
The Impact of Internal Control Components on the Financial Performance, in the Iraqi Banking Sector

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Abstract: The aim of this study was to investigate the impact between Internal Control Components (ICC) and the Financial Performance (FP) of the Iraqi banking sector. The selected components were control environment, control activity, risk assessment, information & communication, and monitoring. The theoretical framework in this study was based on the Agency theory. A quantitative approach using Structural Equation Modelling (SEM) was utilised as the main study design. The data was collected from a group of respondents comprising CFO, CEO, Accountants, Internal Auditors, and Audit Committee selected through non-random purposive sampling. The actual survey questionnaire was distributed to 365 respondents, and the data were analysed using SEM to determine the impact between Internal Control Components and Financial Performance. The study results indicated that the Internal Control Components have a significant impact on Financial Performance. The positive significant relations were control activity ($\beta = 0.311$, $p < 0.05$), followed by risk assessment ($\beta = 0.203$, $p < 0.05$), monitoring ($\beta = 0.176$, $p < 0.05$), control environment ($\beta = 0.164$, $p < 0.05$) and information & communication ($\beta = 0.157$, $p < 0.05$). In conclusion, the control activity is the most dominant ICC factor that affects financial performance. The main implication of the study is that Iraqi banks should focus on the improvement of Internal Control Components to enhance financial performance.

Keywords: Internal Control Components, Financial Performance, COSO Framework and Iraqi Banking Sector.

1. INTRODUCTION

For all corporate organisations and, most specifically, the banking sector, whose business climate is vulnerable to risks that must be mitigated for success and profitability, internal management is critical. Banks control the financial market in Iraq and, thus, have a tremendous effect on the country's economic development and financial stability (Hanoon, Rapani, & Khalid, 2020b). Flamini et al., (2009) stated that research undertaken over the past two decades have found that banks are more profitable with an average asset return of 2%. In the spirit of discovering the factors leading to such results, this analysis found that the financial performance of the banking sector was positively influenced by successful internal controls. Internal controls are the essential operational components that help management provide resources to customers effectively; they help ensure financial records are accurate and consistent with laws and regulations (COSO, 2013). The probability of loss is for organisations with little or poor internal controls (Asiligwa & Rennox, 2017). This fact is reinforced by the conclusions of the 1987 Report of the Treadway Commission in the USA, which stated that the lack of weakness of internal controls is the primary cause in many cases of financial reporting by dishonest firms. In reaction to well-publicized 21st century accounting crises that were seen at Enron and WorldCom, the Sarbanes-Oxley (SOX) Act of 2002 was adopted and mandated all public corporations to reveal internal controls on financial statements. SOX section 404 allows public company managers to issue an internal control report in

which they are responsible for maintaining sufficient internal controls and making claims regarding their efficacy (Asiligwa & Rennox, 2017).

However, Iraq has a thriving banking system that is relatively stable and well regulated, according to the Central Bank of Iraq, (2017). It is made up of the Central Bank of Iraq (CBI), which controls the banking industry. As of 19 July 2019, there were 77 listed banks, and these banks were categorised as Islamic Private Banks/Local Commercial Banks/Foreign Commercial Banks/Governmental Islamic Banks/Local Islamic Banks. The internal control structure of the banking sector is regulated by the Banking Supervision Policy provided by the Basel Committee (1998) for banking organisations. The Basel Committee (1998) stipulated that a system of efficient internal controls is a vital component of bank management and a basis for banking organisations' safe and sound functioning.

1.1 Problem of study

The creation and execution of proper internal controls would often contribute to better financial efficiency, according to Mawanda, (2008). Weak internal management mechanisms have been perceived to be the optimal breeding ground for bribery and controversies (Hanoon, Rapani, & Khalid, 2020a). This was the case for the Enron and WorldCom banking crises of this decade. The "Public Company Accounting Reform and Investor Protection Act" usually referred to as the "Sarbanes-Oxley Act (SOX Act)" has resulted in the passage into legislation of the "Public Company Accounting Reform and Investor Protection Act." The SOX Act specifically stipulates that the management shall take full responsibility for the internal monitoring structure of the company's financial statements and have an assessment of its efficacy (Al-waeli, Hanoon, Ageeb, & Idan, 2020).

As well, The Agency theory advanced by Jensen and Meckling, (1976) establishes that contracting is used by principals and agents to increase their resources. However, in an attempt to increase their own resources, the agents can face a dilemma of working against the interest of their principals. In order to resolve this agency problem, internal management should be used as a safety net (Jensen & Payne, 2003). In the same way, studies have shown that internal controls minimise the expense of agencies (Asiligwa & Rennox, 2017) and that this has a positive influence on a company's financial efficiency. However, rather than as a legislative and social responsibility obligation, they have not been granted the attention they merit. Internationally, the relationship between internal control practises and financial performance of tertiary institutions in Nigeria was reviewed by Ejoh and Ejom (2014), Ayagre, et al. (2014) analysed the efficacy of internal controls on banks in Ghana and only explored two components of internal control; climate of control and surveillance. The effect of internal controls and risk management on banks in Palestine was analysed by (Kemboi, 2019). The CAMEL model was used by scholars such as Islam, et al. (2014) to proxy bank financial results.

