a number of recommendations relating to the improvement of corporate governance in credit institutions.

Thus, in August 2001 a special document "Internal Audit at Financial and Credit Institutions and Relationships between Supervisors and Auditors" was adopted, which for the first time in the world practice outlined a holistic view on the issues of internal audit organization, as well as defined approaches to defining the place and role of internal audit in the corporate governance system.

Every financial and credit institution, as noted in this document, should have a permanent internal audit function. The internal audit function should be independent of the activities being

audited and of the daily internal control procedure. This, in turn, means that internal audit is given a special status within the company and has its own purpose. The main scope of the internal audit shall be the inspection and assessment of the adequacy and effectiveness of the internal control system and the way it performs its functions, as well as the risk analysis.

If we consider the system of used forms of control over the activities of financial-credit institutions, we can distinguish the following forms: external audit, internal control system (which includes internal audit) and supervision by the relevant state authorities. In the domestic literature, however, it is possible to meet a different classification, namely, when internal audit is separated from the system of internal control (Kamysovskaya, S.V., 2019). In our opinion, this approach is not correct.

As we see it, the generic concept of both internal control and internal audit is control as one of the main functions of management or a type of management activity.

What is the difference between internal control and control in general. First of all, internal control is a control exercised at the expense of internal resources of a financial-credit institution. In contrast to external types of control, such as legislative regulation, control by external controlling and auditing bodies, internal control is carried out on the initiative of owners, by internal staff and is aimed at ensuring the smooth operation of all processes and, on a global scale, to achieve the goals of the FCU. In the scientific literature one can find references to economic, administrative, technical and financial control (Suglobov A.E., 2020).

I would like to note that the system of internal control, no matter how well it is planned and reliably functions, reduces the probability of occurrence, but cannot completely prevent events that negatively affect the achievement of set goals and lead to losses. Internal control should economically justify its existence within the company, i.e. benefits from its functioning should exceed the costs of building and maintaining this control system.

At present in Kyrgyzstan there is a transition from total control to risk-oriented control. The starting point for organizing risk-oriented controls is the analysis of risks, both internal and external, that may affect the achievement of the goals of the credit institution and the incorporation of control procedures into operational activities to mitigate or eliminate the effects of risks.

For internal control to become a truly permanent and effective management tool, it must be integrated into the corporate governance system.

That is why the issue of creation and effective functioning of internal audit as the most important element of corporate governance in financial and credit institution is especially important here. Further research involves consideration of the content of internal audit in financial-credit institution, revealing its essence.

Initially, the audit was an activity of independent specialists (auditors) to verify the financial statements of organizations, i.e., it was only external. The division of auditing in the world practice of auditing activities into external and internal refers to the late 40's - early 50's of the XX century. Before that time the audit consisted in the study of documentation, accounting records, their reflection in the statements of the enterprise. Later the audit became system-oriented, i.e. associated with the examination of the objects of verification, taking into account the assessment of the state and effectiveness of internal audit or control. Subsequently, there was a strong tendency to form in their own companies appropriate services that are constantly engaged in the problems of control. These services were called internal audit services (Vardanyan S.A. 2019).

The concept of internal audit in the world theory and practice has evolved over time. We can distinguish three stages in the development of the world internal audit in the XX - early XXI centuries, determined by the role and tasks of internal audit in each of them: initial, transitional, modern (Vardanyan S.A. 2019).

At the initial stage - from the end of the 40s of the XX century, the tasks of internal audit consisted in the inspection of accounting and financial reporting, as well as in the implementation of the audit function - to check the safety of inventories and the implementation of the orders of the management of the organization. In this case, the main consumer of the results of internal audit at this stage is the management of functional departments, usually the financial director or manager of the company; in some cases, internal audit functions within the accounting service with subordination to the chief accountant or the financial controller of the company (Vardanyan S.A., 2019).

At the transitional stage - after the 50s of the XX century, internal audit, along with financial audits focusing on the accounting and financial control system, carries out audits of the internal control system throughout the organization. The main consumers are senior management and heads of functional and industry divisions, usually in the person of the CEO or CFO of the company, deputy directors in various areas (Vardanyan S.A., 2019).

At the present stage, internal audit is involved in improving risk management, control and corporate governance processes. The main consumers are the board of directors (the audit committee of the board of directors) and the top executive management of the company, who determine the direction and tasks of internal audit. This stage is characterized by full independence of internal audit from lower management level. It should be noted that since boards and senior management often have a different understanding of the role and objectives of internal audit, it is critical for internal auditors to be able to effectively communicate with all customers.

In the Kyrgyz economy, the functioning of internal audit corresponds to the second and third stages, depending on the scale of the organization in which it operates. In the context of holdings,

especially if their owners are foreign persons, the activity of internal audit refers to the third stage of the above periodization.

Since the concept of "internal audit" appeared not so long ago in the Kyrgyz practice, and came from abroad, at present there are some contradictions in understanding the goals, objectives, regulations of creation, accountability and subordination of this unit in the organizations. To eliminate these contradictions and bring these issues to a single logic, let us further consider the existing views on internal audit in Russian and foreign sources.

According to well-known American scientists Ahrens E.A., Lobbeck J.K., internal audit is an internal audit that provides the administration with "valuable information for making decisions regarding the effective functioning of their business" (Ahrens E.A., 2001)

English scientist Roy Dodge believes that "internal audit is an integral part of internal control, carried out by decision of the management bodies of the firm for the purposes of control and analysis of economic activity" (Roy Dodge, 2002).

Another English scholar R. Adams defines internal audit "as an element of internal control established by the administration to review, evaluate and report on the accounting and other components of business control" (R. Adams, 1995).

Thus, according to foreign authors, internal audit is an integral part of internal control.

In the domestic literature consider internal audit from a slightly different point of view.

Thus, according to such authors as Rogulenko T. M., Ponomareva S. V., Bodiako A. , internal audit is an independent activity in an organization to verify and evaluate its work in its interests (Rogulenko T.M., 2020).

According to the definition proposed by G.A. Koroleva. "Internal audit is a method of independent assessment of the effectiveness of the organization and its management bodies" (Koroleva G.A., 2015).

The ISA "Internal Audit Review" provides the following definition: "Internal audit is a control activity carried out within an audited entity by its subdivision - the internal audit service.

Suglobov A.E., Zharylgasova B.T., Savin V. consider internal audit as a management function, which covers accounting, financial analysis and control, comparison and evaluation of actually achieved results with the goals and objectives of the enterprise (Suglobov A.E., 2020).

General characteristics highlighted by experts allow to state that the internal audit has the following features: the independence of the activity, which is conducted within the organization and is aimed at assessing the effectiveness of work.

Currently, the most common view is that the purpose of internal auditing is to help employees perform their functions effectively. Without specifying which group of employees is being referred to and what specific functions they perform.

In principle, this approach to the definition of internal audit is also characteristic for the materials of the International Institute of Internal Auditors, according to which internal audit is characterized as "activities to provide independent and objective guarantees and advice aimed at improving the performance of the organization. Internal audit helps a company achieve its goals using a systematic and consistent approach to assessing and improving the effectiveness of risk management, internal control and corporate governance processes" (Suglov A.E., 2020).

The same definition of "internal audit" is followed by a number of modern authors (Sigidov Y.I., 2016). These definitions focus on a new concept of internal audit development - the use of internal audit in risk management. However, again, the content, purpose and objectives of internal audit are not specified.

Thus, in the scientific community there is no unified approach to understanding the essence of internal audit. A number of authors are of the opinion that internal audit is an internal control of the organization in the interests of its management, others consider internal audit as an element of management control, the main purpose of which is to help employees in the effective performance of their duties.

To clarify the understanding of the essence of internal audit, it is necessary to define the objectives, as well as what functions should be performed by internal audit.

According to a number of experts, the objectives of internal audit are considered as the effectiveness of all levels of enterprise management, and help employees in carrying out their functions, and providing information to the owners within a particular organization and an independent and objective assessment of the risk management, control and corporate governance processes.

Consequently, the target focus of the internal audit proposed by the authors is the effectiveness of management of the organization, the protection of legitimate interests and the identification of current problems.

Meanwhile, depending on the size and structure of the credit institution and the requirements of management, the internal audit has a number of objectives:

- *Monitoring the system of internal controls.* Consideration of controls, their operational effectiveness and development of recommendations for their improvement.
- *Examination of financial and operational information.* Review of financial and operational information, analysis of individual items, including detailed testing of transactions, balances, and procedures.
- *Review of operational actions.* A review of the economy, efficiency, and effectiveness of operational actions, including noncommercial actions of a legal entity.
- *Control over compliance with the law.*

- *Risk management.* Internal audit can help the organization by identifying and assessing significant risks, improving risk management. In the process of its activity banks face with a set of different types of risks, differing among themselves by place and time of occurrence, external and internal factors affecting their level, and, consequently, on ways of their analysis and methods of their description. All types of risks are interrelated and have an impact on the company's activities. In the financial and credit institution, internal audit, in our opinion, is aimed at minimizing financial and credit risks to an acceptable level, including measures to maintain the image.

- *Corporate Governance.* Internal audit can assess the corporate governance process regarding internal ethics and values, the communication of risk and control information to the appropriate levels of the organization and the effectiveness of communication between the Board of Directors, external and internal auditors and management.

The objectives that stand before the internal audit in the financial-credit institution cause the necessity to apply a number of methods and procedures of control providing protection of assets and liabilities, minimization of financial-credit risks and maximization of profit. As a consequence, there is a variety of tasks facing the internal audit in the financial-credit institution.

