

Research Article

**The Effect COSO Internal Control System in Reducing the Financial Risks related to
Financial Statements**

Alaa Shahb J. AL-dalmi PROF.Dr .Mohammed Yaseen Qader

Jinan University/College of Business Administration

Abstract

The research aims to measure the impact of the components of the internal control structure according to the updated COSO framework in reducing or reducing data risks in the financial statements, which contributes to improving the quality of accounting information . The study was conducted on a group of companies registered in the Iraq Stock Exchange, and the questionnaire questions were distributed to the study sample amounting to (120) and (110) forms were retrieved from them, which is equivalent to (92). The researcher reached the most important conclusions, the most important of which is that the individuals working in the study sample companies have a good level and awareness of the control environment as an essential aspect of the internal control system. The researcher made recommendations, and it is for the study sample companies to realize the importance and efficacy of the internal control system and its impact on reducing financial risks

Keywords

(COSO, ERM, Internal audit System, Risk Financial)

Introduction

The concept of the internal control system has undergone many developments in response to the changes that occur in the internal control system and the increased interest of organizations in using the available resources in a better way.(Ahmed, 142:2018), It is a set of ways, means and procedures adopted by the organization's management in order to protect assets from theft, manipulation, embezzlement and misuse, and to ensure the accuracy and accuracy of accounting data and the extent of its reliability (Abu Safi, 24: 2019). The Committee of Sponsoring Organizations of (COSO) issued in 1992 a framework that defines the components of the internal control system, which are (control environment, risk assessment, control activities, information, communication and control (Elias, 10: 2017), Risk management in organizations is closely related to the design and implementation of the internal control system within the organization, so the internal control system is affected by a group of managers, management and other workers, and it is designed to provide sufficient confidence about achieving the goals of the organization through the effectiveness and efficiency of operations, reliability of financial statements and compliance with regulations and laws (Moeller, 2015;12), Control activities occur throughout the organization and at all levels and different functions, and it includes segregation of duties and tasks, verification and review of operational performance, etc., control failure may occur due to non-compliance of workers with laws and instructions that are out of their control, so they cannot achieve the goals of the organization Therefore, the risks must be under the control of the management, and the risk management function of small and medium organizations

is subject to the management of the owner and is affected by the extent of the owner's awareness of the risks (Angeline & Teng, 2018;87). Therefore, the quality of internal audit contributes to creating a high professional efficiency of the financial worker, whether the professional is scientific or practical, by overcoming errors as little as possible, and this is what contributes to improving the performance of the auditors' work (Abdul, 109: 2016).

Problem study

Is the level of the internal control system (measured according to the updated COSO system) applied in the Iraqi private companies listed on the Iraqi Stock Exchange?

importance of studying

The importance of this study stems from the growing interest in the Iraqi economic units in the internal control systems in general and the application of the updated COSO internal control with the aim of disclosure and transparency in financial statements and reports, and reducing the risks of negligence, errors, fraud and corruption, which impose on the higher managements of those units to adopt the updated COSO framework for internal control. To improve its performance and increase the confidence of its shareholders, investors and users of all financial statements.

Objectives of the study

Measuring the impact of applying the updated COSO internal control system to reduce financial risks in the financial statements on companies listed on the Iraq Stock Exchange. Evaluation of the internal control framework according to the updated COSO framework in the application on a sample of Iraqi **Study hypothesis** companies.

Is there a correlation with the impact of applying the COSO internal control system to reduce financial risks in the financial statements ?

Theoretical conceptual framework for research

Objectives of the internal control system

1-Helping to achieve the principle of good management (governance), as well as achieving transparency by tracking all the processes that occur in the organization (Lutz, 2014: 6).

2-Raising the level of production efficiency and the effectiveness of operations by reducing waste and extravagance and preventing inappropriate use of the organization's available resources. The optimal use of resources is represented by achieving goals with the least resources (Al-Husseini and Al-Sabri, 1530: 2017).