The impacts of internal controls on savings and credit cooperative societies (SACCOs) in Kenya is examined in local observational studies performed by Magara (2013); the influence of financial output of manufacturing companies in Kenya was studied by Kamau (2014); the impact of internal controls on small and medium-sized enterprises (SMEs) in Kisumu was explored by Nyakundi et al. (2014). On profitability Onuonga (2014) examined bank-specific factors using bank size, capital power, ownership and operational costs; Ongore and Kusa (2013) used capital adequacy, asset quality, management efficiency, earnings potential and liquidity (CAMEL) ratios to proxy bank-specific factors and macroeconomic metrics focused on domestic growth product (GDP), growth rate and inflation (GDP).

It is quite clear from the studies that none of these studies discussed the impact of internal controls on the financial output of the banking sector in Iraq. Moreover, despite numerous studies conducted on financial results in the banking industry, there are not as many studies conducted to stipulate inputs from internal financial performance monitors. Therefore, there is relatively little evidence of the effects of internal controls on the financial industry. To further highlight this, Onuonga (2014) stipulated that the effect of bank output determinants is inconclusive. By addressing the question "what is the effect of internal controls on the financial performance of banks in Iraq?" this thesis seeks to fill this void. "

As a result, the purpose of this paper is to assess the effects of internal controls on the financial output of sectorial banks in Iraq. This study is important because internal controls have an impact on financial results by reducing risk, eliminating theft and mistakes that may lead to material mistakes, encouraging the efficacy and efficiency of operations carried out, supplying accurate, full and timely decision-making information, and maintaining compliance with banking sector laws and regulations. Through stressing the importance of developing an efficient internal control structure that will help them accomplish their organisational goals, the study would help different people, such as senior bank management and board of directors who are mandated to rule the institutions. Furthermore, this analysis would be of value to shareholders by offering fair confidence that the goals of the undertaking in which they participate are to be fulfilled and that their investment is protected from fraud. Furthermore, this report gives advice to the government and regulatory bodies about how best to resolve real and potential problems in the Iraqi banking sector.

2. LITERATURE REVIEW

2.1 Conceptual Framework

The conceptual structures in Figure 1 suggest a clear interaction between independent variables (the control environment, risk assessment, information & communication, control activities, and monitoring) with the financial performance of the banking sector.

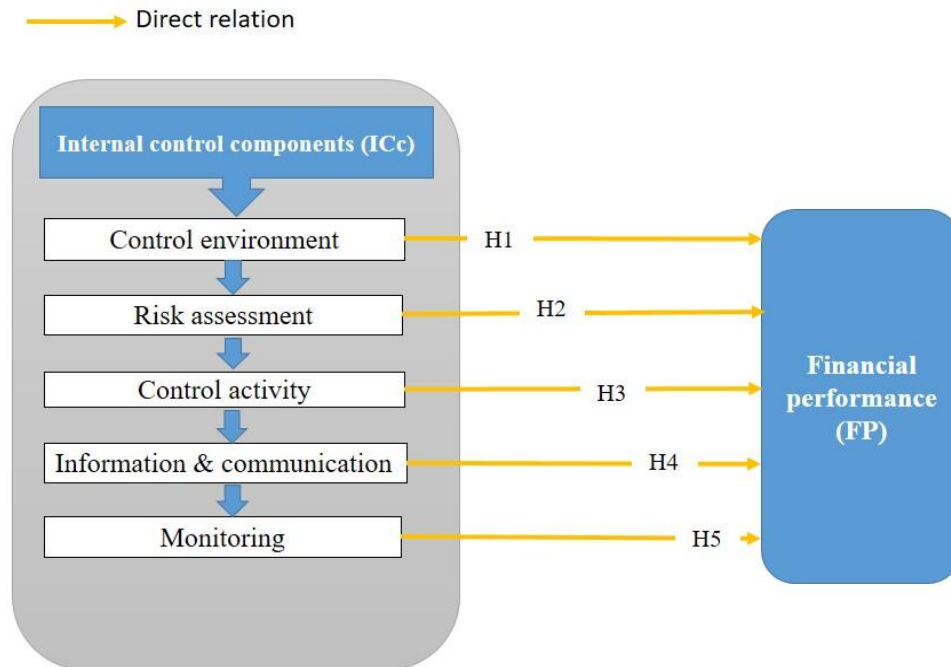


Fig.1 the Conceptual Framework

2.2 Internal Control

The COSO Internal Control System (2004) describes internal control as "a process carried out by the board of directors, management and other personnel of an entity designed to provide reasonable assurance as to the achievement of operational, reporting and compliance objectives." Internal regulation provides measures intended to offer fair confidence that the financial statements of the organisation are correct and compiled in compliance with GAAP (ICFR). International Accounting Principles (IAS) categorise internal monitoring as organisational plan, task segregation, paper management, asset security, personnel competence, calculation and accounting controls, record keeping and record reporting, regulation, authorization and consent, duty vocation and allocation, expense viability, regular and automated controls. A guideline for the assessment of internal control schemes has been provided by the Basel Committee on banking supervision. It stressed that sound internal controls are necessary for banks to function in a responsible manner and that they foster stability in the financial system. The Basel Committee has established 13 criteria to be applicable to the banking supervisory authorities in the evaluation of the internal control mechanisms of banks. These standards were organised in five main fields, namely: supervision of management and the control environment, risk identification and evaluation, activities of information sharing and monitoring & correction of shortcomings based on the COSO Process.

