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The Role of Applying Internal and External Auditing Methods in Reducing the Phenomenon of Money Laundering

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ABSTRACT

This research aimed to use modern methods in internal and external auditing and its implications for combating money laundering and conducting a theoretical study and a field study. The study included a quantitative analysis of the data of commercial banks in the capital of the study country Baghdad, which included (7) Commercial banks. The research sample included a group of (250) individuals working in these banks. The data were processed using statistical methods using the program (SPSS). The results of the statistical evaluation of the data collected using a specially prepared survey tool showed that there is an effect and a correlation between the dimensions of criminal accounting (internal audit, External audit Reasons for money laundering, the perfect effect, Consulting intellectual, considerations individuality) and the variable dependent money laundering, and the availability of a set of characteristics, knowledge, and skills that help the accountant or checker combat or contain money laundering operations. There are several methods and procedures used by it checkers to combat or have money laundering operations.

Keywords*:* Internal and external auditing, Money laundering, Commercial banking.

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INTRODUCTION

Money laundering has a significant negative influence on economic growth and is a key contributing factor to terrorism in many parts of the world, according to history. In addition, it poses a threat to the nation's reputation in the financial sector. The term "money laundering" originated from the Mafia's attempt in the 1930s in the United States to lend illicit funds for the purchase of laundering salons that were later taken over by criminal groups (Oleiwi, 2019). Financial crime is one of the images closely related to these developments. Money laundering is considered one of the most dangerous emerging financial crimes in the current era that threatens the economic growth of any country, as it is one of the modern economic crimes that is usually associated with organized crime because of its negative effects (Al-Jalili, Jamil, 2012). Financial institutions in general and banks in particular are among the most dangerous economies in most countries of the world, due to their role in providing various banking services such as foreign exchange transactions and money transfers, and they are also exposed to risks and corruption, including money laundering. Money laundering crimes due to globalization are increasingly spreading at the local, regional, and international levels, the use of modern technological means, the secrecy of a bank account, the weakness of the processes of controlling, modifying, and renewing current funds and forms of money laundering, hence the effective professional role of the accountant or auditor as an important part of the anti-laundering process Funds, due to its characteristics and integration between scientific and practical skills, knowledge and skills of accounting and auditing. The multiplicity and seriousness of the negative effects resulting from the phenomenon of money laundering led to a multiplicity of mechanisms to combat this phenomenon, Institutions that are vulnerable to money laundering and government regulators contribute to this fight. The audit profession can also contribute to this oversight and have an effective role in it. Here enters the role of the internal and external auditor in reducing money laundering through the use of modern methods to reduce that crime, the research problem lies in the existence of a money laundering process in the surveyed banks and therefore, this is reflected in the negative impact on economic activities. The importance of the study is evident effect use of modern methods and its role in reducing the Money laundering Phenomenon, research attempts to measure and diagnose dimensions of the use of modern methods and their impact on the dependent variable is money laundering, the current study is an important study that gains its importance from being a modern and qualitative study, especially since the subject did not address previous studies of the impact of the dimensions of the use of modern methods in reducing of Money laundering

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Phenomenon.So, the research aims to identify the effect of efficiency procedures and the use of modern methods in reducing one of the negative effects of money laundering in a sample of commercial banks and reaching results that can reduce the phenomenon of money laundering, and presenting the concept of using modern methods and their most important benefits and techniques used in carrying out their tasks and identifying the importance and nature of using modern methods in the organization subject to research, and determine the extent of the impact relationship between the use of modern methods and the phenomenon of money laundering.

Study Hypotheses:

H1: There is a statistically significant effect of the use of modern methods (with their combined dimensions) in money laundering in the commercial banks under study.

H2: There is a statistically significant correlation with the use of modern methods (with their combined dimensions) in money laundering in the commercial banks under study.

