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CONTENTS

PLATFORM MIDDLEWARE-MANAGEMENT: FROM RESOURCE CONTROL TO INTERACTION COORDINATION IN DIGITAL SERVICE ECOSYSTEMS.....	8
Ilgor Abdullayev	
APPROACHES TO IMPROVING KNOWLEDGE EXCHANGE PROCESSES IN INDUSTRIAL CLUSTERS.....	16
Mamadaliyev Anaxxon Ziyodillayevich	
IMPROVING EXPENDITURE ACCOUNTING IN HIGHER EDUCATION INSTITUTIONS	21
Islom Ergash ugli Khonimqulov	
MANAGEMENT OF FOREIGN EXCHANGE AND CONCENTRATION RISKS IN THE OPERATIONS OF COMMERCIAL BANKS	26
Qurbonov Ilhom Jumaqulovich	
WAYS TO IMPROVE THE USE OF NATURAL RESOURCES IN THE DEVELOPMENT OF HEALTH SERVICES.	29
Sobirov Kayum Xamraevich	
REGIONAL BANKING MARKET TRENDS FOR RETAIL DEVELOPMENT	33
Salamov Islom Tashqazaqovich	
REFORMS UNDERTAKEN IN THE REPUBLIC TO INCREASE PRODUCTION CAPACITY AT FOOD INDUSTRY ENTERPRISES	37
Gulmatov Sunnatillo Nurillayevich	
PROSPECTS FOR USING ISLAMIC FINTECH TECHNOLOGIES IN SMALL BUSINESS FINANCING IN UZBEKISTAN	44
Toshxo'jayev Abduqodirxon Abdulmansurxon ugli	
ADAPTIVE CONCEPT OF HUMAN CAPITAL MANAGEMENT: A NEW PARADIGM FOR SUSTAINABLE ECONOMIC GROWTH	51
Dinora Qudrat qizi Yusubboyeva	
MECHANISMS FOR ENHANCING EDUCATION SERVICE QUALITY IN DEVELOPING YOUTH ENTREPRENEURSHIP IN THE ARAL SEA REGION.....	58
Raxmanov Raxmanbergan Abdullayevich	
CONCEPTUAL FOUNDATIONS OF IMPLEMENTING AGILE MANAGEMENT IN PUBLIC ADMINISTRATION	62
Sayfiyev Jasur Ravshanovich	
SCIENTIFIC PERSPECTIVES OF WORLD, EUROPEAN, AND CIS SCHOLARS ON ENTREPRENEURSHIP DEVELOPMENT AND FINANCIAL SUPPORT: A COMPARATIVE ANALYSIS	70
Inobatov Abror Boshlarovich	
SUSTAINABILITY REPORTING AND ESG AUDITING: EMERGING TRENDS IN CORPORATE ACCOUNTABILITY.....	84
Turabekov Bekali, Eshpulatova Zaynab	
ИНДИКАТОРЫ ОЦЕНКИ И МОНИТОРИНГА РАЗВИТИЯ ЖЕНСКОГО ПРЕДПРИНИМАТЕЛЬСТВА В УЗБЕКИСТАНЕ	91
Хусанова Зулфия Рахматуллаевна	
A METHODOLOGICAL APPROACH TO DIGITALIZING INTERNAL AUDIT IN COMMERCIAL BANKS BASED ON THE CONTINUOUS AUDITING CONCEPT	95
Narziyev Xayotjon Azamatovich	
AN AUTHOR'S APPROACH TO THE CLASSIFICATION OF FINANCIAL INVESTMENTS BY MEASUREMENT BASIS FOR ACCOUNTING AND AUDITING PURPOSES	102
Jumamurodov To'libay Yeldashbayevich	
ENHANCING THE CONTINUOUS MONITORING PROCEDURE FOR IDENTIFYING IMPAIRMENT INDICATORS OF NON-CURRENT ASSETS IN JOINT-STOCK COMPANIES.....	107
Fayzullayev Begzod Baxtiyor o'g'li	