The ISA Review of Internal Audit also defines the functional focus of internal audit, noting that the objects of internal audit vary depending on the characteristics of the economic entity and the requirements of its, management or owners.

Internal audit functions in a financial and credit institution should include:

- Control and evaluation of business processes and operations-legal and economic focus (operational audit);
- Control and evaluation of the setting up and maintenance of accounting and reporting (internal audit of financial statements);
- Advising in solving complex issues of law use (legal internal audit);
- Analysis and evaluation of the internal control system (oversight function of the audit);
- Interaction with external audit.

Thus, the main objects of attention of the internal audit are the elements of the management system for the functional areas of the company.

A number of authors consider five elements as the main elements of the modern system of internal audit: Internal audit of financial statements, operational internal audit, legal internal audit, internal audit of corporate governance, strategic internal audit (Suglobov A.E. , 2020). Each of the elements covers its areas of activity. However, the internal audit of corporate governance and strategic internal audit, in our opinion, can be attributed to the competence of the operational internal audit.



Operational audit - concerns the current activities of the organization: inspection of the functioning of the organization in order to assess the productivity and efficiency of operations, etc.

Legal internal audit - verification of compliance in the organization of existing internal rules and procedures, budget, as well as laws and regulations.

Internal audit of financial statements - audit of the organization for its reliability, compliance with accounting policies, generally accepted accounting principles, the tax code.

The requirements of modern realities imply the search for new approaches to the organization of internal audit. And if earlier the internal audit was characterized by a stating character, aimed at checking the reliability of the reflection in the accounting of financial and business transactions in accordance with regulations, it is no longer enough. The owners and users of information expect to obtain from the internal auditors recommendations for making economic decisions, business expertise, competent consulting on various issues, and exhaustive information about the real viability of the company. Therefore, the concept of internal audit development should be linked to the prospects of business development. Internal audit should have a preventive, predictive character, aimed at revealing of possible risk.

The new concept of internal audit development is the use of the risk management concept and the internal audit methodology built on its basis. This means that the internal auditor, when planning his activities, first of all takes into account those areas of activity where, in his opinion, the risk of errors and fraud is high. Detailed, continuous audits are carried out only when such fraud and abuse are detected.

The main criterion of internal audit efficiency is not the number of irregularities detected in financial accounting, but the usefulness of internal audit for a microfinance company and the preventive nature of its work. To this end, internal audit should cover all major functional areas of the company, using a risk-oriented approach to the organization of its work.

Thus, at the present stage of development, internal audit should be aimed at the entire management system of the financial and credit institution, while acting as a controlling element of the management system. All this allows us to give our own definition of internal audit:

***Internal audit is one of the functions of the organization management, carried out by professionals in accordance with the internal regulations to solve the following tasks: control and evaluation of operating activities, control and evaluation of accounting and reporting and control and evaluation of internal control system of the organization.***

Internal audit is facing complex tasks, resulting in an increased burden on internal auditors and higher requirements for internal audit itself. Kyrgyzstan's accession to the Eurasian Economic Union (EAEU) will lead to the availability of the financial services market to foreign capital, and the lifting of certain prohibitions. This will immediately lead to the need to improve the competitiveness of

financial and credit institutions in our country, and there is no doubt that the role of internal audit will constantly increase, which will require a clearly structured regulatory framework of internal audit regulation.

### **3.2 Planning the Approving Internal Audit using risk-based approach**

Internal auditing is necessary to detect and resolve emerging problems before they become too obvious. Moreover, it can and should be used to drive the success of the organization. Since building and maintaining internal audit requires effort, and therefore cost, internal audit must justify its existence economically within the organization. The benefit to the company from the internal audit function should exceed the cost of establishing and maintaining it. Meanwhile, with regard to internal audit, the principle of economic efficiency in domestic companies is not always respected. Firstly, very often a total audit of all activities is carried out; the commercial company, without focusing on high-risk areas. Secondly, the audit itself is not carried out regularly, but periodically, at predetermined periods or during a change of shareholders or management. As a result, the internal audit becomes unnecessarily labor-intensive and ineffective, because to eliminate the consequences of occurred deviations is much more expensive than to prevent the consequences. To solve this problem, it is necessary to develop an internal audit plan based on the Risk-Based Audit Approach.

The essence of such a plan, based on the risk-based approach, is that the annual audit plan includes the areas of the Company's activities with the highest level of risk, which require increased attention of the Company's management. At the same time in the long term the risk-oriented approach allows to ensure the completeness of audit coverage.

In accordance with the requirements of the International Standards for the Professional Practice of Internal Auditing #210 "Planning", the head of internal audit must make a risk-based plan that identifies internal audit priorities in line with the organization's goals.

The creation of a risk-based audit plan is accomplished through the step-by-step actions of the internal auditors that we discussed in chapter one.

*The first step - the formation of the Audit Universe (Audit Universe)*, that is, the totality of all areas of the Company, subject to audit employees IAS.

In international practice, there is no unified view on the procedure for determining the auditable areas. The most commonly used approaches to determine the auditable areas are based on the functions of the company's divisions; the structure of business processes existing in the company; the territorial division of divisions, as well as combinations of the above approaches (Kamysovskaya, S.V., 2019). We used the process approach as the highest priority, in which the audited area is a business process of a certain level in the context of products/services.

The audit universe is created by IAS employees and approved by Company management on an annual basis.

Business process outputs are products and services consumed by other business processes or external customers. Level 1 products are groups of company products/services that have similar levels of inherent risk and are the result of similarly structured business processes.

Determination of the first level product structure is performed by Internal Audit employees based on information on the company's types of operations. The first level product structure must be coordinated with the company's management.

To identify auditable areas, the IAS staff creates a process and product matrix that lists the Level 1 processes vertically and the Level 1 products and services of the organization horizontally. In addition to the product line horizontally, the item "Process Universal" is listed.

At the intersection of the horizontal and vertical, IAS employees define the interrelationships of business processes and products. The area defined by the first level business process and the first level product is a separate auditable area. The IBA staff leaves blank the cell at the intersection of the column and row of the matrix if no such process exists for that product or if that process is considered within another block of operations of the Process and Product Matrix.

Once the auditable areas have been identified, the IAS staff compiles a list of them. The name of the auditable areas must be formulated in such a way that it can be understood by the users without reference to the process and product matrix of the first level. An illustrative example is shown in Table 1.

**Table 1. Matrix of correspondence of processes and products of the first level**

Level 1 processes/products	Process, universal	Lending corporate Customers	Crediting natural persons	Household-new operations
Providing services to customers		X	X	
Accounting and reporting under IFRS	X			
Information technologies	X	X	X	X
Administration and economic activity, etc.				X

The table was compiled by the author according to the requirements of international professional standards of internal audit

*The next step in forming the audit plan is to rank the auditable areas.* As required by International Standards for the Professional Practice of Internal Auditing #210.A1, Planning, the internal audit work plan must be based on a formalized risk assessment conducted at least once a year. The plan should take into account the views of senior management and the Board of Directors.

As part of the audit planning process, the IAS staff assesses the level of risk inherent in a particular audited area.

It is generally accepted to measure the risk of the probability of a threat and the degree of negative impact of consequences by multiplying the probability of occurrence of negative events by their consequences (*risk - consequence probability*), on the basis of which a risk map is made:

Materiality of risk by degree of impact

Table 2

Probability	Impact		
	Irrelevant	Essential	Extraordinary
Probable ( $P \geq 0.5$ )	Medium	High	Critical
Possible ( $0.1 < P < 0.5$ )	Low	Medium	High
Unlikely ( $P < 0.1$ )	Low	Low	Medium

We will not dwell on this method of risk assessment, it is worth noting only that this method is described in detail in theory and is often used in practice.

We propose to use an alternative version of risk level assessment, which includes an assessment of inherent risk (i.e., the risk that is inherent in the audited area in the absence of any action by management) and. assessment of the design of corporate-level control procedures.

The resulting risk profile of the organization determines the priorities for audits.

*Inherent risk* - the susceptibility of a business process to the occurrence of negative events in the absence of restraining control procedures.

In order to obtain an estimate of inherent risk, it is necessary to assess business risks in the following categories:

- Strategic risks;
- Risks of operations;
- Risks of misreporting;
- Risks of non-compliance.

Strategic risks are the risks of ineffective management within the audited area, and also reflect the level of influence of the area on the achievement of the strategic goals of the organization (the strategic importance of the area).

Assessment of risks of operations is carried out by IAS employees in an expert manner. When assessing the risks of operations, IAS employees take into account, among other things, the following factors, which may indicate the presence of risks of such

- Availability of information about cases of implementation of operational risk in the audited area;
- Indicators or detected cases of fraud in the audited area;
- Deficiencies in the internal control system identified by the auditor/regulator;

- Customer Complaints;
- Changes to processes and/or operations performed by employees;
- The level of competence of employees;
- Low level of employee loyalty;
- Large volume of operations;
- Outsourcing operations;
- Information security violations;
- Failures and interruptions in the operation of information systems;
- Integration with information systems and data of other companies and counterparties;
- The complexity of operations (the need for the application of special knowledge);
- The complexity of the business process (complex decision-making structure, the involvement of specialists and information systems).

