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THE ROLE OF INTERNAL AUDITING IN AVOIDING BANKING BANKRUPTCY

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Abstract

This paper aims to realize been assisted by internal audit in avoiding bankruptcy risk to the banks. This study emphasizes the significance of internal auditors in evaluating risk management practices at banks. The analysis covers how these auditors work, including what they help a bank do so it can make an informed decision to help mitigate the possibility of a bankruptcy.

In order to gather data, a questionnaire was designed, which was divided into two main parts; the first part measures the efficacy and commitment of internal auditors, and the second part investigates the role of internal auditing in detecting bankruptcy risks. After circulating this questionnaire, we collected 37 participants who are banking institutions, internal auditors, and professors in the relevant field in the universities.

The researcher adopted a descriptive analytical approach to evaluate the hypotheses and analyse the results. The findings, which were analysed utilizing the Statistical Package for Social Sciences, ascertain that internal auditing mitigates the risk of bankruptcy in the banking sector.

Introduction

Banks contribute significantly to economic development in emerging economies, and its cumulative impact is more pronounced than in developed economies. Such banks are well versed in promoting economic development as their focused ability to respond to ever-changing market conditions. Their strategic investments not only create jobs but also generate wealth, serving as essential pillars for economic recovery and stability in these areas. As banks grow and diversify its activities, their management and organizational structures tend to be more complex. This growth usually means expanding the services they offer customers and scaling their labour force. While expansion is something to seek, it brings greater complexity which sock them against new risks, and I mean all risks, including bankruptcy risk, which never goes more than a few steps from the company.

As such, the operational management facet of banking systems becomes so complex that managing it can get quite overwhelming. In such scenarios, risk understanding and management is the key. Internal auditing is often the source of knowledge shared with the Board of Directors regarding tackling many of these challenges and mitigating any threats that can have damaging consequences to the bank and economies at large. Internal audits can also help in assessing and strengthening the internal control frameworks within the banks. Internal audits are proven to reduce the risk of bankruptcy, making it one of the most important activities for stabilizing the institution through comprehensive assessments and efforts for improvement. This proactivity allows banks to adapt to the nuances of the business environment and ensures their long-term success and sustainability in the market.

Research Problem

This led to the following research question: 'Funding Responsible Small- and Medium-Sized Enterprises: An... - MDPI")

Internal auditing, does that significantly affect the mitigation of bankruptcies? Sub-questions have been designed to explore these questions:

1. Do the principles of internal audit get implemented substantially differently?
2. Do practices implement different procedures to prevent insolvency between different banking systems?

Hypotheses:

In order to address the main research question, three hypotheses are proposed, each one divided into four sub-hypotheses.

The first assumption is that there are not many differences in the practical implementation of internal auditing principle.

The first sub-hypothesis states that the principles of internal auditing do not differ based on age.

Second sub-hypothesis: The qualifications do not affect the application of internal auditing principles.

The third sub-hypothesis indicates that the implementation of internal auditing principles shall not vary according to job title.

As indicated in the fourth sub-hypothesis, there is no statistically significant difference in the application of internal auditing due to experience.

After bankruptcy of any of the lenders, the secondary primary hypothesis states that the performance of the action procedures is not significantly different from the ability of the action procedures that significantly reduce the bankruptcy percentage.

As per second sub-hypothesis, there is no major effect of age in implementation of these procedures.

The following sub-hypothesis suggests that qualifications have no significant effect on the application of bankruptcy risk mitigation procedures.

The last sub-hypothesis states that job titles do not affect the use of these procedures.

According to the fourth sub-hypothesis, the application of procedures for reducing bankruptcy risks does not vary significantly due to experience.

The third main hypothesis contends that internal auditing does not have a significant impact on reducing bankruptcy risks at a significant level of 0.05.

The efficiency of internal auditors is not significant in reducing bankruptcy risks at the 0.05 significance level, according to the first sub-hypothesis under this main hypothesis.

The second sub-hypothesis states that internal auditors' commitment is not significant enough to reduce bankruptcy risks at the 0.05 significance level.