THE INTERRELATIONSHIP BETWEEN MATERIALITY AND AUDIT RISK IN PUBLIC-SECTOR INTERNAL AUDITING AND THEIR APPLICATION WITHIN A UNIFIED METHODOLOGICAL FRAMEWORK.....	114
Ismatillayev Baypo'lat Xushvaqtovich	
THE NATURE, DEFINITION AND CLASSIFICATION OF INTERNAL AUDIT OF PUBLIC PROCUREMENT	122
Rajabov Shukhrat Ismayilovich	
A METHODOLOGY FOR THE COMPOSITE ASSESSMENT OF THE MATURITY OF INTERNAL AUDIT FUNCTIONS IN COMMERCIAL BANKS.....	128
Ismailov Azizbek Madaminovich	
THE ECONOMIC SUBSTANCE OF THE CONCEPT OF "RISK-BASED INTERNAL AUDITING" AND THE THEORETICAL FOUNDATIONS OF ITS APPLICATION IN LIGHT INDUSTRY ENTERPRISES	136
Shahlo Mahmatmurodovna Tojiyeva	

THE ECONOMIC SUBSTANCE OF THE CONCEPT OF “RISK-BASED INTERNAL AUDITING” AND THE THEORETICAL FOUNDATIONS OF ITS APPLICATION IN LIGHT INDUSTRY ENTERPRISES

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Abstract. This article examines the economic substance of the concept of “risk-based internal auditing.” Based on a comparative analysis of existing approaches, the study proposes an author-developed definition of the concept and substantiates its five defining attributes. The research methodology includes a systematic literature review, comparative analysis, logical generalisation and synthesis, and scientific abstraction. The proposed definition and conceptual framework provide a theoretical basis for improving internal control, risk management, and internal audit practices in light industry enterprises.

Keywords: internal auditing, risk-based internal auditing, internal control, risk management, risk appetite, light industry.

Аннотация. В статье исследуется экономическое содержание понятия «риск-ориентированный внутренний аудит». На основе сравнительного анализа существующих подходов предложено авторское определение данного понятия и обоснованы пять его определяющих признаков. Методология исследования включает систематический обзор литературы, сравнительный анализ, логическое обобщение и синтез, а также научную абстракцию. Предложенные определение и концептуальная модель формируют теоретическую основу для совершенствования внутреннего контроля, управления рисками и практики внутреннего аудита на предприятиях лёгкой промышленности.

Ключевые слова: внутренний аудит, риск-ориентированный внутренний аудит, внутренний контроль, управление рисками, риск-аппетит, лёгкая промышленность.

INTRODUCTION

In the contemporary economic environment, the range and complexity of risks affecting business operations continue to increase. Under these conditions, the role of internal audit has undergone a fundamental transformation: it is evolving from the retrospective examination of financial documents into an activity focused on the early identification of risks and the creation of value for management. In the academic literature, this transformation is expressed through the concept of “risk-based internal auditing.” However, the substance of this concept continues to be interpreted in different ways, and a generally accepted definition has yet to emerge within the national academic discourse.

The relevance of this issue is further reinforced by ongoing corporate governance reforms and the modernisation of audit regulation in Uzbekistan. At present, the national regulatory framework governing internal audit is largely oriented towards the public sector, while the theoretical and methodological foundations applicable to commercial enterprises, particularly light industry companies, remain insufficiently developed in terms of their sector-specific characteristics. As a material-intensive sector characterised by multi-stage production processes, light industry imposes specific requirements on risk management and internal control. This necessitates a clearer conceptualisation of risk-based internal auditing within the particular context of the industry.

The purpose of this study is to clarify the economic substance of the concept of “risk-based internal auditing” and to substantiate an author-developed definition. To achieve this purpose, the following objectives were established: to systematise the conceptual approaches that have emerged throughout the evolution of internal auditing; to conduct a comparative analysis of existing definitions and identify their limitations; to substantiate the defining attributes of the concept and formulate an author-developed definition; and to demonstrate the specific features of its application in light industry enterprises. The subsequent sections of the article present the literature review, research methodology, analysis and discussion of the findings, and conclusions in a

logical sequence.

The object of the study is internal audit activity and its conceptual foundations, while the subject of the study is the substance of the concept of “risk-based internal auditing,” its defining attributes, and the interrelationships among them. Conceptual clarity is not merely an academic concern. The way in which the concept is defined directly affects the design of the internal audit charter, the scope of authority assigned to the internal audit function, its planning procedures, and its performance assessment criteria. An unclear or unduly narrow interpretation may reduce internal audit to a conventional inspection function, whereas a broad and well-founded interpretation may transform it into an effective institution of risk management. Therefore, establishing a sound definition constitutes a starting point for the development of internal control practices.