Pany and Whittington, (2001) note that by manipulating the conscious control of persons, the Control Atmosphere sets the tone of the organisation. It is the cornerstone of all other internal management elements which provides discipline and order. According to the COSO (2011) Internal Control - Interconnected structure, the following considerations thoroughly explain the control environment; the theory and working period of management, the division of power and duty by management, the organisation and creation of its citizens by management, the governing body's purpose and course and the concepts of integrity, ethical standards and competitiveness

Risk Management entails defining and assessing the related risks in order to meet the goals of an agency, which forms the basis for deciding how to minimise the risk. Risk evaluation is a structured method for combining expert judgement on likely adverse situations and occurrences and evaluating the possibility of potential financial and non-financial risks arising from their occurrence, with reference to the COSO (2011) internal

management structure. Risk evaluation, according to Adamu, (2020), illustrates the value of management, carefully recognising and assessing variables that may impede it from meeting its operational goals. In any business enterprise whose root is either internal or external, risk is inherent. Owing to the complex design of the market setting, risk evaluation must be a perpetual task. In any company instituted by the governing board, it forms the basis for Business Risk Management (ERM). The COSO (2004) paradigm on internal regulation presents the concept and objectives of ERM. Control operations are the processes and procedures that help ensure the execution of management guidelines and the appropriate steps to address threats to the goals of the organisation, COSO (2011). Activities in regulation take place at all stages and roles of the agency. Which requires licences, permissions, verifications, and reconciliations, organisational performance assessment, asset protection, and division of duties (Idan, Hanani, Rapani, & Khalid, 2021).

Knowledge and coordination requires the efficient detection, processing and dissemination of essential information to the organisation (Janvrin, Payne, Byrnes, Schneider, & Curtis, 2012). In the information and connectivity system, both upward and downward communication networks can be ingrained. This encourages the staff to have a clear understanding of the aspirations of the management and the management to have a clear understanding of the needs of the staff. For the purposes of informed business decision making and external reporting, a contact mechanism can relay information that are accurate, timely and appropriate from both internal and external sources. The tracking tasks include a mechanism that measures the consistency of the performance of the internal control system over time. Monitoring evaluates and aims to minimise the possibility that an organization's internal controls will not offer fair confidence that COSO's financial, monitoring and legal/regulatory targets are reached (2011). It is a feature of both the internal and external divisions of auditing. Under the above setting, reporting should occur; internal audit practises and internal management questionnaire self-assessment.

2.3 Financial Performance

Performance refers to the capacity to work successfully, profitably, to thrive, to evolve and to adapt to environmental opportunities and threats (2008). For the calculation of financial efficiency, Return on Equity (ROE), Return on Assets (ROA) and Net Interest Margin (NIM) are also used. This paper addresses ROE only. Other financial performance metrics in the banking sector other than profitability are liquidity, loan disbursement and consumer netting. Appropriate success metrics, according to available literature, are those that enable organisations to focus their efforts toward achieving their strategic goals. Success is the product of the plurality of the actions and policies of the association (Iqbal, Ahmad, Hamad, Bashir, & Sattar, 2014)(Al-Waeli, Khalid, Ismail, & And Idan, 2020) . It is important for accounting purposes to accurately assess financial results and remains a crucial issue for general associations. Output estimation programmes provide the establishment a roadmap to construct critical strategies, survey consummation of targets, and pay administrators. Despite the fact that performance appraisal is still important in marketing literature, it remains incredibly difficult (Aspal & Dhawan, 2016). A venture's financial performance is the ability to use operating and expenditure options and processes to maintain financial stability for companies (Al-Waeli, Ismail, & Khalid, 2020).

It is the indicator of the achievement of the financial goals of an organisation, driven by its financial priorities and benchmarks. As a fundamental component of the financial system, banks play an important role in contributing to the economic improvement of a country. The effect on the economy may be immense and broad, on the off risk that handling a banking sector would not work well. Study on the success of money-saving foundations is sufficient. Consequences of these studies clearly indicate that bank benefit determinants vary across nations and even across districts of the globe (Al_Khero, Janudin, Abdelhakeem, & Ahmed, 2019). As per the analysis of (Grier, 2007), profitability proportions are also used as part of banks' credit review indicators. As profitability is connected to the results of operational success, bank performance demonstrates the capacity of the bank to achieve sustainable benefits.

