

**OBSERVATION AND MONITORING IN INTERNAL AUDIT
PROCESSES IN ORGANIZATIONS**

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***Abstract.** Observation and monitoring are essential components of the internal audit process, enabling auditors to assess compliance, operational efficiency, and risk management in real-time. This article explores the role of observation and monitoring in internal audits, detailing methodologies, best practices, and challenges. Emphasis is placed on how these techniques enhance the accuracy and relevance of audit findings, ultimately improving organizational governance.*

***Keywords:** Internal audit, observation, monitoring, compliance, operational efficiency*

Introduction. Internal audits are crucial for maintaining accountability, transparency, and efficiency within organizations. While document reviews and data analyses provide critical insights, observation and monitoring offer real-time validation of processes and controls. These techniques enable auditors to verify whether organizational practices align with documented policies and whether risks are effectively managed.

Observation involves directly witnessing activities, processes, and behaviors within an organization, while monitoring entails the ongoing assessment of operations and controls over a specific period. Together, they provide a comprehensive view of an organization's operational reality. This article examines the methodologies, benefits, and challenges of observation and monitoring in the

internal audit process, offering practical guidance for their effective implementation.

The role of observation in internal audits

Observation allows auditors to see organizational processes in action, providing insights that may not be evident from reviewing documentation alone. For example, observing inventory management practices can reveal discrepancies between recorded stock levels and physical inventory. Similarly, observing the workflow in a procurement department may highlight inefficiencies or non-compliance with established procedures.

Key objectives of observation in audits include:

- Validating compliance with policies and regulations.
- Identifying gaps between documented procedures and actual practices.
- Detecting inefficiencies, bottlenecks, or potential fraud.

Observation is particularly effective in areas where human behavior plays a significant role, such as customer service, inventory handling, or cash management. It enables auditors to understand the practical challenges employees face and assess whether internal controls are being followed consistently.

The Role of Monitoring in Internal Audits

Monitoring involves the systematic and ongoing assessment of organizational activities, processes, and controls over time. Unlike observation, which is typically event-driven, monitoring is a continuous process designed to track performance and compliance.

Auditors use monitoring to:

- Assess the effectiveness of internal controls over an extended period.

- Identify trends, anomalies, or risks that may not be immediately apparent.
- Ensure that corrective actions recommended in previous audits are implemented and sustained.

Monitoring can be manual, such as periodic reviews of financial transactions, or automated, using tools that provide real-time alerts for deviations from expected performance. For instance, automated monitoring tools can flag unauthorized access to IT systems or unusual spending patterns in financial accounts.

Methodologies for Observation and Monitoring

Effective observation and monitoring require systematic methodologies that ensure accurate and actionable insights. These methodologies are designed to capture real-time data, validate existing records, and assess compliance with policies and procedures. Below is a detailed exploration of the primary methodologies used in observation and monitoring during internal audits.

1. Direct Observation. Direct observation involves auditors physically visiting a site or department to witness processes and practices in real-time. This methodology provides firsthand evidence of how tasks are performed and whether they align with documented policies.

Key activities include:

- **Watching Task Execution:** For example, observing employees during inventory counts or cash handling. Auditors can compare actual practices to documented procedures and identify deviations.

- **On-Site Inspections:** Verifying compliance with safety, environmental, or operational standards. For instance, checking whether safety equipment is used properly in a manufacturing facility.
- **Activity Monitoring:** Observing interactions, such as customer service processes, to ensure consistent quality and compliance with company standards.

Direct observation is particularly useful in areas where human behavior significantly impacts compliance and performance. However, it is essential to conduct observations discreetly to avoid altering normal operations due to the presence of an auditor.

2. Process Walkthroughs. A process walkthrough involves following a specific procedure from start to finish, documenting each step and comparing it to the organization's standard operating procedures (SOPs).

Steps in a walkthrough include:

- **Mapping the Process:** Identifying each stage of the process, such as procurement, invoice approval, or product shipment.
- **Assessing Documentation:** Comparing the actual process to documented workflows to detect inefficiencies or missing steps.
- **Identifying Bottlenecks:** Observing where delays, redundancies, or unnecessary steps occur. For example, in a procurement audit, a walkthrough might reveal that vendor approvals are delayed due to unclear delegation of authority.

3. Interviews and Discussions. Engaging with employees through interviews or informal discussions provides qualitative insights that complement observational data.

Key approaches include:

- **Structured Interviews:** Asking specific questions about processes, challenges, and compliance. For example, asking payroll staff about common errors or delays in wage disbursements.
- **Focus Groups:** Discussing issues with groups of employees to identify recurring themes or systemic challenges.
- **Clarifications During Observations:** While observing a process, auditors may ask employees to explain why certain steps are performed, revealing undocumented practices or workarounds.