Reporting risks represent the probability of errors that may occur in financial and management reporting, i.e. the level of their impact on the economic decisions made by the users of the reporting. The assessment of reporting misstatement risks is carried out by IAS employees on an expert basis. The following factors are taken into account:

- Volume of operations;
- The impact of a single error on reporting;
- The level of application of professional judgment in the reporting process;
- The complexity of accounting principles, etc.

Risks of non-compliance are potential negative consequences for the organization associated with violations of the requirements of regulators and professional organizations. The assessment of such risks is carried out by IAS employees taking into account the following factors:

- Existence of changes in the requirements of regulators or professional organizations;
- Non-compliance cases identified by auditors and regulators.

Assessment of the effectiveness of corporate level controls for each of the first level processes is carried out by IAS employees by questioning *employees of departments involved in the implementation of the process*.

The effectiveness of the design of corporate-level controls is assessed in terms of the following categories:

- Control Environment.
- Risk management. To assess the risk management system, employees involved in the business processes of the audited area should assess the following criteria for the presence of corporate-level controls:
  - Setting and agreeing on goals;

- Identification, assessment, monitoring of risks;
- Change Management.
- Control procedures. Unit personnel evaluate the following control availability criteria:
  - High-level control procedures;
  - Interrelation of control procedures and risks;
  - General control procedures in information systems.
- Information and Communication. As part of the evaluation of this category of corporate-level control procedures, employees assess the following factors: (a) the relevance, timeliness, relevance, correctness and accessibility of information, as well as (b) the level of internal and external communication.
- Monitoring

The assessment of inherent risks and corporate level controls for each of these categories is on the following scale: 0 - risk not applicable to the audited area, 1 - low risk, 2 - medium risk with a tendency to low, 3 - medium risk with a tendency to high, 4 - high risk. The aggregate assessment of the inherent risk of the audited area is the arithmetic mean of the assessments of the risk categories described above.

*The third final step is to create a plan based on the resulting assessment of the auditable areas.* To construct the audit plan, the IAS staff arranges the audit universe in descending order of the final audit universe score. The set of auditable areas is then broken down by the IAS staff into three parts:

- Audited areas required to be audited in the current year;
- Audited areas prioritized for audit in the current year;
- Audited areas not prioritized for audit in the current year.

The audit plan includes all auditable areas that must be audited in the current year, regardless of the last year of similar audits. The plan also includes half of the auditable priority audit areas and one-third of the non-priority audit areas. In determining the auditable priority and non-priority areas to be included in the plan, the IAS staff takes into consideration a number of other factors that affect the final list of auditable areas included in the audit plan:

- a) The requirements of the board of directors to audit a priority or non-priority auditable area are mandatory. Accordingly, such areas should be included in the audit plan regardless of other factors.
- б) During the three-year audit period, the IAS should cover all auditable areas of the audit universe. If an auditable area has not been audited within the last three years, such area shall be included in the audit plan for the current year.
- c) When planning an audit, the Head of the IAS evaluates the availability, adequacy and feasibility of effective use of resources.

To ensure efficient allocation of resources in the process of forming the audit plan, the Head of IAS evaluates the possibility of combining several audits into one thematic audit (for example, simultaneous audit of all processes for a single product, or audit of processes for managing different types of risks due to the fact that these processes are performed by one unit).

In accordance with the requirements of International Professional Standard 220 "Submission and Approval of Plans," the head of the IAS submits for review and approval by senior management and the Board of Directors an internal audit work plan outlining the resources required to carry them out.

If necessary, the audit plan can be changed during the year. The decision to approve changes to the audit plan is made by the Company's Board of Directors.

Thus, the application of risk-based approach to planning of internal audit contributes to the formation of an annual audit plan of the areas of the company with the highest level of risk. And the significant condition of successful internal audit of the company is the correct conclusions and optimal recommendations of the internal audit, which will be discussed in the following paragraphs.

**Table 3: Format for evaluating auditable areas**

Audited area	Assessment of inherent risks					Evaluation of corporate level controls						Final score
	Strategist s Czech risks	Risks opc and	Risks distortions reporting	Risks non- compliance of	Bott om line	Control environme nt	Managem ent risks	Controls	Informatio n and ring communic ation	Monito ring	Bott om line	
Organization of accounting and reporting	4,00	3,00	4,00	2,00	3,25	3,00	3,00	3,00	2,00	3,00	2,80	9,10
Lending operations to corporate clients	4,00	3,00	4,00	2,00	3,25	3,00	3,00	3,00	2,00	3,00	2,80	9,10
Lending operations to individuals	4,00	3,00	2,00	2,00	2,75	3,00	3,00	3,00	2,00	3,00	2,80	7,70
Business transactions	4,00	1,00	2,00	2,00	2,25	2,50	2,33	2,67	2,50	3,00	2,60	5,85

**Table 4. Creating an audit plan**

Audited area	Assessment of non-acceptable risks (total)	Evaluation of corporate level control (total)	Final risk assessment	Last year's inspection	Number of years during which there has been no	Requirements of the Board of Directors	Included in the audit plan (yes/no)
Organization of accounting and reporting	3,25	2,80	9,10	2019	1		<b>Yes</b>
Lending operations corporate clients	3,25	2,80	9,10	2019	1		<b>Yes</b>
Lending transactions natural persons	2,75	2,80	7,70	2018	2		<b>Yes</b>
Business operations	2,25	2,60	5,85	2017	3		<b>Yes</b>



### 3.3 Regulatory and legal framework for internal auditing

The period of development of audit activities in Kyrgyzstan is rather short. Even 23 years ago, there was no concept of "audit", there were only control and audit services, which were part of the foundation for the emergence and development of auditing.

The beginning of the development stage is associated with the date of January 26, 1993. On this day, Resolution No. 33 of the Government of the Kyrgyz Republic approved "**Provisional Provisions on Auditing Activities and Organization of Independent Control in the Kyrgyz Republic**". Based on this Resolution, Order #47 of the Minister of Economy and Finance of the Kyrgyz Republic dated September 13, 1993, approved "**Regulations on the Audit Council of the Kyrgyz Republic**" and Order #48 of September 13, 1993, approved "**Regulations on Licensing Audit Activities in the Kyrgyz Republic**".

Then, on September 18, 1997 the Ministry of Justice registered the Regulation "**On the Council on Audit Activity of the Kyrgyz Republic**" by order of the Ministry of Finance on July 7, 1997, #236. One of the results of the council's activities was that on April 4, 2000 the **Kyrgyz Standards on Auditing** were approved by Order No. 5 of the State Commission on Auditing under the Government of the Kyrgyz Republic.

The next legislative act was the regulation "**On the State Commission under the Government of the Kyrgyz Republic on Financial Reporting and Auditing Standards**", approved by Government Resolution No. 67 of February 28, 2001. One of the most important functions of the GCA was the development of draft normative legal acts regulating auditing activities in the Kyrgyz Republic.

By that time, the factors that prompted active work to improve legislation on auditing were: the adoption of International Financial Reporting Standards (IFRS), preparatory work for the adoption of International Standards on Auditing (ISA).

Three years before, on June 26, 1998, another normative document was adopted - the Law of the Kyrgyz Republic "On Auditing Activity" #82, which consisted of 9 sections and 40 articles. Most of the section required radical changes, the law was not ready for implementation.

On September 29, 2001, the Government of the Kyrgyz Republic issued Decree No. 594 on **the draft** Law of the Kyrgyz Republic "On Auditing Activities. The law "**On Auditing Activity**" No. 134, was adopted on July 30, 2002. The underlying reasons for adopting the law were:

- in connection with the adoption of the Kyrgyz Standards on Auditing, it became necessary to exclude the articles of the law that duplicate the standards;
- The previous Law of the Kyrgyz Republic "On Audit Activity" had articles providing for "Civil liability of auditors and audit organizations" and "property liability of auditors". However, property liability is a component of civil liability, which is reflected in the Civil

Code of the Kyrgyz Republic (Chapter 20 "Liability for breach of obligations", Chapter 31 "Paid services");

- norms of the law often duplicate other laws, such as articles defining the rights and obligations of auditors and customers, the procedure for entering into contracts;
- articles on licensing of auditing activities duplicated the articles of the Law of the Kyrgyz Republic "On Licensing". Regulations "On Licensing of Certain Types of Entrepreneurial Activity", etc.

On April 22, 2003, the Government of the Kyrgyz Republic adopted a resolution to approve **International Standards on Auditing (ISA)**, 2001 edition, as auditing standards in the Kyrgyz Republic. Since that time, ISAs have been recognized as national standards in the Kyrgyz Republic.

On June 28, 2006 the Board of the National Bank of the Kyrgyz Republic approved the Regulation "On minimum requirements for external audit of microfinance organizations in the Kyrgyz Republic". This regulation establishes the rules of external audit of annual financial statements of microfinance organizations.

One year later, on February 14, 2007, the NBKR Board approved the Regulation "On minimum requirements for the organization of internal control in microfinance organizations and credit unions of the Kyrgyz Republic in order to combat the financing of terrorism (extremism) and legalization (laundering) of proceeds from crime. The purpose of the regulation is to define the minimum requirements for the organization of internal control in microfinance organizations, which do not attract deposits.

On January 26, 2009 the President of the Kyrgyz Republic adopted the Law No. 25 "**On internal audit**". This law applies to ministries, state committees, administrative departments, other state bodies, other executive authorities, bodies of state social insurance and pension system, local self-government bodies, their subordinate organizations, state enterprises.

The above-mentioned law does not regulate the relations arising in the internal audit of private companies in any way.

At present, issues related to internal audit are not regulated by Kyrgyz law, except for certain provisions relating to financial and credit institutions and professional participants of the stock market.