2.4 The Effect of Internal Control on Financial Performance.

In assessing organisational targets, Muraleetharan, (2011), found that the internal management structure and financial results were statistically important. This is in line with this study's target. Internal controls improve performance, reduce the risk of loss of funds and help ensure that financial statements are accurate and consistent with laws and regulations. Pany and Whittington, (2001), addressed the comprehensiveness of internal controls in addressing financial statements, procedures and compliance with laws and regulations to accomplish targets. Doyle et al. (2005) observed that poorer earnings output is correlated with the degree of control concerns that cannot be audited as effectively, investigating connections between disclosure of content deficiency and theft, earnings management or restatements. Efficient internal controls are one of the tools used to resolve the issues of the department, according to Magara (2013). Banks that have good organisational controls in place quickly fix the concerns of the agency, reduce agency expenses and eliminate revenue management, resulting in scandalous reporting that may lead to resource losses. The issues addressed by the institution have a detrimental influence on the viability of banks.

2.5 Hypotheses Development

The relationship between internal regulation and financial performance has been researched by many academics. Ndamenenu, (2011) reviewed internal management and its contributions to organizational productivity and efficiency: Eco bank Ghana Limited's case study. The results reinforced the statement of the Committee of Supporting Organizations (COSO) Treadway Commission that it is the duty of the management to set up the internal control structure and that the role of the internal auditor is to determine the system's efficacy or otherwise. The study concluded that the efficiency and effectiveness of internal controls lies with the internal audit team and that every company and its branches must be institutionalized. The efficiency of banks' internal control mechanisms was researched by (Ayagre, Appiah-Gyamerah, & Nartey, 2014). This study examined the components of the internal control systems of the Ghanaian banks' control environment and controlling operations using the criteria and characteristics of COSO's evaluation of the efficacy of internal control systems. The study found that components of the internal control systems of banks in Ghana are closely regulated in the control environment and in the monitoring activities. The study indicated that bank boards in Ghana should not be complacent about the outcome, but should work hard to maintain constant continuing and separate oversight of internal controls to assess that controls still operate and are working properly.

The value of the internal management mechanism in the banking sector was analyzed by Hayali, (2014), Evidence from Turkey. The importance of the internal control mechanism was reflected in this report, and its implications on the banking system were also studied. Research has shown that the internal management practices of the banks in Turkey are tailored to international norms and the banking system has efficient control procedures. Moreover, successful internal management structures have a significant influence on the Turkish banking sector's solid and secure outlook. The effect of internal control and risk management on banks in Palestine was analyzed by Bayyoud, (2015). The inquiry has helped to identify the implications of recent financial reforms and the laws on bank risk management, detection and reduction. The results found that, in terms of both quantitative and qualitative efficiency, the overall internal control and risk management structures in Palestine had a positive effect on banks (Adetiloye, Olokoyo, & Taiwo, 2016).

The effects of internal restrictions on the financial efficiency of deposit-taking Savings and Credit Cooperative Societies (SACCOs) in Kenya has been analyzed by (Inoue et al., 2013). To proxy internal regulation, the analysis used the control environment, risk evaluation, control practices, and monitoring. They also made a positive contribution to the financial results of SACCOs in Kenya. Research on the impact of internal management systems on the financial output of small and medium-scale companies in Kisumu City was carried out by Nyakundi et al., (2014). Based on the results of the report, the financial success of SMEs is greatly affected by internal control systems. The study also revealed that the introduction of internal controls was difficult, particularly in view of the fact that the internal audit feature, which is the bedrock of internal controls, is not adequately equipped with the necessary technological manpower, which has clearly affected its effectiveness. Inadequate financial services, evidenced by sporadic audit practices and the lack of frequent results, have also accelerated their inefficiency. The research showed gaps in ICSs in the market skills of entrepreneurs. Finally, the study concluded that an important positive association existed between the method of internal regulation and financial efficiency (Kim, Song, & Zhang, 2011).

In order to empirically examine the impact of internal regulation on financial output in tertiary institutions, (Ndiwa & Kwasira, 2014). Carried out an analysis led by the Agency Principle. The thesis used the analysis design of a case study. The results revealed that the Internal Audit Department of the institution was insufficiently staffed. It recommended that the Internal Audit Department be adequately staffed and that the auditors' appointment process should be free from the control of management. A study was conducted by (Ireru & Wagoki, 2014), to develop the role of components of the internal control mechanism in Kenyan public universities. The research discovered that universities had internal monitoring systems, but they were unsuccessful. In order to ensure that all staff are not only aware of controls but are actively engaged in their effectiveness, the study proposed improving instruction and instructions in internal management systems. The following theories were proposed based on prior research.

H₁: there is a positive relationship between the Control Environment and the financial performance in Iraqi banking Sector.

H₂: there is a positive relationship between Risk Assessment and the Financial Performance in Iraqi Banking Sector.

H₃: there is a positive relationship between Control Activities and financial performance, in Iraqi Banking Sector.

H₄: there is a positive relationship between Information & Communication and financial performance in Iraqi Banking Sector.

H₅: there is a positive relationship between Monitoring and financial performance in Iraqi Banking Sector.