LITERATURE REVIEW

The classical foundations of internal audit theory have been extensively developed in the international literature. L. Sawyer interprets internal auditing as an independent appraisal activity encompassing all aspects of an organisation’s operations and places particular emphasis on its function of serving management (Sawyer et al., 2003). R. R. Moeller systematises the body of knowledge relating to internal auditing and substantiates its role within the corporate governance system (Brink and Moeller, 2016). K. Pickett provides a detailed discussion of modern internal audit tools, including risk-based planning (Pickett, 2010). A specialised examination of risk-based auditing is presented by P. Griffiths, whose work places the allocation of audit resources in accordance with assessed risk levels at the centre of the approach (Griffiths, 2005). From an educational and methodological perspective, K. Reding and co-authors describe internal auditing as an integrated combination of assurance and consulting services (Reding et al., 2013).

At the institutional level, the contemporary concept of internal auditing is shaped by the Institute of Internal Auditors. The Global Internal Audit Standards, issued in 2024 and effective from 9 January 2025, position internal auditing as an independent, risk-based, and objective activity that strengthens an organisation’s ability to create, protect, and sustain value by providing assurance, advice, insight, and foresight to the board and senior management (The IIA, 2024). The COSO enterprise risk management framework provides a conceptual foundation for risk management and links the concept of risk appetite to organisational strategy (COSO, 2017). In the context of technological development, M. Vasarhelyi and co-authors substantiate the concept of continuous auditing and demonstrate how a risk-based approach can be integrated with real-time monitoring (Vasarhelyi et al., 2004). From the perspective of management accounting, C. Drury examines the relationship between costs and risks (Drury, 2012).

Issues relating to internal auditing have also been addressed in a number of national studies. K. Akhmadjonov substantiated directions for improving internal audit methodology in the context of economic modernisation (Akhmadjonov, 2016). Sh. Ilkhamov proposed criteria for assessing the effectiveness of internal auditing in business entities (Ilkhamov, 2019). N. Khojimuratov examined trends in the development of audit methodology (Khojimuratov, 2021). The principal regulatory sources include the revised Law on Auditing Activity (Republic of Uzbekistan, 2021) and the National Internal Audit Standards (Ministry of Finance of the Republic of Uzbekistan, 2022).

The analysis of regulatory sources warrants particular attention. The National Internal Audit Standards include a requirement for planning based on risk assessment. However, these standards are primarily intended for government bodies and public-sector organisations, while the methodological mechanism for applying their requirements in commercial enterprises remains insufficiently specified (Ministry of Finance of the Republic of Uzbekistan, 2022). The Law on Auditing Activity institutionally recognises internal auditing but does not provide a substantive definition of the concept (Republic of Uzbekistan, 2021). Thus, while the regulatory framework establishes a general orientation towards a risk-based approach, it does not define the concept itself. This provides further justification for developing a rigorous academic definition.

The review demonstrates that the risk-based approach has been widely discussed in the international literature as a practical audit tool. Nevertheless, the concept of “risk-based internal auditing” is frequently used intuitively and without an explicit definition. In the national literature, the concept has only recently entered academic discourse, and its sector-specific characteristics, particularly its substance in the context of light industry, have not yet been adequately examined. This gap gives rise to the central research question of the present study: what essential attributes distinguish risk-based internal auditing from other approaches, and how can the concept be defined on the basis of those attributes?

RESEARCH METHODOLOGY

This study is theoretical in nature and employs a conceptual analytical research design. The information

base consists of secondary sources, including seminal monographs in the field of internal auditing, international professional standards and frameworks issued by The IIA and COSO, and national regulatory and legal documents. The sources were selected on the basis of their recognised standing within the field and their direct relevance to the substance of the concept under investigation.

The research methods employed include a systematic literature review to identify existing approaches to the concept; comparative analysis to distinguish the common and distinctive features of the definitions examined; logical generalisation and synthesis to substantiate the defining attributes and formulate an author-developed definition; and scientific abstraction. The reliability of the study is supported by the official or peer-reviewed nature of the sources, while analytical rigour is ensured through the consistent documentation of each stage of the analysis. All intellectual sources used in the study were acknowledged through numerical references formatted in accordance with the applicable GOST requirements.

ANALYSIS AND RESULTS

The evolution of internal audit theory makes it possible to distinguish four conceptual approaches. Under the earliest inspection-oriented approach, internal auditing is regarded as a means of conducting ex post verification of the accuracy and validity of completed transactions. The systems-based approach shifts the focus from individual transactions to the assessment of the reliability and effectiveness of the internal control system.

The risk-based approach links internal audit activity to the assessment of organisational risks. Audit resources are directed towards areas exposed to the highest levels of risk, while the audit plan is developed on the basis of the organisation's risk map. Finally, the value-adding and continuous auditing approach positions internal audit as a strategic partner that creates value for management through advisory support and real-time monitoring. A comparative overview of these approaches is presented in Table 1.