When considering the issue of legal support of internal control and internal audit, it is necessary to refer to international standards of auditing, designed to a certain extent to outline the legal framework for auditing activities in the Kyrgyz Republic, while taking into account international practice.

According to the law "On Auditing Activities" the ISAs are obligatory only for auditing firms. At the same time, for the purposes of internal control and internal audit they also have an important methodological significance, as they define the requirements for the organization of internal control and internal audit, the conduct of audits under certain conditions, the composition of documents, etc.

ISA "Audit Risk Assessment and Internal Control by the Audited Entity" gives a fairly detailed description of the internal control system, the control environment and control procedures, but mentions internal audit only as a component of the control environment. The ISA Review of Internal Audit Work deals with the role of internal audit in the activities of the audited entity, and external auditors are required to examine the results of internal audit work in order to plan their work on assessing the reliability of financial statements.

It should also be noted that by adopting international auditing standards as national standards, the Government of Kyrgyzstan for the first time in Kyrgyz practice has defined the concept of "internal audit".

The Civil Code of the Kyrgyz Republic, the Laws "On Joint Stock Companies", "On Limited Liability Companies", which are legislative acts of general application, do not mention internal audit. At the same time, the lack of a unified provision regulating internal audit issues, in turn, prevents the possibility of implementing in practice the goals, functions and objectives of internal audit in the management of microfinance companies.

In the banking sector of Kyrgyzstan, the regulatory requirements for internal control and risk management systems are the closest to those recommended by international institutions, such as the Basel Committee on Banking Supervision, the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS).

Compared to other sectors, the current banking legislation of the Kyrgyz Republic has the most developed regulatory and legal framework in the area of internal control (audit). This is due to the fact that international norms and rules in the field of banking regulation and supervision were taken into account in its development. In particular, when developing the NBKR Regulation "On Internal Control in the Banks", the principles of internal control recommended by the Basel Committee on Banking Supervision were taken into account.

The NBKR has now issued numerous documents regulating and defining internal control (audit) mechanisms for the FCIs in certain areas of their activities.

The Regulation "On the organization of internal control in banks" of the NBKR mainly used the approaches to the construction of the internal control system and its position in the management system recommended by the Basel Committee, based on the COSO model ("Internal Control - Integrated Framework"), taking into account professional standards of internal audit,

developed by the Institute of Internal Auditors. However, this provision has disadvantages. For example, notions of "internal control" and "internal audit" are not completely separated in the provision these notions are substituted; the function of internal audit is mentioned only once, which is the reason of confusion in practice in organization of the work of internal control and internal audit services, and in methodological development of these notions. Besides, there are no requirements for qualification of personnel, and there are no statements about confirmation of professional competence of ICS personnel. Though it should be noted that many functions, rights and obligations of internal controllers in this regulation are adequate to those which may and should be exercised by internal auditors.

Analysis of the state of legal and (regulatory) regulation of the essence, organization and purpose of internal audit indicates an insufficient level of regulation of this direction of activity at present. The lack of clear concepts and definitions of internal audit in the legislative acts of the Kyrgyz Republic, regulatory documents of the NBKR, the Ministry of Finance of the Kyrgyz Republic negatively affects the application of internal audit in the FCU. And this, in turn, does not create prerequisites that would protect the interests of owners, its investors, as well as clients, which is very important.

For a practical solution, the use of internal audit in the FCU, as well as to improve its legal regulation is now necessary:

- Separate and legislate the concepts of "internal audit" and "internal control" in the NBKR Regulation "On the organization of internal control in banks and other financial and credit institutions".
- To amend the Law "On Joint Stock Companies" by adding an article "Organization of internal audit of the company."
- Using the experience of international practice, develop unified internal audit standards that are recommendatory in nature.
- To develop and consolidate a model regulation of the NBKR on the internal audit service, as well as to develop and approve job descriptions of employees of the internal audit service in microfinance companies.

In conclusion, it should be noted that to date, the formation of external audit in the Kyrgyz Republic has taken place, while the domestic internal audit in the professional, legislative and institutional aspects is still in its development stage. Organization of internal audit implies systematization of certain principles of internal audit, definition of rights and duties, as well as responsibilities of internal auditors, development of regulations on internal audit service and relations with external auditors.

#### **4. PECULIARITIES OF INTERNAL AUDITS**

Internal audit is a system of internal control and a system of security measures of the company in order to ensure the protection of depositors' interests, preservation and achievement of specific results in the activities of the company.

It includes a set of company plans, methods and procedures used within it to protect assets, increase profits, and ensure clear compliance with the instructions of company management.

Thus, the main purpose of the internal audit of operations is to assess the effectiveness of the management system of a microfinance company (analysis - planning - regulation - accounting and management accounting - control procedures - incentives), timely reporting to the management and owners of the company identified problems and proposals for their resolution.

To achieve this goal, the internal audit department has to solve a number of tasks:

- Evaluate the compliance of operations with strategy and policy, as well as legislation and bylaws;

- make sure that the overall asset quality assessment is accurate and communicated to company management in a timely manner;

- assess the adequacy of the internal control system to the nature and volume of the company's operations;

- Identify management bottlenecks, gaps in strategy, policies and procedures.

Depending on the scope and complexity of the tasks to be performed, the following classification of internal audit types can be used:

- Compliance audit (checking compliance of operations with legislation, internal policies and procedures);

- Financial audit (checking the accuracy, completeness and timeliness of the company's operations in accounting and management reporting);

- Operational audit (evaluation of the effectiveness of procedures, analysis of compliance of organizational structures, working methods and resources of the company with the goals set);

- management audit (evaluation of the quality of management as part of achieving the company's goals).

Internal Audit is organizationally represented as a structural subdivision of the company and reports to the Board of Directors of the company.

Internal audits of major operations are usually conducted in accordance with the approved audit plan and program as part of a comprehensive audit at least once a year, as well as thematic

audits of this area of work on the instructions of higher authorities or as part of the annual audit plan approved by the company's Board of Directors.

The plan establishes the main tasks, areas, time frame of the audit, requirements for the qualifications and number of auditors. The audit program is a detailed list of audit tests required to achieve the audit

As part of the audit, it is advisable for internal auditors to study and document the technology of transactions, make a document flow chart, identify control procedures and test their functioning. Based on the results of testing of control procedures, the necessary scope and structure of credit transaction tests are determined.

The final stage of the audit is the formation of conclusions and their coordination with employees and management. It is very important to properly assess the identified deficiencies and prepare recommendations to the company's management. A clear, detailed description of the problems and irregularities identified during the internal audit, as well as recommendations for their elimination, presented in the audit report, is of paramount importance for improving the operations practices of the Kyrgyz company. The following procedure is used to describe the violation: its essence; the place where the violation was identified; which paragraph - article - section of the regulatory document was violated; the responsible person (body) of the company that allowed the violation.

## **2.1 Peculiarities of internal audits of customer lending**

Loan operations are the most profitable item of a microfinance company. This source generates the main part of the net profit, which is allocated to the reserve funds and goes to the payment of dividends to the shareholders of the company. Banks grant loans to various legal entities and individuals from their own and borrowed resources.

When conducting inspections of company divisions as scheduled, it is useful to pay attention to such aspects of credit operations as:

- oversight of the company's board of directors and management;
- planning and testing of new credit products;
- the criteria for granting loans (how conservative or, on the contrary, liberal they are);
- correct calculation and compliance with internal lending limits;
- Delineation of the rights and responsibilities of company employees in the process of granting loans;
- restrictions on lending on non-commercial terms;
- credit administration, credit and collateral monitoring;

- a system of assigning internal risk ratings to loans;
- pricing of credit products;
- Compliance with the requirements of regulatory acts when conducting credit operations (including mandatory standards, rules for classifying loans by degree of risk and creating reserves for possible credit losses, requirements for documentation and recording in the books);
- the adequacy of information-analytical systems;
- general structure of the loan portfolio (for compliance with the adopted credit policy and strategic guidelines);
- stress testing procedures;
- credit revue;
- internal control;
- work with problem loans.

To determine the objectives of the internal audit of credit operations it is necessary to refer to the analysis of the components of the credit process (supervision of management, granting loans, credit administration and monitoring, internal control procedures), to identify existing shortcomings and note potential opportunities for improvement.

First of all, let's focus on management oversight. In many Kyrgyz companies the control of the company's Board of Directors over the actions of the management is weakened and has a formal character. For more active participation of the board members in determining the directions of development of credit operations of the company in the short and long term it is necessary to develop a special document (credit policy).

When developing credit policy, factors influencing the level of credit risk should be taken into account. Such factors include: the degree of concentration of credit activity of the company in an area sensitive to changes in the economy, which is expressed by the degree of concentration of clients in certain industries or geographic regions, especially susceptible to changes in the economy; the share of clients experiencing certain specific difficulties; concentration of credit activity of the company in little-studied, new, unconventional areas; making frequent and significant changes in credit policy; the share of new and recently arrived

In a microfinance company, the content of the Credit Policy is as follows (Table 5).