3. METHODOLOGY

For data collecting, a questionnaire was used. Based on previous studies in the same area, the elements of both constructs have been created. The measuring origins of all products is added. The questionnaires were circulated to the respondents of 77 banks in the Iraqi banking sector (Chief Executive Officers, Chief Financial Officers, Accountants, Auditors and Audit Committee). To enter the final questionnaire, the preliminary questionnaire was subjected to a pilot analysis and the judgments of experts. To remove any uncertainty in the questions and to eliminate any hesitation, the questionnaires were delivered by hand to the respondents. It took about 4 months for the entire process of circulating the questionnaire and gathering the answers. The basic random sampling method was based on sampling. The number of survey questionnaires issued was 385, but the correct answers used in the review process were 365, resulting in a 94 percent response rate. The collected data was analysed using SPSS and SmartPLS.

4. DATA ANALYSIS RESULTS

This section presents data analysis and interpretation of the Effect of Internal Controls on Financial Performance of the Iraqi Banking sector.

4.1 Reliability Test of All Constructs

Table 1 Reliability of Instrument on The Basis of Pilot Test

Sr.	Dimension	Cronbach's Alpha	No. of items
1	Control environment	0.844	10
2	Risk assessment	0.877	10
3	Control activity	0.882	10
4	Information and communication	0.895	10
5	Monitoring	0.883	10
6	Financial performance	0.899	10
	Total	0.894	70

The reliability of the sample questionnaire was checked to check the questionnaire's reliability and validity. Table 1 displays the findings of the pilot testing and finding it to be consistent. Different scholars have listed numerous thresholds for the appropriate value of the alpha of Cronbach, but the present study used the value of 0.70 as a construct reliability threshold value (Hiraoka, 2017).

4.2 Inter-Item Correlation

According to, Kaiser, (1974) put the following values on the results (0.00 to 0.49 unacceptable, 0.50 to 0.59 miserable, 0.60 to 0.69 mediocre, 0.70 to 0.79 middling, 0.80 to 0.89 meritorious, and 0.90 to 1.00 marvelous. Hence the table 2 value of 0.760 shows that the value for KMO is middling (Kaiser, 1974).

Table 2 KMO and Bartlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.760
Bartlett's Test of Sphericity	Approx. Chi Square	12895.144
	df	2415
	Sig.	.000

Legend, df= degree of freedom, Sig. = significance

4.3 PLS Modified Model with 66 items (Measurement Model)

The model was run again after deleting four items having the factor loading less than 0.60. The modified model is presented as figure 2.