3-Emphasis on compliance with the laws and legislation established by the supervisory authorities or by the bodies and organizations related to the preparation of auditing and accounting financial reporting standards (Al-Khairo, 25: 2014).

4-The credibility of the financial reporting standards that aim to protect the organization's assets, the honesty and fairness of the financial statements, the effectiveness and efficiency of operational processes, and the commitment to applicable policies and regulations (Jerboa, 11:2009).

The report of the COSO Committee classified the objectives of the internal control system into three types, namely (COSO, 2011,3);-

1-Operational objectives, which relate to the efficiency and effectiveness of the performance of the work of organizations .

2-The objectives of the financial performance process and the protection of assets from loss and loss.

3-The objectives of the report, which are related to the accuracy of the report, which includes the preparation of internal and external financial and non-financial reports, as well as the commitment objectives related to compliance with the laws and regulations to which the organization itself is subject .

(Falah and Jamil) believes that the importance and role of the internal control system can be determined within any organization through the following (Falah and Jamil, 2015: 321);-

-Guiding and correcting the course of the various departments within the organization .

- Helps and directs the administration instead of criticizing it

-Participate in the development of strategic plans through the opportunities and risks it reveals. -

-Appropriate ways are presented to the administration in the field of development and exploitation of economic resources .

-Provides independence and objectivity in the performance of employees or those in the audit and control profession .

The components of the updated internal control system according to the COSO framework include five main components that are determined, designed and implemented by the administration to ensure the achievement of internal control objectives. These components are (Arens, et.al, 2013; 314);-

-Control environment: which is the basis for the internal control system, because the availability of an appropriate structure in setting strategies and objectives prepared by senior departments in organizations, and the control environment contains several principles that contribute to the effectiveness of the internal control system, which are (COSO, 2019;6);-

-Demonstrates commitment to integrity and ethical values.

-The independence of the board of directors from the executive management and the supervision of the internal control system .

-Establishing the organizational structure, authority and responsibility.

-Expressing commitment to developing and maintaining employees' efficiency in line with the unit's objectives .

-Strengthening the accountability of individuals in their responsibilities within the internal control system in the follow-up and achievement of objectives .

The components of the internal control system exist whenever there is integrity and efficiency for employees. Scientific expertise and scientific qualification of employees through training and educating employees, as well as their distinction with integrity increases the effectiveness of the organization's economic work (Elder & Others, 2010; 296).

Internal Audit Functions

The internal audit function is no longer confined to protecting assets and auditing financial operations before and after disbursement, but rather it has evolved to include the financial and administrative audit function and its advisory role to ensure the fairness and validity of the financial statements and their conformity with the accepted standards in accordance with the applicable accounting policies (Al-Batout, 15: 2015). The internal audit function is an activity that evaluates all activities and processes in the organization with the aim of developing these systems and raising their productive efficiency by what they provide to management in various fields. 2020):0

1-An independent evaluation function: The internal audit should be independent of the activities that have been subject to scrutiny and criticism (Al-Wardat, 36: 2014).

2-Objective function: This means that the auditor performs his work without bias or discrimination and practices justice when collecting and evaluating the evidence and criticizing it (Stewart, Subramanian, 2010;5).

3-Consulting function: The internal auditor provides advice to the management of the organization in order to add value and improve its activity to achieve its goals by providing it with the studies, analyzes and proposals necessary for decision-making (Shurba, 48: 2015);-

4-Assurance function: The internal audit provides an independent evaluation of risk management and evaluation of the effectiveness of the internal control system, which reassures management about the results of risk assessment (Yacoub, Abboud, 154: 2014);-

5-Adding value to the organization: The internal audit function adds value to the organization's management through the objectivity of the reports submitted in order to enhance the course of the organization's work (Avram & others, 2010; 2);-

2- Objectives of the external audit

The main objective of the external audit is to critically and systematically examine the internal control systems and data used by each organization with the intent of expressing an impartial technical opinion on whether the financial statements were presented fairly and clearly and in accordance with the applicable accounting framework (Al-Kinani, 550:2020). External audit through the following points (Thomas and Henky, 319: 2007) (Al-Jaafari, 29: 2006) (Al-Obaidi, 404: 2018

1-Verifying the accuracy and correctness of the presentation of the financial statements and determining whether they express truthfully and fairly the result of the organization's activity and the degree of disclosure in the financial statements and its notes .