Table 5 - Credit policy of microfinance company

№	Contents	Regulatory documents
1	Introduction	<ul style="list-style-type: none"> <li>○ Civil Code of the Kyrgyz Republic;</li> <li>○ Law No. 60 of July 29, 1997 on Non-Commercial Institutions in the Kyrgyz Republic;</li> <li>○ Law of KR "On Pledge" № 49 of March 12, 2005;</li> </ul>
2	Basic terms and concepts	
3	Goals, Objectives and Principles	

4	Risk management in the provision of credit products	<ul style="list-style-type: none"> <li>○ Law of KR "On company secrecy" № 122 of July 23, 2002</li> <li>○ Law of KR "On Combating Terrorist Financing and Legalization (Laundering) of Proceeds of Crime" № 135 of July 31, 2006</li> <li>○ Regulation of the NBKR "On minimum requirements for credit risk management in financial and credit institutions licensed by the NBKR" dated April 27, 2005 № 12/7;</li> <li>○ Instruction of the NBKR "On Requirements for Operations with Insiders and Affiliates of Commercial Companies and Other Financial and Credit Institutions Licensed by the NBKR" dated December 10, 2003 № 34/10;</li> <li>○ Instruction of the National Bank of the Kyrgyz Republic "On Credit Limitations" dated September 15, 2004, № 24/4;</li> <li>○ Regulation No. 18/3 of the NBKR "On Classification of Assets and Related Allocations to the RPFU" dated July 21, 2004.</li> </ul>
5	Level of authority and division of responsibility (Credit Committee)	
6	The lending process:	
6a	The main conditions of the credit product	
6б	Requirements for a financial product	
6B	Collateral Guide	
6r	Legal expertise	
7	Monitoring	
8	Working with problem loans	
9	Assessment of the quality of the loan portfolio	
10	Conclusion	

Table developed by the author according to <https://salymfinance.kg>

Analysis of lending practices in Kyrgyz companies showed significant shortcomings in their marketing policies. For example, many companies do not define at the appropriate level the target markets of loans, there is no clear division of borrowers - individuals by economic, social and age characteristics, there is no accurate distinction between the benefits of different credit products for borrowers, etc. That is why it is so important for companies to define in detail the criteria for granting loans to borrowers: who can get a loan, in what amount, what types of loans the company issues and on what terms.

The lending process itself is usually divided into several stages: development of internal instructions for a new credit product; consideration of the credit application and decision-making on granting a credit product to the borrower; debt service by the borrower, monitoring of his financial condition and collateral. In order to reduce operational risks it is important to strictly formalize the procedure of consideration and approval of the company's credit application (documentary confirmation of all actions, the possibility of identification of responsible persons).

Many Kyrgyz companies conduct a high-level analysis of the loan application when granting a loan, but the quality of the subsequent monitoring of the loan condition in them sometimes leaves much to be desired.

Let us consider a concrete example of the results of an internal audit of the credit operations of a Kyrgyz microfinance company.

Since the lending process in the company involves many subdivisions (credit division, distressed assets division, branches, etc.), internal audit can not be limited to the audit of individual



units of the company. An end-to-end audit of the entire lending process in all of the company's divisions involved in lending was carried out.

The check of the credit portfolio was carried out by sampling method and according to the sample agreed with the company, all loans over 360.0 thousand KGS, and not less than 70% of the credit portfolio minus loans over 360.0 thousand KGS were included. A total of 2,441 loans out of 3,256 or 75% of the loan portfolio were checked, including by division of the company (Table 6):

Table 6 - Branch data

Name of unit	Number of borrowers	Number of credits audited by auditors
Branch	127	99

Table developed by the author according to <https://salymfinance.kg>

In reviewing the condition of the branch loan portfolio, it was assessed:

- availability in the branch and compliance with internal documents;
- the branch's compliance with internal lending limits;
- setting credit work (negotiating with the client, analysis of the credit application, the conclusion of a lawyer, the validity of the decision by the credit committee of the branch, monitoring the business of the borrower, etc.);
- the correctness of the design and maintenance of credit files;
- collateral analysis procedures;
- reliability of management reporting on credit operations submitted to the head office;
- compliance with the NBKR regulations governing the classification of loans by risk, accounting procedures for the creation and use of provisions for potential losses and credit losses, interest accrual and payment.

The current state of the loan portfolio was evaluated on the basis of points (Table 7).

Table 7 - Evaluation of the loan portfolio

Parameters of the loan portfolio audit:	Points:
Evaluation of debt service (max - 12 points per loan)	11,48
Assessment of the financial condition of the legal entity (max - 4 points per loan)	0,01
Assessment of the financial condition of an individual (max - 3 points per loan)	0,75
Availability of collateral (max - 8 points per loan)	7,67
Inspection of collateral (max - 2 points per credit)	0,97
Availability of credit documentation (max - 16 points per loan)	9,81
Monitoring assessment (max - 5 points per credit)	2,03

Table developed by the author according to <https://salymfinance.kg>

A score-based assessment of the company's loan portfolio showed that the company's overall financial condition score for legal entities was 0.01 points with a maximum of 4 points, and for individuals 0.75 points with a maximum of 3 points. This indicates unsatisfactory company practices in assessing the primary source of repayment of credit and interest, and a violation of the requirements of the company's Credit Policy.

On the basis of the above, the following conclusions can be made:

1. When granting loans, first of all, availability of collateral and its assessment are taken into account, and no attention is paid to the availability of income from business, sufficient earnings, profits. A common problem for many Kyrgyz companies is the incorrect assessment of the risk-return ratio for an individual loan and the profitability of cooperation with the borrower in general and, therefore, the failure to receive adequate compensation for the risks taken. A company overestimates the role of collateral when making a decision to grant a credit. It is important to bear in mind that collateral cannot replace thorough examination of a borrower and compensate for the lack of information about him. Using collateral as a source of repayment for credit debts usually does not allow the company to generate income. In addition, the value of collateral is capable of decreasing due to the same factors that have led to a decreased likelihood of loan repayment.
2. Credit files often do not contain the information necessary to determine the current financial condition of the borrower (current financial statements, results of financial analysis, documentation of risk group assignment); documents confirming the decisions made on the loan. The company does not always conduct an on-site inspection of the collateral (goods in stock), does not confirm its evaluation. This suggests that the company's credit policy is built not on the prevention of the emergence of problem loans, but to work with the existing problem loans. The company has an underdeveloped procedure for monitoring the condition of individual loans and borrowers, which includes examining the current financial condition of the borrower; assessing the adequacy and realizability of collateral; identifying violations of the terms of the loan agreement and the timely classification of problem loans; notifying the company's department to work with troubled assets. Table 8 below shows the level of the current state of monitoring:

Table 8 - Monitoring the state of the loan portfolio

Indicator name	Rating level, points
Journal of visits, negotiations with clients	0,52
Report on the current status of the loan	0,34
Conducting an independent assessment of the condition of the loan portfolio	0,67
Monitoring of collateral in accordance with the frequency established by the credit policy	0,23
Providing financial reports for legal entities	0,55

Table developed by the author according to <https://salymfinance.kg>

3. The composition and format of many loan documents (questionnaire, business plan, cash flow plan) has not changed for several years. Completion of some documents is formal and does not take into account the industry focus of the loan (commercial, mortgage, consumer, etc.). Below we consider the main violations in the formation of credit documentation (Table 9)

Table 9 - Violation of credit documentation  
Legal entities and individuals

Name of document	Number of cases of missing documents	in % of the total number of borrowers
Documents on state registration (certificate, patent)	11	11,22
Passport copy	5	5,10
Feasibility study on the need for a loan and the timing of its repayment	4	4,08
Plan-forecast of cash flows for the period of credit use	17	17,35
Copies of contracts, agreements and other documents confirming the purpose and scope of the loan	90	91,84
Licenses to carry out licensed activities	85	86,73
Analysis of solvency, customer rating	24	24,49
Opinion of a lawyer on the borrower's documentation	84	85,71
Conclusion of the economist of the credit department on the possibility of granting a loan	2	2,04
Borrower's credit history with the company	76	77,55
Authorization of credit	4	4,08

Table developed by the author according to <https://salymfinance.kg>

4. In the course of the audit the state of control over the completeness and timeliness of payment of interest on loans by legal entities was assessed through spot checks on at least 25% of active and closed personal accounts of borrowers (Table 10), and at the same time it was established:

- there were cases of late payment of interest;
- the penalties provided for in the loan agreements were applied to such borrowers in a timely manner;
- determined the company's under-received income from uncollected interest on the use of the loan and the non-application of the relevant penalties.

Table 10 - Debt service indicators (by branches)

Branch name	Branch	
The presence of arrears of up to 1 month (in KGS):	Regular payment of the main debt	1 003 500
	Interest	0
The presence of arrears of up to 3 months (in KGS):	Regular payment of the main debt	307 400
	Interest	0
	Regular payment of the main debt	20 000

The presence of arrears of up to 6 months (in KGS):	Interest	3 461
The presence of arrears of more than 6 months (in KGS):	Regular principal payment	4 753 280
	Interest	187 021
Terminated accrual of interest, the number of	0	
Repayment at the end of the term, amount	0	
Availability of prolongations (principal balance), in soms	Availability of one extension	784 359
	Availability of two extensions	9 108
	More than two renewals	0
As % of the total credit portfolio of the branch		6,65

Table developed by the author according to <https://salymfinance.kg>

Based on the results of the audit of the microfinance company, the following recommendations were made:

- Make additions to the credit policy, including provisions and procedures for controlling the current state of the loan portfolio, clearly spell out the conditions for granting loans to shareholders, insiders; list the types of loans that are undesirable. It is proposed to develop a system of financial incentives for loan officers for the indicators of the state of the loan portfolio. It is advisable to pay attention to the possibility of a conflict of interest among employees, whose performance is assessed on the basis of such indicators as the volume of the loan portfolio, its quality or profitability in the short term.