Table 1
Comparative Characteristics of Conceptual Approaches to Internal Auditing

Approach	Core idea	Primary audit focus	Key considerations
Inspection-oriented	Ex post examination of completed transactions	Accuracy of documents and compliance with established requirements	Primarily retrospective orientation; limited consideration of risk priorities
Systems-based	Evaluation of the internal control system	Reliability and effectiveness of control procedures	Risk prioritisation is not the central focus
Risk-based	Allocation of audit resources according to risk assessment	High-risk areas and the risk management system	Effectiveness depends on the reliability of risk identification and assessment
Value-adding and continuous	Advisory support and real-time monitoring	Value creation for management decision-making	Requires advanced technological and data capabilities

Source: Compiled by the author based on [9; 12–14].

As Table 1 demonstrates, the risk-based approach does not reject the preceding stages in the evolution of internal auditing; rather, it reorganises them through the lens of risk. Conventional audit procedures are retained, but their focus and depth are determined by the results of risk assessment. At the same time, a comparative analysis of the existing definitions identifies three areas requiring further conceptual clarification. First, many existing studies primarily consider the concept from the perspective of audit planning, although it represents a broader framework encompassing the entire audit cycle. Second, the definitions do not reflect the dual relationship between internal audit and the risk management system, under which the latter serves both as an object of evaluation and as a source of information. Third, the definitions are generally neutral with respect to industry-specific characteristics and therefore require further clarification before they can be applied to sectors with distinctive operating features, such as light industry.

Another aspect that requires further clarification in the existing definitions is the relationship between a risk-based orientation and the independence of internal audit. Since risk-based internal auditing relies on risk assessments, the question arises as to the source of those assessments. If internal audit relies solely on the risk assessments provided by executive management, the objectivity and independence of its assessment may be constrained. Under a mature approach, therefore, internal audit uses information generated by the risk management system while also developing its own independent assessment of risks and comparing

the two. Any divergence between these assessments may itself constitute significant audit evidence. This aspect is incorporated into the proposed definition through the combined interpretation of its object-related and methodological attributes.

The future development of the concept should also be acknowledged. With the increasing adoption of digital technologies, risk-based internal auditing is being enhanced by continuous monitoring tools, through which risk indicators are tracked automatically and deviations from established thresholds are identified immediately (Vasarhelyi et al., 2004). This development does not displace the risk-based approach. On the contrary, it enables its preventive purpose to be implemented more fully through technological means. The proposed definition is therefore open to technological development, while continuous auditing tools are regarded as a contemporary manifestation of its methodological approach.

To address the shortcomings identified above, five defining attributes of risk-based internal auditing are distinguished: (1) its purpose is to facilitate the early identification and mitigation of risks before their adverse consequences occur; (2) its object includes not only financial reporting but also the risk management and internal control systems themselves; (3) its method involves determining the audit plan, scope, and procedures on the basis of the results of risk identification and assessment; (4) its criterion is the extent to which risks correspond to the level accepted by the organisation, namely its risk appetite; and (5) its outcome is a preventive effect and the creation of value for management. The combination of these attributes is illustrated in Figure 1.

Each attribute requires separate justification. The purpose-related attribute changes the time perspective of internal audit activity. Whereas the traditional approach focuses primarily on the past, risk-based internal auditing is forward-looking and seeks to prevent losses that may arise in the future. This preventive purpose also changes the economic substance of internal audit: its value begins to be measured not by the monetary amount of errors detected, but by the losses prevented. It is precisely this attribute that transforms internal audit from a control cost into a management investment and establishes its economic justification for the enterprise.

The object-related attribute shifts the focus from individual transactions to organisational systems. In this context, the risk management system has a dual status. It is both an object of internal audit, since the existence, maturity, and effectiveness of the system are evaluated, and a source of audit information, since the risk register and risk assessments generated by the system provide a basis for audit planning. It is important for this dual relationship to be reflected in the definition because it preserves the boundary between internal audit and the risk management function. Internal audit evaluates the system but does not assume responsibility for managing risks. This distinction is a direct consequence of the requirement for internal audit independence.