2-Verify the validity and legitimacy of the economic events recorded in the records, as it should be ascertained that the events actually took place, and their proof and how they were relayed should be

reviewed, and whether this was done in accordance with the specific rules and regulations and in accordance with the accepted standards and principles .

3-Verifying the ownership of the assets that are under the control of the unit, as well as the obligations arising from them. This is done by viewing the assets on the ground, as well as requesting the original documents that support the proof of ownership of the item under audit

Components of project risk management according to the updated COSO framework

In 2017, COSO issued its latest version, a new framework for managing project risks, integrating with strategy and performance. The framework itself is a set of principles, numbering (20) organized and distributed over the project risk management components. The project risk management components can be identified according to the structure of the COSO internal control system updated with the following components (Thnoun, Talluah, 165: 2020) (Romny & Stinbart, 2015; 22). (Passenheim, 2010;12)

The internal environment: it contains a set of elements such as the philosophy of risk management, which includes knowledge of risks, moral values and the amount of risk that organizations can occur and manage these risks in line with the nature of their work, which can be divided into five principles (COSO.2017;21);-

A- Practicing the profession of supervising the risks to which the Board of Directors is exposed

B - Establishment of operational structures

T- Defining the desired culture

d- Clarify commitment to core values

C - Attracting and developing the retention of experienced workers

2-Defining the goals: Most of the administrations set their goals before the events, which reflect their mission and which must be coordinated with the amount of risk tolerance, in addition to the necessity of evaluating those risks and their implications. Which can be divided into four principles (COSO.2017;21);-

A- Business context analysis

B - Determining the willingness to risk

T- Evaluate the alternative strategy

D- Formulating business objectives

1- Indications of fraud and error in financial statements

The accountant or the holder of accounting records or books sometimes resorts to concealing the error or fraud in order to hide his ignorance and incompetence by committing a deliberate error, but in good faith, as in the case of the accountant who manipulates the trial balance by changing the numbers or values of some accounts so that the deficit or loss does not appear before , The organization's management, or some try to hide a certain embezzlement so as not to be detected, so it

The Effect COSO Internal Control System in Reducing the Financial Risks related to Financial Statements

manipulates the financial data, and among these indicators are (Shafa'amri, 14:2014) (Sarah, Muhammad, 487: 2018);-

1- The difference in the accounting records, including the following

a) Financial transactions not recorded in a complete manner or in a timely manner, or recorded at an) inappropriate time in relation to the amount, accounting period, or policy of the organization .

b- Unsupported or unauthorized balances or transactions.

C- Evidence that employees may have systems and records that are inconsistent with what is necessary to perform their authorized duties .

2- Conflicting or contradictory evidence: which may include the following

A- Incomplete documents.

b- Documents in which a change has been made .

c- Important items or matches that are not understood or explained .

d- Unusual changes in the balance sheet or statement of financial position, or changes in trends or ratios of financial statements and the relationships between them .

C- canceled or incomplete checks that do not exist in the cases in which the canceled checks are returned to the organization with a statement of the bank statement of conformity .

h- Inventory or missing financial assets of significant importance .

Problematic or unusual relationship between the auditor and management, including the following -3 ;-

A- Preventing access to accounting records or books, except for those authorized to perform work .

B - Inappropriate time pressures imposed by the administration to resolve complex issues or the subject of disputes .

c- Unusual delays by the organization in submitting the required financial statements.

d- Unwillingness to amend the disclosure in the financial statements to make them more complete and understandable .

C- Unwillingness to address the specific weaknesses in the internal control system in a timely manner .