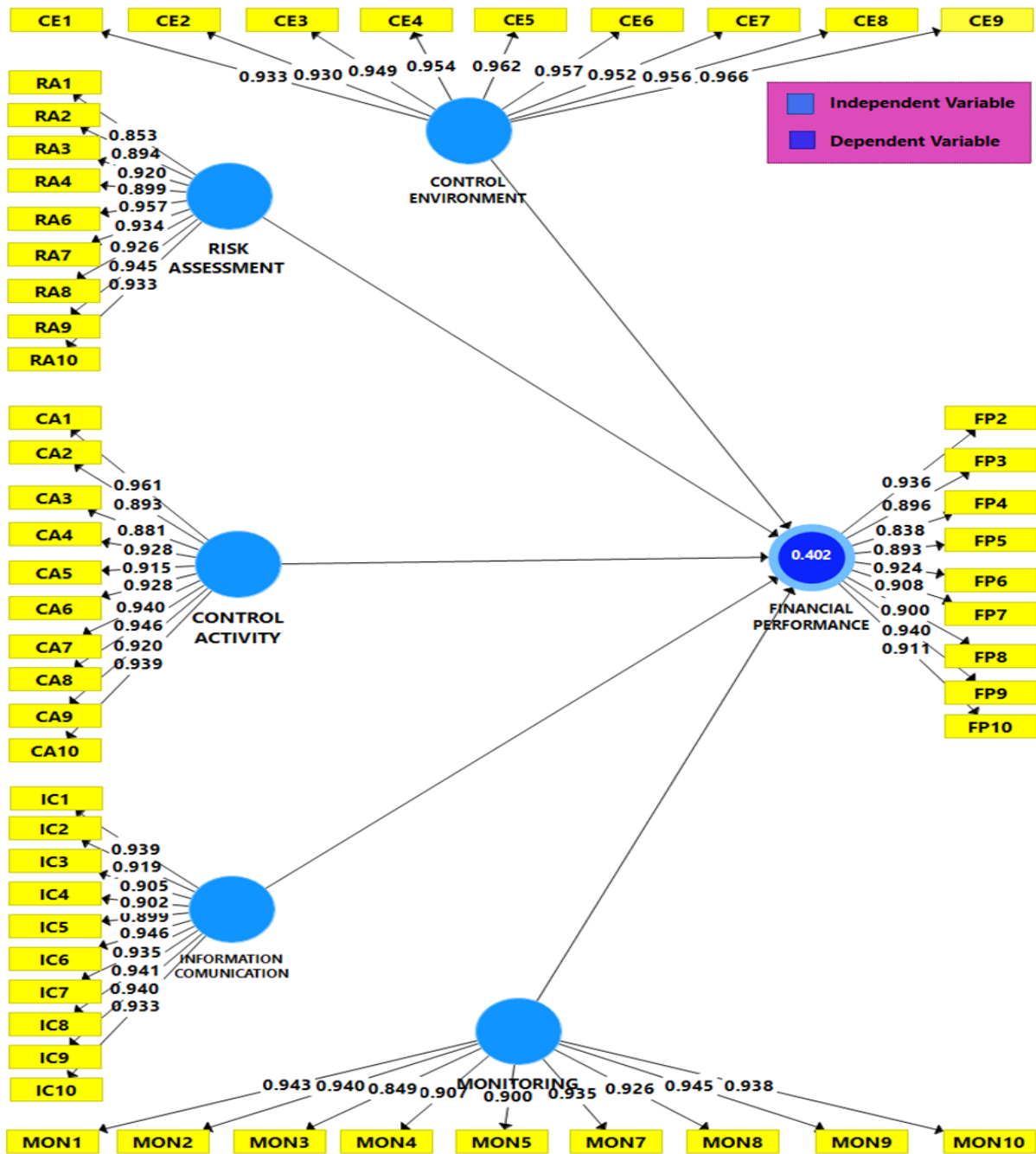


Fig.2: Modified Model 66 items and R-Square (Measurement Model)

4.4 Internal Consistency Reliability

Internal consistency is measured by composite reliability (CR) (Chin, 1998). Composite reliability (CR) takes into account indicators that have different loadings, whereas, Cronbach's alpha provide severe underestimation of internal consistency reliability and assumed that all indicators are equally weighted (Chin, 1998). Thus, this study will consider CR instead of CA. Furthermore, researcher has followed the guideline suggested by Nunnally, (1978) stated that an internal consistency is considered satisfactory when the value is $\geq .70$, whereas value < 0.60 indicate lack of reliability of measures. Table 3 shows that the CR of each construct for this study ranges from 0.976 to 0.989 and this is above the recommended threshold value of 0.7. Thus, the internal consistency reliability of the constructs is confirmed.

Table 3 Results of Final Modified Measurement model

Model Construct	CR	AVE
Control Activity	0.983	0.856
Control Environment	0.988	0.904

Information Communication	0.984	0.857
Monitoring	0.98	0.848
Risk Assessment	0.98	0.843
Financial Performance	0.976	0.820

4.5 Fornell and Larcker Criterion

Fornell and Larcker, (1981) argued that by analysing the association between the metrics of the potential competing structures, discriminant validity is calculated. The average variance shared between each construct and its metric, according to Compeau et al., (1999) should be greater than the variance shared between the constructs and other constructs. Based on the results, in their corresponding row and column, all square roots of AVE surpassed the off-diagonal elements. Table 4 tabulates the square root of the AVE; all off-diagonal elements are smaller than the square root of the AVE (bold on the diagonal). Thus, with the Fornell and Larcker criteria, the result verified the discriminant validity of the measure.

Table 4 Discriminant Validity using Fornell and Larcker's criterion

	CA	CE	FP	IC	MON	RA
Control Activity	0.925					
Control Environment	0.368	0.951				
Financial Performance	0.529	0.357	0.905			
Information Communication	0.287	0.214	0.312	0.926		
Monitoring	0.192	-0.001	0.273	0.047	0.921	
Risk Assessment	0.392	0.221	0.404	0.109	0.146	0.918

4.6 Goodness of Fit of the model GOF

Hair et al., (2017) defined GOF as the global fit measure and the geometric mean of AVE and the average of R^2 of the endogenous variables. The purpose of GOF is to account for reliance on the study model at both levels conceptually and empirically, namely, measurement. Table 5 shows that the GOF value is 0.588 greater than 0.36. The criteria of GOF to determine whether GOF values are no fit, small, medium, or large to be considered as globally valid by the PLS model have been given by Henseler et al.,(2014). The result indicated that the model's goodness of fit measure was higher than the adequate validity of the global PLS model. Structural model focus on the overall performance of the model (Henseler et al.,2014). The calculation formula of GOF is as follows: $GOF = \sqrt{R^2 * AVE}$

Table 5 Goodness of Fit of the Model (GOF)

	R Square	AVE
AC		0.901
CA		0.856
CE		0.904
FP		0.820
I&C		0.857
MON		0.848
RA	0.402	0.843
The average of (AVE)	0.861	
GOF	0.588	

4.7 Path Coefficient of Hypothesis Testing

The current study proposed to examine the effect of the relationship of the five independent variables (control environment, risk assessment, control activity, information and communication, and monitoring) on the dependent variable financial performance. For this purpose, five hypotheses were developed, and they were tested through the SmartPLS. The results of the effects are shown in table 6.

Table 6 Path Coefficient Assessment

H No	Relationships	Direct Effect β	Standard Error	T Values	P Values	Result
H1	Control Environment → Financial Performance.	0.164	0.047	3.53	0.000	Supported
H2	Risk Assessment → Financial Performance.	0.203	0.046	4.36	0.000	Supported

H3	Control Activity → Financial Performance.	0.311	0.044	7.08	0.000	Supported
H4	Information & Communication → Financial Performance.	0.157	0.039	4.04	0.000	Supported
H5	Monitoring → Financial Performance.	0.176	0.042	4.22	0.000	Supported

The results showed that all the hypotheses are supported because the P-Value summit is less than 0.05.