The Study Significance

The significance of internal auditing in the banking system is emphasized by this study. These audits demonstrate how they can assist banks in addressing various risks, particularly the risk of bankruptcy. This paper's significance is based on the significance of its topic:

- Helping the institution evaluate and control risks is crucial for creating value.
- By pinpointing strengths and weaknesses, the institution's status can be understood, leading to actions to prevent bankruptcy.
- It demonstrates how small and medium-sized enterprises can benefit from implementing internal auditing practices.
- It emphasizes the significance of internal audits within an institution and their role in safeguarding and securing long-term sustainability.

The study was conducted using the following methods:

The field part is studied using an analytical method through a questionnaire, while the theoretical chapter is studied using a descriptive method. The SPSS program's use as a tool was instrumental in the analysis process.

The theory of auditing.

The IIA, also known as the Institute of Internal Auditors, gives a comprehensive explanation of auditing, describing it as an independent evaluation process that is systematically implemented in an organization. The goal of this process is to provide management with effective support in decision-making by thoroughly reviewing accounting, financial practices, and other operational functions. Auditing is important because it assesses the effectiveness of other control mechanisms. The assessment of these controls can verify that the organization is running well and has adhered to standards from auditing perspective. This definition emphasises the relevance of auditing for enhancing the overall governance and functional integrity of an organization. According to Leung, Cooper, and Perera (2011), auditing is the process of reviewing the financial information of any organization, whether in the private sector, public sector or not-for-profit. The American Federation of Certified Public Accountants Definition of auditing is the systematic process of objectively obtaining and evaluating evidence regarding financial statements or economic actions. This process reviews these statements for compliance with recognized standards and communicates the results to the relevant stakeholders.

Efficiency

Effectiveness and efficiency refer to how well-established goals and objectives are met in general terms, but also the quality and impact of the goal achievement. This principle is also crucial to the practice of internal auditing. Internal audit functions need to develop specific performance metrics and evaluation criteria which are reflective of the peculiarities and needs of their organization. Their success will be measured against stated goals and this customized approach will allow us to accurately present this with a focus on the quality of the audits they conduct.

Bankruptcy

The legal public record of bankruptcy suggests that a company has more debt than assets. This state is referred to as insolvency court, which is legally defined. This can affect the economy in multiple ways as the announcement of bankruptcy creates a considerable asymmetry in information in the market. Bankruptcy is initiated by the slightest indication of potential insolvency, with drastic immediate effects. This underscores the importance of perceived financial stability, which can have a ripple effect on the impacted company and other businesses and stakeholders. Filing for bankruptcy may affect the confidence and stability of the investors, or the entity itself (Dankiewicz and Szyma ska, 2020).

Businesses, individuals, and occasionally governments use bankruptcy as a legal process to manage their financial difficulties. When debts are not paid on time or when debts exceed assets, people or organizations can file for bankruptcy. The causes of bankruptcy are both internal (microeconomic) and external (macroeconomic) factors. Internal problems revolve around the company's organizational structure, management practices, and financial information access. A harmful cycle of declining business performance can be caused by ineffective management that can damage stakeholder relationships.

Recent papers show that a significant relation exists in many corporations between corporate social responsibility (CSR) activities (per the authors' categorization into environmental protection, social relationship, human rights committee, employee welfare, etc.) And the most relevant financial indicators represented by the market value and risk of bankruptcy (Myšková & Hájek, 2019). Moreover, studies in human capital management show that effective recruitment and retention of talented employees are of paramount importance for financial success (Bilan et al., 2020).

The study Tools: The study sample, method, and variables are presented in this section.

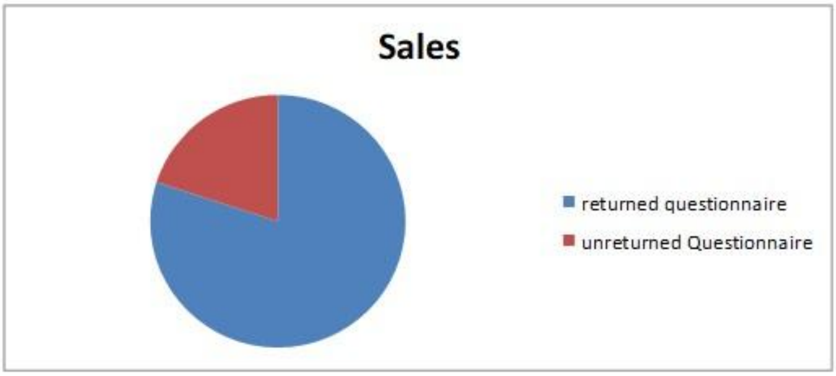
A- The study sample

This study was conducted in Baghdad by a group of consulting employees, accountants, auditors, and university professors, with 40 questionnaires distributed and 37 returned.