- Provide in the credit policy and regulations on lending a system of differentiated approach to different clients depending on the risk group, borrowers, industries, regions of the country, currencies, types of loans and collateral, terms. An important element of credit management is the establishment of limits for separate borrowers and groups of connected borrowers, not contradicting the obligatory norms of NBKR, such as: limit of regional risk (limits the company's investments in the economy of separate region); limit of branch risk (limits the volume of credits given by bank to enterprises of any branch); operational limits (for example, limit on the volume of "overnight" credits given to counterparty, limit on the amount of its purchased bills for a period over 10 years). It is recommended to calculate the following types of limits for branches: limit for granting of credits at the expense of own resource base (without funding by the head office); limit for independent crediting per customer (limits the amount of credit, which can be granted by the branch without coordination with the head office); credit period limit (maximum term for which the branch can grant credit without coordination with the head office); interest rate limit for credit products (minimum interest rates for credits of certain maturity); limit for credit products (maximum interest rates for loans of fixed term).

- Develop regulations on lending for each type of loan, taking into account clearly spelled out control mechanisms, responsibilities, methods of calculating the interest rate, etc., amend the existing regulatory documents in terms of the formation of credit files for each type of loan (commercial, mortgage, retail, consumer, etc.), as well as to conduct an inventory of all credit files.

- Develop a system of business and collateral monitoring. Monitoring should include research of possible negative moments in relation to individual loans and various segments of the loan portfolio, it is necessary to conduct scenario analysis (stress testing), to identify events and economic conditions that can have a negative impact on credit investments, as well as to assess the degree of preparedness of the company to counter them.

- Organize a system of continuous training for employees.

- It is necessary to develop an internal system of risk rating, which allows differentiating the value of credit risk of company investments, as formalized criteria for classifying loans by degree of risk, established by the Regulations of the National Company of the Kyrgyz Republic are not always adequate to the needs of optimizing the bank's management. For example, as long as the loan payments are not overdue, it may be assigned to the 1st risk group, regardless of the quality of the collateral. In accordance with the developed internal rating system to make adjustments to the accruals on RLPU.

- Strengthen the internal control system by having qualified specialists conduct a parallel assessment of loans (credit review), presenting its results to company management in a unified format, as well as aggregating information on the status of the company's loan portfolio and the use of the established limits. The performance of parallel assessment of loans can be assigned to a unit not directly related to lending and be performed only for loans above 0.05% of the balance sheet currency.

#### **4.2 Specifics of internal auditing of cash transactions**

Uninterrupted cash servicing of clients is one of the most important functions of companies. Cash service to clients is a complex of services provided to legal entities and individuals on transactions with cash in national and foreign currency, other values. Cash operations of companies is a very labor-intensive process, during which there are operational risks associated with the violation of internal control over cash transactions.

When conducting inspections of company divisions as scheduled, it is useful to pay attention to such aspects of cash transactions as:

- oversight of the board of directors and management of companies;
- the technical strength of the vault, the equipment of operating cash desks and the procedure for organizing security;

- organization of cash operations (how conservative or, on the contrary, liberal);
- Correct calculation and compliance with internal limits of operating cash balances;
- Delineation of rights and obligations of company employees in the process of organizing cash work;
- inventory of the operating cash desk and other valuables that are in the cash desk;
- the use of cash registers;
- pricing of cash services;
- Compliance with the requirements of regulatory acts when conducting cash transactions (including standards for compliance with the cash balance limit, cash inventory, requirements for documentation and recording in accounting);
- the adequacy of information-analytical systems;
- general structure of cash on hand (for compliance with the adopted cash policy and strategic guidelines);
- internal control;

To determine the objectives of the internal audit of cash operations, it is necessary to refer to the analysis of the components of the cash process, to identify existing shortcomings and note potential areas for improvement.

Let us consider a concrete example of the results of an internal audit of cash operations of a Kyrgyz microfinance company

The whole check of cash transactions was conducted in three stages: familiarization, main, and final.

During the introductory phase, the internal regulatory framework and open accounts were studied.

At the main stage the analysis of transactions of the reporting period, reconciliation of the amount of cash balance with the data in the journal was carried out. Correctness of documentary registration, safety of cash, correctness of application of cash control equipment, completeness and timeliness of crediting of cash, correctness of writing off money as expenditure, compliance with the established cash balance limit, organization of storage of free cash in cash offices, and periodicity of cash inventory were checked.

At the final stage of the audit a package of working documents of the auditor is formed and an audit report is prepared, which, together with the working documentation, is submitted to the head of the audit.

Cash operations were inspected on a continuous basis and covered the period from January to December. Employees of the Cash Operations Department perform their duties in accordance with the approved job descriptions, which define qualification requirements for their appointment.

The current state of cash operations was evaluated on the basis of points (Table 11).

Table 11 - Evaluation of cash management in a microfinance company

Availability of internal regulatory documents, job descriptions and agreements on full material responsibility (max - 10 points)	8,4
Completeness and timeliness of cash transactions in accounting (max - 10 points)	10
Correctness of cash documents (max - 10 points)	9,67
Signatures of responsible persons and recipients of funds on cash documents (max - 10 points)	7,54
Generation of cash documents (max - 10 points)	7,5
No corrections, erasures, etc. (max - 10 points)	9,45
Compliance with audit procedures (max - 10 points)	5,63

Table developed by the author according to <https://salymfinance.kg>

Evaluation of cash operations of companies on the basis of scores showed that the average score for the company is 8.31 points with the maximum score of 10 points. This indicates the existence of facts of violations in the organization of cash work, inventory of cash and other valuables and shortcomings in the execution and registration of transactions with cash.

The conducted internal audit of cash operations gives sufficient grounds to express the opinion that the cash discipline of the Companies complies with the strategic goals and objectives of the Companies. The work performed by cash departments generally complies with the requirements of regulatory documents. All goals and objectives are met, with the exception of certain aspects described below:

1.1. The organization of cash accounting and operations in the Company is determined by a number of internal documents, including: Regulations on cash and cash transactions, job descriptions of cash workers and agreements on material responsibility. The existing regulatory framework in the Company is developed in accordance with the requirements of the legislation of the Kyrgyz Republic and regulations of the NBKR, but not enough attention is paid to the conclusion of contracts on full financial responsibility with cash workers. Here it is important to keep in mind that the absence of these contracts carries an operational risk and may lead to additional material losses.

1.2. In reviewing the procedure for registration of transactions for the receipt and issuance of cash from cash, maintenance of forms of primary accounting documents, compilation of daily consolidated statements of cashier on cash transactions revealed that cash documents often do not contain the full mandatory details, there are cases of improper execution of cash documents. As an example, we can mention absence of signatures of responsible persons and recipients of cash on cash documents, passport data of recipient of cash and filling in consolidated statements of cash turnovers. This indicates that the Company does not always apply double control. The company has underdeveloped cash procedures for compliance with the "four eyes" principle.

1.3. When comparing the cash book of valuables with the daily balance and the report on off-system accounts, the following off-system accounts were found to be incorrectly assigned: 95301 (Blanks of strict reporting); 95302 (Miscellaneous valuables and documents); 95304 (Blanks of shares, certificates, bonds and other securities issued by the bank). Documents on pledged property, shall be accounted on account 95001 - "Written-off credits" and 95008 - "Overdue interest". At one of the branches, the respective book of registration of strict and other reporting forms is missing. ), which indicates a weakening of internal controls.

1.4. In terms of equipment and safety of the cash desk, it was found that the window of the cash desk and the ventilation hole do not meet the requirements of NBKR for the arrangement of premises. The size of the cash register window exceeds permissible parameters, the grid of the ventilation hole is installed with large gaps. There are operational, financial and safety risks.

**1.5.** In order to minimize risks, branches of companies have a limit of operating cash balance, but there are cases of non-compliance with the limit. For example, one of the branches of the companies has a limit of 1,000 thousand soms, which is constantly violated. This is explained by the fact that due to an increase in the flow of clients, customers' requests for cash in the branch is 1 000 - 1 500 thousand soms. As a result, the branch has to conduct daily exchange of assets with branches of other companies to provide customers with cash in a timely manner, which leads to additional costs. In addition, customers often deposit revenue in the amount of 1,500 thousand soms, sometimes 2,000 thousand soms in cash at the branch. Operational and financial risks are present here, which in turn will lead to the loss of customers.

1.6. During the audit, it was found that in the Company's cash registers and its branches there is no uniform order of formation and filing of primary documents of the day. There are cases of non-compliance with date chronology.

1.7. There were also cases when funds were issued from a client's account to third parties without a power of attorney, indicating passport data not of the recipient of funds, but of the owner of the account, which is a gross violation of cash discipline.

1.8. In accordance with the Regulation on Cash Operations, the company carried out audits of cash and valuables, but did not ensure compliance with the frequency of audits of cash turnover and other valuables. It should be noted that cash and treasury are audited at the time of temporary shifts of cashier's staff. A total of 16 audits were performed during the audit period and the results are shown in Table 17:

- There are no audit reports or they are not approved by the head of the company (7 cases).
- In accordance with clauses. 2.7 and 2.8 of the Cash Operations Regulations, if any shortage or surplus of cash or valuables is identified, one copy of the act is sent to the Company's Board



of Directors. In violation of the above paragraphs, the Company's Board of Directors was not notified of any cash shortages identified in the Company's cash registers.