4-Other items including

A- The administration's unwillingness to allow the auditor to meet independently and personally with those assigned to perform the work .

b) Frequent changes in financial or accounting estimates that do not appear to be caused by changes) in circumstances .

c- Allow violations of the organization's code of professional ethics

Application side

First: Cronbach's alpha test to determine the stability of the resolution paragraphs. The Cronbach's Alpha method was used to measure the reliability of the questionnaire, and as shown in Table (1), the reliability coefficients ranged

Table (1)

It shows the stability coefficients of the resolution axes

Axle	Axis Address	Number	Cronbach's alpha coefficient of stability
1	There is a statistically significant relationship between the control environment and the regulatory aspect (assessment of disclosure of financial risks)	12	0.735
2	There is a statistically significant relationship between the risk assessment and the organizational side, the assessment of financial risk disclosure.	10	0.742
3	There is a statistically significant relationship between the control activities and the regulatory aspect, the evaluation of disclosure of financial risks)	11	0.703
4	There is a statistically significant relationship between information, communication and the regulatory aspect of financial risks	10	0.672
5	There is a statistically significant relationship between monitoring the regulatory aspect of financial risks	8	0.783

Second : The validity and reliability of the questionnaire

A- The validity of the questionnaire

The questionnaire was presented to a group of arbitrators, who are faculty members in the College of Administration and Economics - Accounting Department - University of Al-Muthanna, and the opinions of the arbitrators were responded to, and accordingly, the paragraphs of the questionnaire were deleted and modified, and thus the final questionnaire was issued .

B - The validity of the internal consistency of the questionnaire items

The internal consistency of the questionnaire items was calculated for the study sample, which amounted to (57) items, as well as the calculation of the correlation coefficient between all those .items

Descriptive statistics for search variables

The Effect COSO Internal Control System in Reducing the Financial Risks related to Financial Statements

Table (2)

control environment											
Q1	Q2	Q3	Q4	Q5	Q6	Q7	Q8	Q9	Q10	Q11	Q12
4.07	4.07	4.07	4.01	3.76	3.98	4.07	4.14	4.21	4.21	4.10	4.07
.766	.634	.741	.781	.961	.871	.835	.779	.832	.712	.785	.716
The risk assessment											
Q13	Q14	Q17	Q18	Q19	Q20	Q21	Q22	Q23	Q24		
4.00	4.00	4.01	4.16	4.18	4.21	4.14	3.83	3.92	4.00		
.816	.962	.827	.811	.722	.737	.803	.855	.878	.769		
control activities											
Q29	Q30	Q31	Q32	Q33	Q34	Q35	Q8	Q9	Q10	Q11	
4.23	4.10	4.05	4.10	4.00	3.00	5.00	4.00	4.24	4.16	4.20	
.719	.875	.704	.685	.000	.000	.000	.733	.731	.825	.755	
communication & Information											
Q1	Q2	Q3	Q4	Q5	Q6	Q7	Q8	Q9	Q10		
3.69	3.39	3.60	3.84	3.79	3.92	4.00	3.88	4.01	4.15		
.798	1.14	.839	.817	.884	.895	.784	.800	.693	.662		
monitoring											
Q1	Q2	Q3	Q4	Q5	Q6	Q7	Q8				
4.11	4.09	3.92	3.94	4.01	4.16	4.18	4.21				
.669	.740	.895	.718	.827	.811	.722	.737				
the regulatory aspect of financial risks											
Q1	Q2	Q3	Q4	Q5	Q6						
4.10	4.07	4.20	4.00	4.00	4.00						
.785	.716	.755	.769	.816	.962						

Third: hypothesis testing

1-There is a statistically significant correlation and effect between the control environment and the regulatory aspect (assessment of disclosure of financial risks).

To test the relationship, the One sample T test was used. The calculated T value was 26.538, which is greater than the tabular T value, which is 1.671, and the significance level is 0.000, which is less than 0.05. Therefore, the hypothesis that there is a statistically significant correlation and effect is accepted

between the control environment and the regulatory aspect assessment of disclosure of financial risks.