Table No.1: The questionnaire's statistics.

Survey	Questionnaire Percentage	
The number of questionnaires that were distributed	N.	Percentage
	40	100
Number of questionnaires that have not been returned.	8	20
The number of questionnaires that were returned.	32	80

Figure N.1 The survey's results are displayed in number 1.



Prepared by the researcher The Survey:

The purpose of this is to gather data from community members. Auditing experts prepared and reviewed a questionnaire, taking their feedback into account to correct any errors and enhance the questionnaire's validity. Two parts make up the definitive version:

1. Part One's focus is on personal information.

2. Part Two: topic-related information comprising two axes:

➢ **Axis 1: Efficiency and Commitment of the Internal Auditor (9 items)** ➢ **Axis 2: Procedures for Reducing the Risk of Bankruptcy (9 items)**

The questionnaire was filled out by the respondents using a five-point Likert scale, which had choices such as Disagree, Neutral, Agree, and Strongly Agree.

B- The study Variables

Internal auditing plays a role in preventing bankruptcies for banks, and the study focuses on two key variables: internal auditing as the independent variable and bankruptcy risk as the dependent variable.

Part Two: The Questionnaire:

Following a review of relevant scientific studies, the researchers concluded that arranging the questionnaire around these two main axes would be efficient in gathering the required information.

✓ **The first axis: personal data: which includes age, certificates, job position, and experience.**

Table No. 2: Age variance of the study sample

Age	Frequency	Percentage
Less than 30	10	25%
From 30 to 40	15	37%
From 40 to 50	12	30%
More than 50	3	8%
Total	40	100%

Source: Prepared by the researcher based on ships.

✓ **The second axis: The auditor's efficiency and commitment**

The auditor's competence and commitment were measured through 8 phrases by identifying them through a set of questions (8 phrases) in this axis.

✓ **The third axis**: Procedures to reduce the risk of bankruptcy

Nine questions were included in this axis to identify procedures that can prevent bankruptcy.

The study Reliability

To validate the questionnaire, the researcher performed several tests, including expert arbitration, in addition to the necessary tests to verify its reliability, as follows:

1- Arbitration Reliability:

The survey was found to have no scientific or methodological flaws and was adjusted to the study's objectives according to previous studies and arbitrators' observations. The survey was found to have no scientific or methodological flaws and was adjusted to the study's objectives according to previous studies and arbitrators' observations.

2. Internal consistency:

40 individuals were asked to assess the questionnaire's internal consistency by expressing their opinions on undefined phrases. Pearson correlation coefficient values were derived by comparing each statement and paragraph value to ensure consistency.

➢ **Table No.3**: The internal validity of the auditor's efficiency and commitment axis is demonstrated.

The statement	Correlation Coefficient	Significance Level
The documents submitted are evaluated and analysed by him.	0.749	0.000
Neutrality and integrity are his guiding principles when performing his work.	0.814	0.000

By contributing, he contributes to the improvement of the bank's risk management, internal control, and governance system.	0.734	0.000
He ensures that the efficiency and effectiveness of risk management are met.	0.746	0.000
He conducted an independent review of the control systems.	0.27	0.27 0
He examines the most important risk management process.	0.99	0.589
The reports he presents validate that the bank's practice complies with the specified standards.	0.163	0.371
The Audit Committee should evaluate performance to promote independence in internal audit activities.	0.250	0.167

Source: Prepared by the Researcher

According to the table, the phrases on the efficiency and commitment axis are strongly linked, with a correlation coefficient range of 0.163 to 0.814. The statistical significance of each phrase is below 0.05, except for phrases (1, 2, 3, 4) that exceeded the level, which indicates the validity of the phrases.

- The questionnaire's internal validity is questionable.