Table 12 - Results of audits of cash and valuables

<u>Results</u>	<u>Number of cases</u>	<u>Kyrgyz som</u>
<u>Flawed</u>	<u>4</u>	<u>801,52</u>
<u>Surplus</u>	<u>3</u>	<u>50</u>

Table developed by the author according to <https://salymfinance.kg>

Identified violations of cash discipline can lead to various operational risks.

In the course of the audit 8 recommendations were prepared, the implementation of which, in our opinion, will help to eliminate the identified deficiencies and risks and improve cash discipline.

- Conduct a legal review of contracts on full financial responsibility, renegotiate contracts with all cash workers.
- Revise regulations and procedures governing cash transactions, clearly prescribe the procedure for cash transactions, registration of cash documentation, taking into account the principle of double control.
- To regulate the frequency of unannounced audits of the cash desk and pantry of the branch and savings banks at least once a quarter, for compliance with regulatory requirements of the NBKR and companies on cash transactions and their technical reinforcement.
- Organize a system of continuous training for employees.
- The Cash Operations Department should expedite its consideration of the branch's cash limit.
- Develop a procedure for generating accounting and cash documents of the day and provide training for employees.
- The branch should open an account book of valuables and accounting forms and strengthen control in the field of compliance with numbering, availability of signatures and a seal of the branch in stamped documents, etc., and strictly account for the movements of all documents in the strict accountability forms in accordance with the current Chart of Accounts.
- Eliminate deficiencies in the organization of the cash point and ventilation in the vault and bring in line with the regulatory requirements of the NBKR and the Ministry of Internal Affairs of the Kyrgyz Republic "On the unified requirements for the technical reinforcement of commercial companies, financial institutions and their security procedures in the Kyrgyz Republic," Order № 3/03 of 06.01.04.

## 5. Assessing the Effectiveness of Internal Audit in Microfinance Companies

In order to assess the current state and prospects of development of internal control and audit, as well as to analyze the situation in the organization of internal control and audit in the Republic of Kyrgyzstan, we conducted a survey of companies (Appendix 1).

The results of the survey make it possible to assess the current situation and outline the directions of further development. In compiling the questions and model of the survey, we took into account the results of similar studies (Institute of Internal Auditors and the audit and consulting company FBK), recommendations of outside experts and opinions of managers and specialists of internal control and audit services. Therefore, the questionnaires were distributed to both company managers and heads of the internal control service (ICS) or internal audit service (IA).

Some questions contained several pre-proposed variants of answers, some required independent completion of the questionnaire. The questionnaire contained 23 questions. As mentioned above, the Regulations on Internal Control of the NBKR do not make a clear distinction between internal control and internal audit services. Companies may have both units at the same time. There are also other specialized control services in companies (compliance controller, professional securities market controller, risk managers, auditing commission). This ununified multitude of control services made it very difficult to compile questionnaires. Nevertheless, we distinguished between the concept of ICS and IAS.

For this purpose, and to increase respondents' understanding of the following questions, the first two questions were formulated as follows: "Do you distinguish between Internal Control Service (ICS) and Internal Audit Service (IAS) in the structure of a microfinance company?" and "Do ICS and IAS exist separately in the structure of a microfinance company?" All subsequent answers were based on the answers given to these questions.

The survey was conducted from October to November 2021. For the mailing list included the largest companies, as well as microfinance companies that have expressed their desire to participate in the study (7 companies). Questions of the questionnaire were developed taking into account the Regulations on internal control of the NBKR, as well as a number of international documents.

The answers to the following questions did not match the initial expectations:

- with a positive self-assessment of their work (75%), full independence is rated very low - 44% vs. 56%, indicating an incomplete fulfillment of the requirements of the Company of Kyrgyzstan;

- description of control and audit methods and procedures in the developed regulations on ICS (ICS) are available only 56% of cases, the negative is the fact that 38% of respondents do not see any need for it;
- only 31% of companies have a separate compliance control service. Given the not insignificant flow of securities transactions, more such responses were expected;
- the main users of the results of inspections are the Chairman of the Board and the Board of Directors - 81% and 69% respectively. The Audit Commission - 13%, shareholders - 19%, which is a low level;
- attend special trainings/seminars on VC (IA) at least once a quarter only 13% of the respondents, once a year - 31%, do not attend at all - 56%, which is a negative factor.

44% of the companies see the lack of personnel as a weak point in the work of ICS (IAS), and 63% of respondents intend to expand the staff. Recruitment of specialists is planned either from third-party companies or from the company's own staff. At the same time, none of the companies plans to recruit employees from auditing companies, because the high level of professionalism of such employees requires high remuneration of their work.

It should also be noted that 19% of respondents do not distinguish between the concepts of ICS and IAS. One of the respondents substitutes the concepts of Audit Commission and Internal Audit Service, which, in our opinion, are different structures.

Thus, the study of the experience of functioning of the ICS (IAS) in the republic allows us to draw a number of conclusions.

International norms and rules in the field of organization of internal control and audit are taken into account by companies when implementing NBKR requirements. However, the goals set at the beginning of the survey are not fully achieved - 81% of the surveyed companies distinguish between the concepts of ICS and IAS. As a result, all answers were given to questions about ICS. The profession of internal auditor in the republic has not yet taken off and has not found its place in the organizations.

In order to continuously improve the performance of the internal audit service it is necessary to analyze the effectiveness of internal audit. In this thesis I have developed a methodology for analyzing the effectiveness of internal audit of microfinance companies in Kyrgyzstan. The methodology was tested by me in one of the Kyrgyz companies.

The analysis is based on a point estimate. The following criteria are used in the work:

- 8.5 - 10 points - fully compliant;
- 3.5 - 8 points - corresponds partially;
- 0 - 3 points - there are significant deviations from generally accepted standards.

The scoring criteria given are approximate; other quantitative assessment tools may be used. In all tables developed, a score between 0 and 2.5 should be assigned for each answer.

*The first stage of the analysis is the block "Organizational structure and internal audit functions".*

Table 13

**Compliance with the principle of independence of internal audit**

<b>Questions:</b>	<b>Maximum value</b>	<b>Company Results</b>
1. Is the internal audit service an independent structural subdivision of the company?	2,5	2,5
2. Does each internal audit employee have an independent relationship with the company?	2,5	2,5
3. Does the company's internal audit department report to the company's Board of Directors?	2,5	2,5
4. Is the internal audit function's structure and staffing approved by the company's Board of Directors?	2,5	2,5
<b>Total</b>	<b>10</b>	<b>10</b>

The table was developed by the author in accordance with the requirements of international professional standards of internal audit

Applying these criteria to the analyzed company, we can conclude that the principle of independence of the internal audit service is fully respected in this company.

Table 14

**1.1 Powers of internal audit**

<b>Questions:</b>	<b>Maximum value</b>	<b>Company Results</b>
1. Does the company have a Regulation on Internal Audit?	2,5	2,5
2. Does the Regulation on Internal Audit comply with generally accepted international standards of internal audit activities and current regulatory requirements of the NBKR?	2,5	2,5
3. Does the internal audit regulation contain a full description of the authority of internal audit staff?	2,5	2,5
4. Do internal audit staff adhere to their authority in practice?	2,5	2,5
<b>Total</b>	<b>10</b>	<b>10</b>

The table was developed by the author in accordance with the requirements of international professional standards of internal audit

The company's Internal Audit Regulation contains a paragraph describing the authority of the internal audit staff. Employees fulfill all items of these authorities.

Table 15

**1.2 Internal audit reporting**

<b>Questions:</b>	<b>Maximum value</b>	<b>Company Results</b>
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1. Does the Internal Audit Regulation contain the necessary items for the content of the internal audit report?	2,5	2,5
2. Is the final report submitted to the company's Management Board for review and action by the company's Board of Directors?	2,5	2,5
3. Does the head of internal audit report periodically to the audit committee and senior management on internal audit activities?	2,5	2,5
4. Is the periodicity respected in practice?	2,5	1
<b>Total</b>	<b>10</b>	<b>8,5</b>

The table was developed by the author in accordance with the requirements of international professional standards of internal audit

According to Table 15, we can conclude that the internal auditor reporting score does not correspond to the maximum value because the company had a vacancy in the position of internal auditor from January to July 2021. In July 2021, an employee was hired by executive order. From July to December, most of the work scheduled for the year was done, which caused the periodicity of the company's performance reporting to be compromised.

This fact does not characterize the company in the best way. There were no internal audit activities in the company for six months.

Table 16

### 1.3 Mission and goals of internal audit

<b>Questions:</b>	<b>Maximum value</b>	<b>Company Results</b>
1. Does the Regulation on Internal Audit contain the concept of "mission" and "purpose" of internal audit?	2,5	1,5
2. Are the mission and goals of the internal audit department consistent with the company's current strategy?	2,5	1,5
3. Has the company developed an internal audit strategy?	2,5	-
4. Is the internal audit strategy appropriate and in line with the company's strategic goals and objectives?	2,5	-
<b>Total</b>	<b>10</b>	<b>3</b>

The table was developed by the author in accordance with the requirements of international professional standards of internal audit

The company received only 3 points on this question, which is due to the fact that the company's Internal Audit Regulation only specifies the goals and objectives of the internal audit service. The existence of the mission and its sharing by employees of the company is a very important component for the development of activities. Employees should have a vision of their work.

The company's strategy outlines an increase in the branch network by the end of 2021 to 5 branches across the country. Based on the internal auditor's reports for the previous periods, we

can conclude that the internal audit service does not carry out any work to achieve the above-mentioned strategy of the company.