The methodological approach describes the practical mechanism through which a risk-based orientation is implemented. The audit plan, the scope and frequency of audit engagements, the size of audit samples, and the composition of audit procedures are determined on the basis of the results of risk identification and assessment. High-risk areas are examined more frequently and in greater depth, whereas low-risk areas are subject to less frequent and less extensive examination. This enables limited audit resources to be allocated rationally. At the same time, it makes the quality of audit conclusions dependent on the quality of the underlying risk assessment. Consequently, a sound risk assessment methodology becomes an integral component of risk-based internal auditing.

The criterion-related attribute provides a clear basis for comparison when formulating audit conclusions: identified risks are compared with the level consciously accepted by the organisation, namely its risk appetite. This attribute transforms evaluation from a matter of subjective judgement into an objective conclusion based on a criterion formally approved by management. The expected outcome defines the ultimate product of the activity. Internal audit does not merely record deficiencies; it creates value for management by issuing actionable recommendations aimed at addressing them. Taken together, the five attributes form an integrated system: the purpose determines the direction of internal audit, the object and method define its substance, and the criterion and outcome provide the basis for assessing its quality.

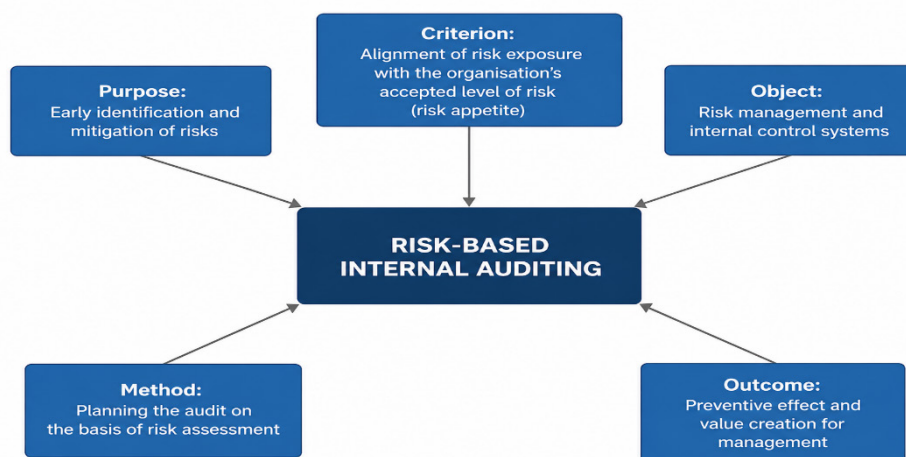


Figure 1. Defining Attributes of Risk-Based Internal Auditing

Source: Developed by the author.

On the basis of the defining attributes identified above, the following author-developed definition is proposed: risk-based internal auditing is an internal audit activity aimed at independently evaluating and facilitating the improvement of an organisation's risk management and internal control systems, in which the planning, scope, and procedures are based on the results of risk identification and assessment, and which creates preventive benefits and value for management by determining whether risks remain within the organisation's accepted level. This definition integrates all five attributes into a coherent framework and thereby provides a more integrated interpretation than those commonly presented in the existing literature.

The academic novelty of the proposed definition is reflected in three respects. First, it extends risk orientation beyond a planning technique and establishes it as a systematic principle governing the entire audit cycle. Second, it incorporates the dual relationship between internal audit and the risk management system. Third, by introducing the criterion of "alignment with the accepted level of risk," the definition establishes a direct connection with the COSO framework and the Global Internal Audit Standards, thereby ensuring its consistency with international practice (COSO, 2017; The IIA, 2024).

Distinguishing the concept from related categories further clarifies its substance. Risk-based internal auditing is not equivalent to risk management itself. Risk management is a managerial function for which executive management is responsible, whereas internal audit independently evaluates the effectiveness of that function. Nor is risk-based internal auditing identical to systems-based auditing. While the systems-based approach examines the reliability of internal control procedures, the risk-based approach first determines which areas should be audited and the depth of examination required on the basis of risk assessment. Finally, it differs from the risk-based approach applied in external auditing in terms of its purpose. An external auditor evaluates risk from the perspective of its potential effect on the reliability of financial statements, whereas internal audit considers risk in relation to the achievement of the organisation's objectives.

The proposed definition performs three theoretical and practical functions. Its analytical function lies in the fact that the defining attributes may be used as criteria for assessing the current state of an internal audit function. They make it possible to determine which of the five attributes are present in its activities and which are absent or insufficiently developed. Its design function is that the definition provides a basis for determining the charter, authority, and operating procedures of a newly established or reformed internal audit function. Its didactic function is that the definition and its attributes enable the concept to be presented systematically when teaching the subject of Internal Auditing. These functions demonstrate that the definition is not merely a terminological exercise but a theoretically grounded instrument with practical utility.