Table No.4: Demonstrates the internal validity of the statements in the second axis: Procedures to reduce the risk of bankruptcy.

The statement	Correlation Coefficient	Significance Level
He summarizes the findings, so that these findings include identifying the risks and the procedures that must be followed to avoid them.	0.873	0.00
He estimates the risks leading to bankruptcy via studying and evaluating the internal control system	0.882	0.00
Auditing the financial aspect, clarifying the true financial position of the institution, and supporting it Recommendations to avoid falling into financial difficulty.	0.861	0.00
Through the auditing process, the auditor discovers errors and fraudulent operations that occur within the bank.	0.855	0.00
Auditor's discovery and analysis of the risks that threaten the bank is a step that can protect the institution from bankruptcy.	0.795	0.00
The auditor evaluates the effectiveness of risk management and contributes to its improvement.	0.797	0.00
The internal auditor relies on the results of studying the internal control system of this bank to build the appropriate plan to work.	0.844	0.00
Risk assessment is a crucial step to address the risks that threaten the bank.	0.790	0.00

Source: Prepared by the researcher

A correlation coefficient of 0.790 to 0.882 is observed between the statements of the axis of bankruptcy risk reduction procedures in the table. The validity of the statements for their intended purpose can be confirmed by the fact that they are statistically significant at a significance level of less than 0.05.

Discussion and Results

According to the study, the perception of internal auditing concepts is not significantly different among sample members at a 5% significance level, with subsequent sub-hypotheses dividing the findings.

At a 5% significance level, there are no significant differences in how sample members perceive internal auditing concepts, which is the first main hypothesis evaluated. Age was attributed to the first of the divided sub-hypotheses.

Table No. 5: The analysis of variance

ANOVA	Total Sum of Squares	Degree of freedom	Mean of squares	F	Sig.
Between-Group Sum Of Squares- SSB	**0.203**	**3**	**0.068**		
Within- Group Sum Of Squares- SSW	**20.535**	**32**	**20.332**		
Total				**0.093**	**0.963**

In the previous table, it was demonstrated that the total squared area of the groups is 0.203, the F value is 0.093, and the significance level is 0.963, which is higher than 0.05. The sample members' perceptions of internal auditing concepts are not significantly different based on age, as demonstrated at a 5% significance level.

The objective of internal audit is to improve administrative decisions for better performance, particularly in oversight roles that protect the institution from potential risks. Internal audit is crucial for the organization. Internal auditors examine the divergent functions to protect the institution's assets, guarantee the accuracy of information exchanged, and detect any errors or manipulations that point out weaknesses in the internal control system. Their solutions aim to address these weaknesses and improve the system's effectiveness. Internal audit is a crucial resource for banks because they are particularly vulnerable to risks, such as bankruptcy. The recommendations and solutions provided by audit reports are valuable in improving the control system and supporting the management decision-making process to mitigate risks. Specific hypotheses were evaluated in this study, resulting in the following findings:

Age, qualifications, job roles, or experience did not have statistically significant differences in the application of internal auditing concepts, all with a significance level of 0.05. The response to internal auditing practices is consistent, as indicated by this. The consistency in responses was strengthened by the fact that there were no significant differences in the use of bankruptcy risk reduction procedures related to age.

The homogeneity of responses among sample members indicates that bankruptcy risk reduction procedures do not differ significantly based on qualification, job, or experience at a 0.05 significance level. Audit efficiency and commitment have a significant impact on reducing bankruptcy risks. The importance of internal audit lies in protecting assets, ensuring information integrity, and activating control systems. The internal auditor's efficiency is essential in instilling confidence in senior management's decisions, detecting errors and fraud, evaluating financial statements, and serving as a vital tool in institutional decision-making.

Recommendations:

When making decisions, management should consider auditor recommendations, as recommended by the researcher. Furthermore, it is necessary to evaluate auditor's suggestions to improve the internal audit system. Prioritizing the effectiveness of the internal control system is essential. In order to avoid risks, it is necessary to incorporate auditing into all functions. The control body should emphasize the efficiency and skills of its employees.

Conclusions:

This study points to several areas for further research:

- Examining internal audit's role in evaluating internal control systems.
- Investigating how internal audits can improve job performance.
- Analyzing internal audit's influence on administrative decisions.

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