The company has not developed an internal audit strategy.

To achieve the maximum score for this criterion, I **recommend** the following actions:

1. Develop and incorporate the concept of "mission" into the Regulations on Internal Audit, to convey to each employee the meaning of this item;
2. Develop a 3-year internal audit strategy based on the company's strategic goals.

Table 17

#### 1.4 Internal audit structure

Questions:	Maximum value	Company Results
1. Is there a Board-approved structure for the internal audit function?	2,5	2,5
2. Is the current internal audit structure capable of performing the assigned tasks with the appropriate level of quality?	2,5	2,5
<b>Total</b>	<b>5</b>	<b>5</b>

At the moment, the approved structure of internal audit of the company is able to qualitatively solve the tasks.

Table 18

#### 1.6 Responsibilities of internal audit

Questions:	Maximum value	Company Results
1. Does the Regulation on Internal Audit contain a description of responsibilities that meet international performance standards and regulatory requirements of the NBKR?	2,5	2,5
2. Are internal auditors performing all of their proper duties?	2,5	2,5
3. Does the Regulation on Internal Audit prescribe a paragraph on mandatory reporting to company management on the occurrence or threat of circumstances that lead to negative consequences for the company?	2,5	2,5
4. How applicable is this point to the work of the internal audit service?	2,5	1,5
<b>Total</b>	<b>10</b>	<b>9</b>

The table was developed by the author in accordance with the requirements of international professional standards of internal audit

Regulation on internal audit of the company fully covers all duties of employees of the internal audit service and contains a paragraph "on mandatory informing the management of the company of the occurrence or threat of circumstances that lead to negative consequences for the company. For even greater implementation of this paragraph in practice, I **recommend** that

internal audit staff notify the Board of Directors of the company about the delinquency of more than 30 days, loans over 1,000,000 soms.

*The second stage of the analysis is a block of criteria "Methodology and procedures of internal audit"*

Table 19

### 2.1 Planning and conducting internal audits

Questions:	Maximum value	Company Results
1. Does the company's Board of Directors approve the procedure, program and work plan of the internal audit service?	2,5	2,5
2. Are the requirements for the audit defined in accordance with the requirements of the legislation of the Kyrgyz Republic?	2,5	2,5
3. Is the effectiveness of the internal control system for key business processes assessed on a regular basis (at least once a year)?	2,5	2,5
4. Is annual planning conducted using a risk-based approach, based on a map of risks ranked by importance in accordance with the identified problem areas of the last period's audit and the set strategic objectives?	2,5	-
<b>Total</b>	<b>10</b>	<b>7,5</b>

The table was developed by the author in accordance with the requirements of international professional standards of internal audit

Comparing the audit programs for 2020 and 2021, attention is drawn to the fact that the objectives of these programs are identical, except for minor subtasks. This suggests that the company's problem areas and overall strategic goals are not taken into account.

In drawing up the internal audit program for 2022, **it is recommended** to use a risk-based approach, to take into account the violations of the past period, to take into account the strategic goals of the company for 2022.

Table 20

### 2.2 Performing audit assignments and procedures

Questions:	Maximum value	Company Results
1. Does the Board of Directors approve an annual work plan for the Internal Audit Service?	2,5	2,5
2. In practice, is the internal audit conducted in accordance with the plan?	2,5	2,5
3. Are the intended objectives being met?	2,5	2
4. Do the internal audit staff have the necessary qualifications and experience to perform their tasks?	2,5	2,5
<b>Total</b>	<b>10</b>	<b>9,5</b>

The table was developed by the author in accordance with the requirements of international professional standards of internal audit

In some cases, there are small deviations from the plan due to new circumstances in the company. For example, it was planned to open a new branch in Karakol, but the company was not able to implement the task. In this regard, there was no audit of the branch.

It is recommended to plan the audit even more carefully, taking into account all factors, risks, external conditions of the company.

Table 21

### 2.3 Procedure for monitoring and control over the elimination of identified violations

Questions:	Maximum value	Company Results
1. Does the company have a register of detected violations and recommendations, indicating the deadline for elimination and the employee responsible for the elimination and the internal audit employee responsible for monitoring the implementation of recommendations?	2,5	-
2. Are all recommendations and violations corrected in a timely manner?	2,5	-
3. Is there follow-up monitoring in the company's offices?	2,5	1,5
4. Are there certain sanctions in cases of untimely elimination of violations and implementation of recommendations?	2,5	-
<b>Total</b>	<b>10</b>	<b>1,5</b>

The table was developed by the author in accordance with the requirements of international professional standards of internal audit

The company does not have any register of detected violations, the persons responsible for the elimination of violations are not recorded, there are no definite deadlines for elimination.

Monitoring is conducted, but it is a very fuzzy process, there are no specific deadlines for eliminating violations. If the monitoring of elimination of violations is not carried out at the proper level, then another question arises: "Why conduct internal audit at all?"

The following **recommendations** should be followed in order to move to the next step in remediation:

1. Create a register that would identify violations and recommendations for their elimination, the employee responsible for eliminating the violations, the employee of the internal audit service responsible for monitoring the implementation of recommendations. Apply this register in the company's representative offices as well;
2. Develop sanctions for untimely implementation of the auditor's recommendations.

*The final stage of the analysis is a block of criteria "Resources of the internal audit service, the system of motivation and development of internal audit staff".*

Table 22



### 1.1 Resource planning for the internal audit service

Questions:	Maximum value	Company Results
1. Has a system of qualifications and professional experience been developed for each position in the internal audit structure?	2,5	-
2. Have job descriptions been developed for all levels of the internal audit function and do they contain detailed job descriptions and authorities?	2,5	2,5
3. Do the activities of the internal audit staff comply with their job descriptions?	2,5	2,5
4. Is there a resource planning process in place to improve quality and efficiency?	2,5	2,5
<b>Total</b>	<b>10</b>	<b>7,5</b>

The table was developed by the author in accordance with the requirements of international professional standards of internal audit

The company has developed job descriptions for employees of the internal audit service, but there is no system of qualifications and experience for each position.

**It is recommended** to develop a competency framework that would give an accurate idea of the experience and skills that an internal audit staff member should have. This system would be useful in the hiring and monitoring process of the department.

Table 23

### 1.2 Professional development of employees of the internal audit service

Questions:	Maximum value	Company Results
1. Is a training program developed that meets the goals and objectives set for the internal audit service and the specifics of the company's activities?	2,5	-
2. Does this program apply to the company's activities?	2,5	-
3. Does the company have individual training plans for each employee in accordance with the need to develop certain competencies and the needs of the company?	2,5	-
4. Are these plans being implemented?	2,5	-
<b>Total</b>	<b>10</b>	<b>0</b>

The table was developed by the author in accordance with the requirements of international professional standards of internal audit

On this issue, according to Table 20, as of today the company has no professional development program for its internal audit staff and no individual training plans. All this is primarily due to the small size of the company. But given the fact that, according to the strategic plan of the company, in 2023 the branch network of the company will be increased to 40 representative offices across the country. To achieve this goal, it is already necessary to prepare the company's employees now.

To do this, on this point, **it is recommended that** you start by making an annual plan to improve the skills of employees, do it systematically, which will eventually lead to increased efficiency and quality of work .

Table 24

### 1.3 Motivation system for employees of the internal audit service

Questions:	Maximum value	Company Results
1. Is there a system in place to evaluate the performance of internal audit staff?	2,5	-
2. Is the performance evaluation methodology communicated to each employee?	2,5	-
3. Does the company have systems of bonus incentives for employees of the internal audit service?	2,5	-
4. Are all of the above points fulfilled in practice?	2,5	-
<b>Total</b>	<b>10</b>	<b>0</b>

The table was developed by the author in accordance with the requirements of international professional standards of internal audit

The company does not evaluate the work of the internal audit service, which indicates a low motivation of employees. The amount of salary does not reflect the quality of the auditors' work. In conditions of market competition, this fact can serve as a bad joke for the company.

To improve the quality of work, one tool can be to increase the motivation of employees. **It is recommended** to develop a system of remuneration based on the quality of performance of tasks and to develop a system of bonus incentives.

Provided the company starts using the above recommendations in practice, it will bring the work of the internal audit service to a new level. There will be a clear system for eliminating and preventing violations, clear requirements for the work of internal audit employees, and high motivation and productivity.

As the example showed, the developed methodology is an effective tool for analyzing the work of the internal audit service. It reveals the weaknesses and strengths of internal audit, reveals new development horizons and brings the internal audit service of the company to a new level of work.

## **6. Conclusion**

Internal audit is an important element of the internal control system of a microfinance company. Currently, most companies substitute the concepts of "internal audit" and "internal control", which is a consequence of the lack of generally accepted terminology in professional language today when referring to internal control and its types.

The new concept in the development of internal audit is the use of the risk management concept and the internal audit methodology built on its basis. It means that while planning activities the internal auditor first of all takes into account those areas where in his opinion the risk of errors and fraud is high: detailed overall audits are carried out only if facts of fraud and abuse are revealed. The main criterion of the effectiveness of the internal audit is not the number of violations revealed in the financial accounting, but the usefulness of the internal audit to the company and the preventive nature of its work. For this purpose, the internal audit shall cover all the main functional areas of the company using a risk-oriented approach to the organization of its work.

The results of the study allow the author to conclude on the need for proper organization of internal audit, as well as to ensure the improvement of internal audit methodology, which can improve the level of corporate governance and improve internal control system.

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