2-There is a statistically significant correlation and effect the risk assessment and the organizational side, the assessment of financial risk disclosure.

To test a relationship, the One sample T Test was used, and the calculated T value was equal to 25.395, which is greater than the tabular T value, which is equal to 1.671, and the significance level is equal to 0.000, which is less than 0.05, and accordingly, the hypothesis that there is a statistically significant correlation and effect is accepted the risk assessment and the organizational side, the assessment of financial risk disclosure.

3- There is a statistically significant correlation and effect between the control activities and the regulatory aspect, the evaluation of disclosure of financial risks)

To test a relationship, the One sample T Test was used, and the calculated T value was 24.445, which is greater than the tabular T value, which is 1.671, and the significance level is 0.000, which is less than 0.05. Therefore, the hypothesis that there is a statistically significant correlation and effect is accepted between the control activities and the regulatory aspect, the evaluation of disclosure of financial risks).

4- There is a statistically significant correlation and effect between information, communication and the regulatory aspect of financial risks

To test the relationship, the One sample T Test was used. The calculated T value was 21.321, which is greater than the tabular T value, which is 1.671, and the significance level is 0.000, which is less than 0.05. Therefore, the hypothesis that there is a statistically significant correlation and effect is accepted between information, communication and the regulatory aspect of financial risks .

5- There is a statistically significant correlation and effect between monitoring the regulatory aspect of financial risks

To test the relationship, the One sample T Test was used. The calculated T value was 15.619, which is greater than the tabular T value, which is 1.671, and the significance level is 0.000, which is less than 0.05. Therefore, the hypothesis that there is a statistically significant correlation and effect is accepted between monitoring the regulatory aspect of financial risks .

Table(3) shows a test schedule to prove the hypotheses that there is a correlation and effect between the five hypotheses .

Test Value = 3					
t	df	Sig. (2-tailed)	Mean Differe nce	95% Confidence Interval of the Difference	
				Lower	Upper

The Effect COSO Internal Control System in Reducing the Financial Risks related to Financial Statements

Sample Test	Axis							One-Table (3)
	Axis 1	26.538	110	.000	1.33830	1.2374	1.4392	
	Axis 2	25.395	110	.000	1.27491	1.1745	1.3753	
	Axis 3	24.445	110	.000	1.17884	1.0824	1.2753	
	Axis 4	21.321	110	.000	.96812	.8773	1.0590	
	Axis 5	15.619	110	.000	.91032	.7937	1.0269	

First: the conclusions

1-The results of the study showed that the individuals working in the study sample companies have a good level and awareness of the control environment as an essential aspect of the internal control system .

2-The results of the study concluded that the individuals working in the companies of the study sample have a good level of risk assessment .

3-The results of the study concluded that the individuals working in the study sample companies have a good level of control activities, that is, there is a state of high commitment to the policies and procedures set by their companies.

4-The study concluded that individuals working in the study sample companies have a high level of information and communication uses .

5-The results of the study showed that the individuals working in the study sample companies have a good level and awareness of monitoring and follow-up as a basic aspect of the internal control system, and this indicates that the internal control system is well monitored and followed up by the study sample companies.

Second. Recommendations

1- The study sample companies should realize the importance and efficacy of the internal control system and its impact on reducing financial risks.

2-The study sample companies should take into consideration the importance of creating the appropriate climate and control environment as it represents the cornerstone of the internal control system by providing the necessary support and attention to the transfer of expertise, skills and mutual capabilities between individuals working in specializations, financial and accounting jobs .

3-The study sample companies should pay attention to financial and accounting thought, especially those related to the aspects of financial risk, in order to achieve acceptable returns with the lowest level of risk, especially as they operate in a rapidly changing environment characterized by a high degree of uncertainty and risk .

4-The current study recommends the study sample companies to use the scientific standards and indicators used in evaluating and controlling financial risk .

5-It is necessary for the study sample companies to provide the means that raise the level of the internal control system to improve the level of financial performance of companies. There are many ways in which the system of internal control can be strengthened.

