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### **FINANCING DIVERSIFICATION AND INTERNAL AUDIT FOR LOCAL BUDGET EXPENDITURE IN UZBEKISTAN**

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#### **Abstract**

Sustainable financing of local expenditure requires both a broader funding base and reliable control over public resources. Dependence on transfers limits planning flexibility, while alternative financing can create future repayment and guarantee obligations. The central proposal is therefore to coordinate financing diversification with risk-based internal audit. Projects should be assessed through their lifecycle costs, fiscal exposure and measurable service outcomes, rather than the amount of private or external capital attracted.

**Keywords:** Local budgets; financing diversification; contingent liabilities; internal audit; digital financial control.

Mortgage refinancing illustrates Uzbekistan's diversification experience. In 2025, approximately 9,000 citizens received mortgage loans totalling UZS 2.2 trillion. International financing comprised USD 30 million from the Asian Development Bank, USD 20 million from the International Finance Corporation and USD 13 million from the European Bank for Reconstruction and Development: USD 63 million in total. Domestic capital-market funding reached UZS 600 billion [1]. The implementation note reports authorised capital raised to the equivalent of USD 100 million [5]. These national figures demonstrate financing capacity, without establishing local budget savings. Cross-currency



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comparisons require a common conversion basis; capital stocks and financing flows remain distinct.

The proposed local financing portfolio combines budget allocations, international financial institution resources, domestic capital-market instruments, bank co-financing and public-private partnerships. Mortgage-backed instruments are relevant where suitable loan pools exist. Source selection should reflect project purpose, effective financing cost, maturity, currency exposure and repayment capacity. Public funding remains necessary for essential services without adequate commercial revenues. Partnership arrangements require disclosure of future public payments and guarantees, since reduced initial expenditure may conceal substantial lifecycle commitments [2].

Financing diversification is measured by  $D = 1 - \sum_{j=1}^m s_j^2$ , where  $s_j$  denotes non-overlapping source shares summing to one, calculated for a common period and currency. A larger value indicates broader distribution, without proving lower risk. Financing cost is assessed through  $WACF = \sum_{j=1}^m s_j c_j$ , where  $c_j$  includes annual effective interest, fees, issuance and applicable hedging costs. The direct budget burden is  $KB = B/F \times 100$ , with B representing budget contributions and F total project financing,  $F > 0$ . Its adjusted form,  $KB^* = [B + PV(CL)]/F \times 100$ , adds the present value of contingent and guaranteed public obligations beyond B, without double counting. Discount assumptions must be disclosed.

A fiscal risk passport should accompany each major financing arrangement. It records the funding source, contractual terms, currency and maturity, guarantees, repayment revenues, expected outputs and audit trail. Stress scenarios should test interest-rate increases, exchange-rate changes where relevant, and weaker demand or revenues. Linking these records to treasury and investment systems



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through common project identifiers would make financing commitments traceable from approval to payment and delivery.

Internal control and internal audit perform distinct responsibilities. Managers own operational decisions and routine controls; finance, risk and compliance functions support monitoring; internal audit provides independent assurance, consistent with the IIA's Three Lines Model [3]. Uzbekistan's 2022 budget-efficiency reforms support strengthening these mechanisms [4]. Audit priorities can be guided by  $R_i = P_i I_i (1 + C_i)$ , combining likelihood  $P_i$ , financial or service impact  $I_i$ , and control weakness  $C_i$ , with higher values indicating weaker controls. This proposed score requires calibrated scales and prioritises audit work; it is not a validated estimate of expected loss.

Remote audit should connect treasury payments, procurement, payroll and asset records. Duplicate payments, unusual supplier concentration, persistent execution deviations and fully paid projects with incomplete outputs can trigger examination. Alerts require verification and contextual assessment. A digital citizen-auditor channel can complement professional audit by collecting location-specific reports and supporting evidence. Verified signals should lead to proportionate review, corrective action and public feedback, with appropriate confidentiality. Citizen reporting supplements assurance but does not replace the auditor's independent judgement.

The cited implementation note reports a 17.8% improvement in State Budget expenditure efficiency during 2022–2023 [5]. Because its calculation method and baseline are unspecified, this figure should be treated as a reported result, rather than a causal estimate. Performance monitoring should instead combine recommendation implementation, repeat findings, coverage of high-risk activities, and changes in service quality and unit costs. Financial execution alone does not demonstrate efficiency.



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A proposed 2026–2030 sequence begins with an inventory of financing sources and public obligations in 2026, followed by risk-based audit pilots in 2027, integrated digital records in 2028, verified citizen feedback in 2029, and use of audit and outcome evidence in budget decisions by 2030. The expected contribution is a financing and accountability framework in which additional resources are matched by transparent obligations, independent scrutiny and demonstrable public-service results.

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