The application of the definition to light industry enterprises is further specified by the distinctive characteristics of the sector. In light industry, the predominance of material costs in total production costs, the multi-stage nature of production processes, and the inherent occurrence of waste and material losses create a specific risk profile. The movement of inventories, material consumption standards, and product cost calculation therefore constitute the highest-risk areas. Accordingly, risk-based internal auditing in a light industry enterprise should focus primarily on these areas, while the risk management system should place the control of material flows at its centre. In this way, the proposed definition provides a theoretical basis for designing internal control and audit practices at the sectoral level.

The sector-specific application of the definition may be demonstrated through each of its five attributes.

In light industry, the purpose-related attribute is reflected in the prevention of material losses. Since material costs account for a substantial share of production costs in the sector, the economic benefits of preventive measures are particularly significant. With regard to the object-related attribute, the risk management system subject to evaluation primarily encompasses controls over the flows of raw materials, work in progress, semi-finished goods, and finished products. The methodological attribute requires risks to be classified according to the stages of the production chain. Procurement, production-related and technological, financial, and sales risks should be assessed separately, and the audit plan should be developed in accordance with their relative priority.

The criterion-related attribute requires the risk appetite of a light industry enterprise to be expressed through specific indicators, such as the acceptable percentage of production waste, the maximum permissible deviation from material consumption standards, and the standard inventory turnover period. Audit conclusions are then based on an assessment of whether actual values remain within these limits. The expected outcome has a clearly measurable financial dimension in the sector: prevented material losses, reductions in excess inventory, and the monetary value of identified consumption in excess of established standards are direct indicators of the value created by internal audit. Thus, the general theoretical definition becomes fully operational through sector-specific attributes and is rendered suitable for practical application.

Discussion of the findings requires comparison with the existing body of knowledge. The proposed definition is consistent with the general principles established in the Global Internal Audit Standards and further specifies them through the defining attributes of a risk-based orientation (The IIA, 2024). Building on Griffiths' emphasis on risk-based planning, the proposed definition extends risk orientation to the entire internal audit cycle (Griffiths, 2005). Compared with national studies (Akhmadjonov, 2016; Ilkhamov, 2019), it offers a systematic formulation of the concept together with a sector-specific perspective on its application. Nevertheless, the definition remains theoretical in nature, and its practical utility should be examined in subsequent empirical studies. This represents a limitation of the present study and provides a basis for further research.

The significance of the findings for national practice also deserves particular attention. As corporate governance practices in Uzbekistan continue to develop, the role and responsibilities of internal audit functions in joint-stock companies and large enterprises are becoming more clearly defined. In some organisations, however, internal audit functions continue to retain certain features of the traditional inspection-oriented model. In such cases, risk assessment may not yet be fully integrated into audit planning, while considerable attention continues to be given to documentary compliance. The proposed definition and its five attributes provide a structured basis for the further development of this practice. By assessing the activities of an internal audit function against each attribute, organisations can develop a gradual roadmap for moving from an inspection-oriented model towards a risk-based model. This demonstrates the practical relevance of the proposed definition to the continued development of internal audit practices in Uzbekistan.

CONCLUSIONS AND SUGGESTIONS

The purpose of the study has been achieved. Four conceptual approaches in the evolution of internal auditing have been systematised, three areas requiring further conceptual clarification in the existing interpretations have been identified, and an author-developed definition of "risk-based internal auditing" has been substantiated on the basis of five defining attributes. The definition treats risk orientation as a principle governing the entire audit cycle, reflects the dual relationship between internal audit and the risk management system, and is consistent with contemporary international professional standards.

The following practical recommendations are proposed: to incorporate the proposed definition and its five attributes into advisory methodological documents on internal auditing for commercial enterprises; to revise the internal audit charters of light industry enterprises in accordance with the principles of the risk-based approach; and to include the evolution of conceptual approaches and the proposed definition in the teaching of Internal Auditing in higher education institutions. Future research should focus on developing a risk-based internal audit methodology for light industry enterprises on the basis of the proposed definition and empirically evaluating its effectiveness.

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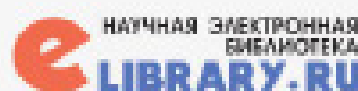
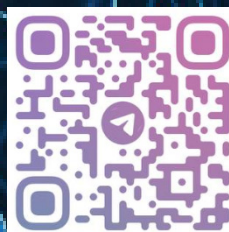
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