Interviews help auditors understand the reasons behind observed behaviors and processes, offering context that may not be apparent from direct observation alone.

4. Data Monitoring Tools. Data monitoring leverages technology to provide continuous oversight of organizational activities and detect anomalies in real-time.

Examples of tools and techniques include:

- **Dashboards:** Visual tools that track key performance indicators (KPIs) and provide alerts for deviations. For example, a dashboard may flag when procurement expenditures exceed approved budgets.

- **Automated Alerts:** Notifications triggered by unusual activities, such as multiple logins from different locations within a short timeframe.
- **Trend Analysis:** Identifying patterns, such as a gradual increase in employee overtime hours, which may signal potential inefficiencies or misuse.

Data monitoring tools enable auditors to analyze large datasets efficiently, reducing manual effort and enhancing the accuracy of findings.

5. Sampling Techniques. Sampling allows auditors to review a representative subset of data when analyzing every record is impractical. Steps in sampling include:

- **Selecting the Sample:** Using statistical or judgmental methods to choose a subset of transactions, records, or processes. For example, reviewing 50 invoices from a pool of 500.
- **Testing the Sample:** Verifying compliance, accuracy, and consistency within the selected records.
- **Drawing Conclusions:** Extrapolating findings from the sample to the larger dataset.

Sampling is particularly effective for detecting trends and anomalies in large datasets, such as financial transactions or inventory records.

6. Continuous Monitoring. Continuous monitoring involves the ongoing assessment of processes and controls over an extended period. This methodology ensures that compliance and performance are sustained beyond the initial audit period.

Key activities include:

- **Real-Time Data Collection:** Using automated systems to track activities continuously, such as financial transactions or IT access logs.
- **Periodic Reviews:** Regularly reviewing key metrics or control reports to detect changes or deviations.
- **Follow-Up Audits:** Revisiting areas of concern highlighted in previous audits to assess progress and sustained compliance.

Continuous monitoring is particularly effective for high-risk areas, such as financial management or IT security, where constant oversight is essential.

Summary of methodologies for observation and monitoring

Methodology	Description	Example
Direct Observation	Witnessing processes and activities in real-time to validate practices.	Observing inventory counts to ensure compliance with recording policies.
Process Walkthroughs	Following a procedure from start to finish to compare it with documented workflows.	Analyzing the procurement process to identify delays in vendor approvals.
Interviews and Discussions	Engaging with employees to gather insights and understand challenges.	Interviewing payroll staff to identify common errors in wage calculations.
Data Monitoring	Using technology to track KPIs, trends, and	Employing dashboards to monitor

Tools	anomalies.	spending patterns in procurement.
Sampling Techniques	Reviewing a representative subset of data to draw conclusions.	Verifying 50 invoices out of 500 to assess compliance with procurement policies.
Continuous Monitoring	Ongoing assessment of processes and controls over time.	Using automated alerts to detect unauthorized access to IT systems.

By employing a combination of these methodologies, auditors can ensure a comprehensive approach to observation and monitoring. Each method contributes unique insights, allowing auditors to validate compliance, assess operational efficiency, and identify risks effectively. The integration of traditional techniques with modern technology enhances the accuracy, efficiency, and impact of internal audits.

Challenges in Observation and Monitoring

Despite their benefits, observation and monitoring present several challenges:

- **Bias and Subjectivity:** Observations can be influenced by the auditor's perceptions, leading to potential biases in findings.
- **Resistance from Employees:** Staff may alter their behavior when they know they are being observed, creating an inaccurate representation of normal operations.

- **Resource Intensity:** Both observation and monitoring require significant time and effort, particularly in large or complex organizations.
- **Integration with Technology:** Implementing and maintaining monitoring tools requires technical expertise and financial investment.

Best Practices for Effective Observation and Monitoring

To maximize the effectiveness of observation and monitoring, auditors should adopt the following best practices:

- **Define Clear Objectives:** Identify specific questions or concerns that the observation or monitoring aims to address.
- **Use a Risk-Based Approach:** Focus on high-risk areas where non-compliance or inefficiencies are most likely to occur.
- **Leverage Technology:** Incorporate automated tools to enhance efficiency and reduce manual effort.
- **Engage Employees:** Explain the purpose of observation and monitoring to gain cooperation and reduce resistance.
- **Document Thoroughly:** Maintain detailed records of observations, findings, and evidence to ensure transparency and accountability.

Conclusion. Observation and monitoring are indispensable tools in the internal audit process, providing real-time insights into organizational practices and controls. While observation offers immediate validation of processes, monitoring ensures ongoing oversight of performance and compliance. Together, these techniques enhance the relevance and accuracy of audit findings, enabling organizations to address risks, improve efficiency, and strengthen governance. By adopting systematic methodologies and best practices, auditors can overcome

challenges and maximize the impact of observation and monitoring in internal audits.

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