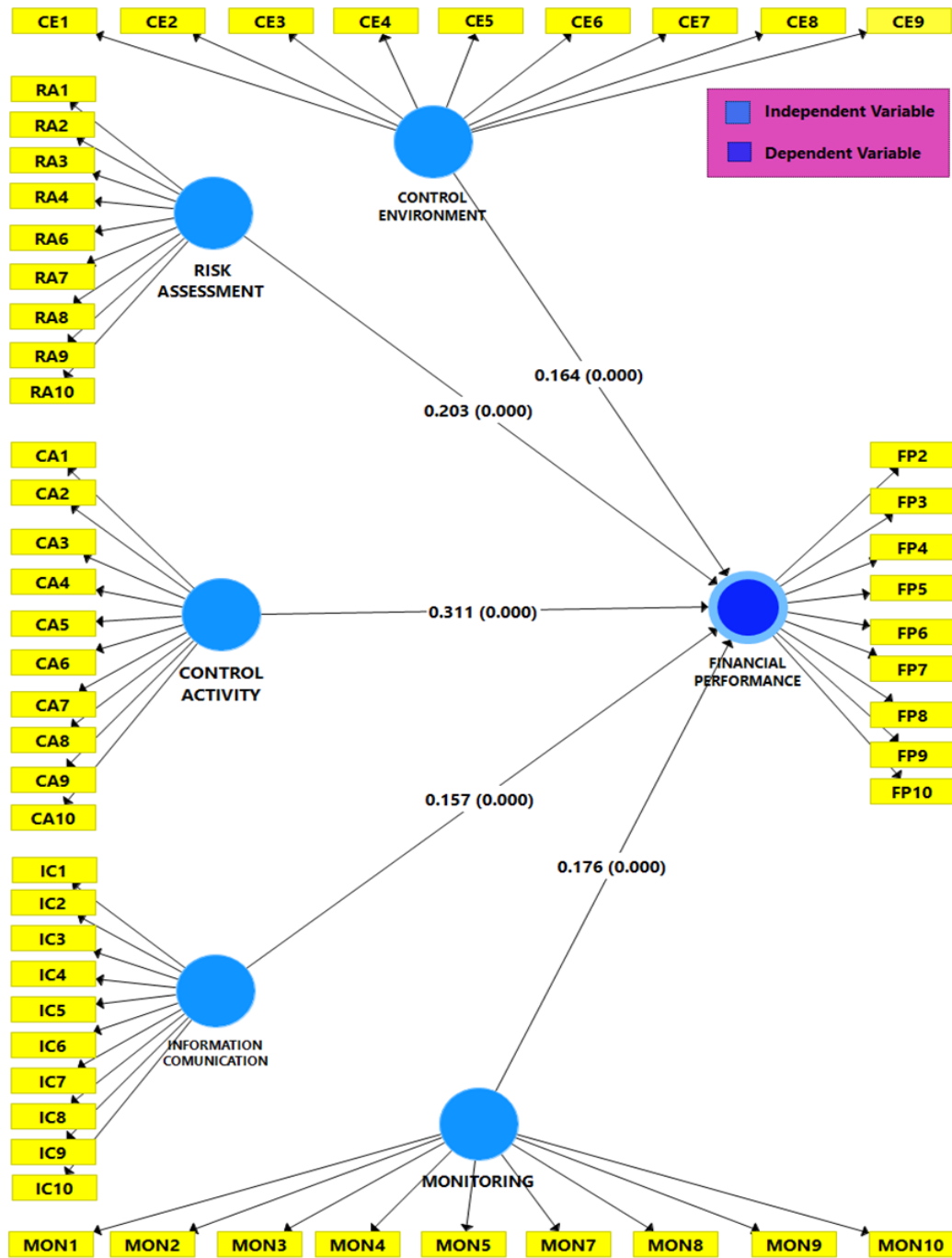


Fig.3: Model showing path coefficient with P-values

DISCUSSION

To evaluate the targets and test the hypotheses, the present analysis used SmartPLS. In addition, convergent and discriminant validity, latent variable (Fornell-Lacker Coefficient), and R² are present in this study. The path coefficient of the study hypothesis is explained in this section and focuses on direct hypotheses. In addition, the model and the study discussion are the object of concern. In SEM-PLS, the next step is to evaluate the structural model. The model checked as seen in Table 6 and Figure 3, the structural model has been clarified. The R square value was 0.40, which indicates that 40 percent of the variation of the dependent variable can be explained by the model variable (Cohen, 1988). Hypotheses suggested that the internal control components were strongly linked to the financial performance, which indicates that hypotheses are confirmed in Table 6 and Figure 3 (beta=0.164; t=3.53; p<0.000). This outcome demonstrated that the control environment was important for enhancing financial performance results and thus endorsed H₁ of the report. Similarly, H₂ is accepted, as are Risk Assessment and the Financial Performance (beta=0.203; t=4.36; p<0.000), H₃ is accepted, the effect between Control Activities and Financial Performance (beta=0.311; t=7.08; p<0.000). The big influence on the Information & Communication and financial performance (beta=0.157; t=4.04; p<0.000) was important, so H₄ acknowledged. Since the key result of the Monitoring and financial performance, a hypothesis has an effect on financial results (beta= 0.176; t= 4.22; p< 0.000), H₅ acknowledged it.