Reference

Ahmed, Ashraf Abd Rabba (Examination and evaluation of the internal control system according to - the framework of COSO in private university education), Al-Muthanna Journal for Administrative and Economic Sciences, Volume 8, Issue 2 for the year 2018 .

Elias, Ben Ali (The extent of the response of the internal control system in economic institutions - with the framework of (COSO), Master's thesis, Faculty of Economics and Commercial Sciences, Kasdi Merbah University - Ouargla - Algeria, 2017 .

Abu Safi, Sabreen Rashad (The Compatibility of the Internal Control System in Private - Shareholding Companies Operating in the Gaza Strip with the COSO Framework), Master's Thesis, The Islamic University - Gaza, Graduate Studies Unit, Palestine, 2019 .

Falah, Hussain Jassim, Jamil, Ali Tawfiq (Approval of Project Risk Management ERM to assure the - quality of control), Al-Kut Journal of Economic and Administrative Sciences, College of .Administration and Economics - Wasit University, No. 17 of 2015.

Abd, Haider Abbas (The impact of internal audit quality on the efficiency of implementing - investment budget projects in young Iraqi universities), Al-Muthanna Journal for Administrative and Economic Sciences, Volume VI, Issue Three, 2016.

Al-Hussaini, Mortada Majid Shani, Al-Sabri, Ibrahim Abdel Musa (Employment of Internal Control - Components, Quality of External Audit), Babylon University Journal, Issue 4, Volume 25 of 2017 .

Al-Khairo, Iman Muayyad (Improving the Effectiveness of Internal Control According to the COSO Model), Master's Thesis, College of Administration and Economics - University of Baghdad, 2012.

Jarbou, Youssef Mahmoud (Auditing between theory and practice), Al-Warraq Publishing and - Distribution Corporation, Amman - Jordan, 2009 .

Al-Batout, Khaldoun Odeh Abdullah (The Role of Audit Committees in Improving the Efficiency of - Internal Audit for Risk Management in the Jordanian Electricity Companies), Master's Thesis, Middle East University - College of Business - Accounting Department, 2015 .

The Effect COSO Internal Control System in Reducing the Financial Risks related to Financial Statements

- Angeline ,kiew heong, Tery , Saw(COSO enterprise risk management ; small- medium enterprise evidence),Asia-pacific management accounting journal , volume 13 , issue 2 ,2018.
- Lowers, Timothy & Ramsay Robert, & Sinason , David & Stawser , Jerry (2007) , Auditing & Assurance services , second edition , MC graw –hill,NewYourk .USA.
- Arens, Alvin,A. & Elder , Randal J , & Beasley , Mark , S. (Auditing and Assurance services) , 14th ed , pearson , 2012.
- Arens, Alivin, A,& Elder , Randal .J & Beasley , Mark.S,(Auditing and assurance services , An integrated Approach),15th ed , Pearson education INC.2014.
- COSO, INTERNAL CONTROL – Integrated framework) , january international 2019. www.COSO.ORG 17/03/2021.
- Elder, Randal & Marks. Bwasly & Alvin , A. arens (Auditing and assurance services , Boston colum Indianapolis copyright @by Pearson education,INC,2010
- Al-wardat,K,(The internal audit guide in accordance with IIA Internal standards Amman warraq publishing and distribution east,2014
- Moeller, R(COSO ENTERPRISE RISK MANAGEMENT , UNDER Standing the new integrated ERM) , New jersey . john wiley & sons,2015.
- Committee of Sponsoring Organization of the tread way internal control –Integrated framework , Newyourk ,December 2011.
- Lutz,H.(Committee of sponsoring organization of the tread way commission ;internal control – integrated framework with special of changes in the 2013 Reissue),Master thesis ,University of Applied Sciences Mittweida, Vienna,2014
- Wirawan,S.(Assessing the implementation and of management sciences & education , VOL.7(4),October 2018.
- Romney, M., Paul ,S., (Accounting information system) , Eleventh edition ,Pearson prentice hall, Pearson education international America ,2009.