Furthermore, Banks in Iraq manage the banking environment effectively by carefully watching the execution of internal controls, giving input on internal controls to junior officers, providing a code of ethics to guide employees, separating accounting and financial divisions, creating an independent board of directors and its council, maintaining ethical standards in all decisions, contributing Risk management is performed by banks in Iraq (Hassan & Al-Amiri, 2020). The results showed that commercial banks have established suitable targets, recognised risks that could impact the achievement of these goals in the prescribed time period, have guidelines in place to assess essential risks for them, and have placed in place processes to minimise these risks as they occur during the course of doing business (Al-Taie & Shaker, 2017).

As well, In Iraq, the banking sector efficiently manages operations by consistent division of responsibilities, educating personnel on the application of accounting and financial management programmes, correcting their shortcomings by disciplinary actions, having a structured map of accounts, safeguarding access to useful information and assets, monitoring their spending (Organization, 1993), carrying out departmental budget assessments where there are differences Employs role checking on the job of the others, though, was not highly accepted. In the banking sector in Iraq, an important knowledge and communication mechanism exists. The study showed that the system ensured that timely, accurate, and credible information was detected, collected, and distributed to relevant stakeholders, and that unrestricted knowledge flow allowed employees to understand the expectations and management of management to understand the concerns of employees (Blunden & Thirlwell, 2012). There is a reporting mechanism for the financial industry that assesses the consistency and efficiency of internal controls. This is achieved by frequent and continuing assessments and thorough evaluation of execution. The regression analysis found that there is an important positive association between internal controls and the financial performance of sector banks in Iraq in the model received. It means that the improvement in units in either of the internal control elements would boost the financial efficiency of the bank sector in Iraq (Njonde & Kimanzi, 2014).

CONCLUSION OF STUDY

The impact of internal controls on the financial output of the Iraqi banking sector was identified in the report. For a population of 77 banks used, a Descriptive study Design was used. Both primary data is used as information sources. The primary data was obtained from 77 banks in Iraq through a questionnaire. By obtaining the level of education of the respondents, years of experience in the banking sector, their views on the effects of internal controls on the financial performance of banks in Iraq and the efficacy of the application of the five elements of internal controls (Control Climate, Risk Evaluation, Control Practices, Information Controls), the questionnaire is intended to gather appropriate data for the analysis. The collected data was tested for authenticity and reliability and cleaned up. For linear regression and descriptive statistics such as mean and standard deviation, data analysis was conducted using the Statistical Kit for Social Scientists SPSS and Smart PLS. The results obtained were described and discussed using maps, graphs, and tables and inferences as provided in this report.

However, the results of the study showed that banks that successfully incorporated internal management elements had comparatively improved financial efficiency. An important positive association between internal controls and the financial performance of the banking sector in Iraq has been established from the regression study, and the lack of internal controls results in negative financial performance. In short, the financial performance of the banking sector in Iraq is poor, partially as a consequence of the introduction and maintenance of effective internal controls. The highly regulated and structured atmosphere in the banking sector can be due to the lack of effective internal controls.

Recommendation for Policy Development

The study advised that, due to the risky nature of the banking sector and its effects on the country's economic development, banks should quickly enforce and retain internal controls. As a corporate governance legal provision, banks must have an independent Board of Directors and its Commission. In addition, a well-trained and staffed independent audit department should be set up in all branches of banks to promote the successful operation of internal controls.

Moreover, Banks should provide an information system in place that enables the delivery to customers of timely, correct and accurate information and the free flow of upward and downward information between management and employees. Ethical principles of decision-making, honesty, and increased expertise should be maintained. Management should ensure, above all, that an environment of shared confidence occurs within its banks. In order to improve their technical expertise and activities, banks should design and arrange ongoing courses and conferences to train their management and personnel in finance, accounting, and internal audit departments relating to internal controls, policies, and procedures. To ensure that financial statements, legal and regulatory standards are fulfilled by banks, and transparent periodic reporting to stakeholders on corporate governance, risk management, and internal controls is conducted, the Iraq Bankers Association should regulate and supervise banks in Iraq.

Limitations of the Study

As of 31 December 2018, the analysis was limited to only 77 licenced banks operating in Iraq, where five questionnaires were filled out for each bank. Only the COSO system was taken into account in the Internal Management Framework introduced, assuming that no other internal control systems contributing to financial results existed. As an indicator of financial efficiency, the analysis only concentrated on ROE, ROA, and ROS. It did not discuss how other financial performance measures, such as NIM, could be implemented in order to evaluate how internal controls apply to such financial performance measures. Study findings on the effect of internal controls on the financial performance of the Iraqi banking sector are therefore inconclusive.

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