Default Study Form

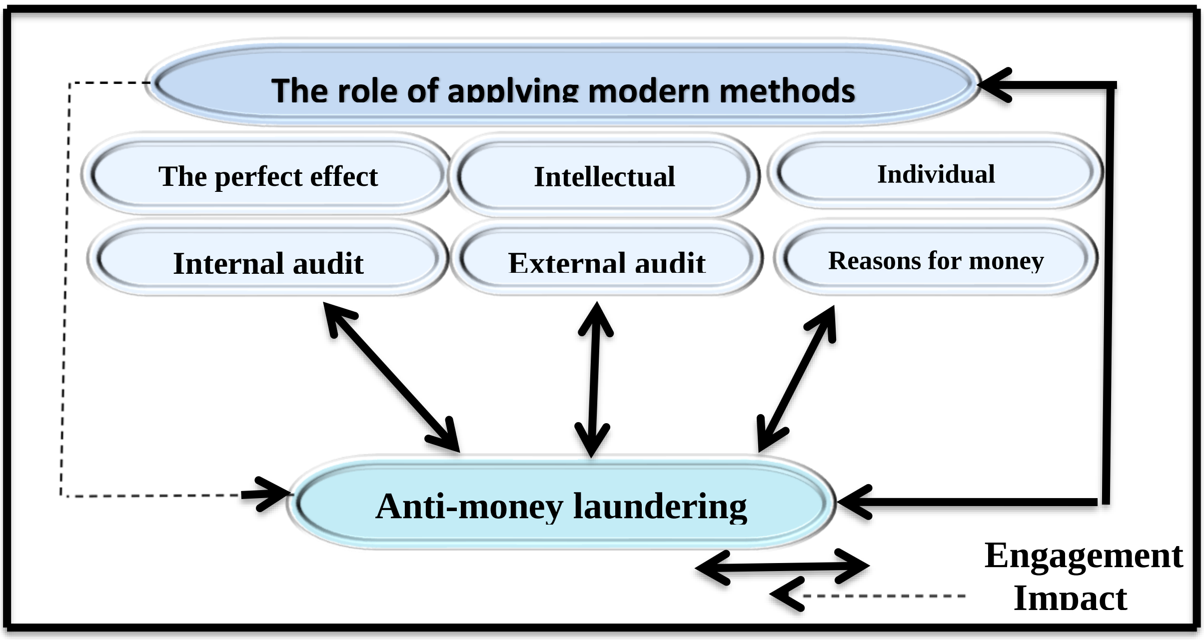

Figure 1: **T Default Search Scheme**

Source: Prepared by the researcher

Population and Sample Research:

The Iraqi commercial banking sector in the capital was identified as a population to test the model and hypotheses of the study as one of the important sectors in the population, and the justifications for testing the banks under discussion can be formulated such:

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1. Choosing the private commercial banking sector as an area for applying the study, due to the great importance of this sector in the study state economy.
2. The surveyed banks test was adopted according to the nature of the study, the available capabilities, and the extent of cooperation the banks dispatched with the researcher and based on the results of the field survey, which included personal interviews with some officials in commercial banks, and what was mentioned in the bulletins and periodic reports issued by it.
3. The selected banks are characterized by being the most active and spreading their branches in the governorates of Iraq.

DATA COLLECTION METHODS

The researcher adopted several methods in collecting data, including:

1. Continuous review of books, scientific journals, and some foreign and Arabic publications related to the subject of the study, the use of modern methods, and the issue of money laundering
2. Reviewing what was published on the Internet in terms of the use of modern methods and the issue of money laundering survey form.
3. Interviews with the respondents among the decision-makers in the banks under study.

Money Laundering

The practice of converting unlawful riches into legitimate gains is known as money laundering. Put another way, turning filthy money into clean money. Le-Khac (2016) emphasized that the majority of criminals want to profit financially from these sorts of organizations by using illicit methods. Through this process, criminals may enjoy their unlawful behavior without worrying about getting caught. A significant amount of illegal money can be generated by bribery, prostitution, arms smuggling, cyber and other computer crimes, drug sales, human trafficking, illegal car sales, and many other illegal activities. These criminals can then use money laundering to transfer their proceeds into a financial institution. When committing any of these crimes, criminals typically find a way to move the money to a location where it is hidden or secure (Mohsin et al., 2022).

According to Colladon and Remondi (2017), criminals accomplish this by moving money outside the purview of law enforcement or by leveraging their sources. In 1989, a task team of the seven most developed economies globally, known as the G-7, was established in

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Paris to address this threat. The Financial Action Task Force on Money Laundering (FATF) was the group's official name. Among many other things, this force's main responsibility was to offer as many recommendations as possible so that these countries might implement steps to combat money laundering as a top priority on their agenda.

The Three Stages of Money Laundering:

One of the illicit financial practices that entrepreneurs should stay away from is money laundering. The Financial Action Task Force, a special task force, believes that money laundering occurs when funds obtained unlawfully are processed to conceal their true source. Primorac (2018) stated that a variety of illicit activities, including drug smuggling, illegal arms selling, terrorist activities, organized crime, human trafficking, embezzlement, and prostitution, are the sources of this money. We compiled and depicted the three universally acknowledged processes of money laundering in order to educate the businessperson on what money laundering truly is and includes.

Stage 1- Placement

Payment of illicit funds is referred to as placement. The process of money laundering begins here. At this point, the money launderer adds the illicit funds to the financial institution and moves them around. According to Demetis (2018), in order to carry out this illicit crime, large sums of money are broken up so that no law enforcement agency can find them. Following this, a financial institution receives funding in a variety of ways. Depositing these modest portions of the money profits into many bank accounts is one strategy to send money into circulation while preventing legal authorities from seeing any larger transactions that draw attention or flagging them as suspicious. After being bought, money orders, deposit checks, and other financial instruments are put into circulation. Money is most frequently smuggled into nations with lax laws against such behavior.

Stage 2- Layering

Laby and Frankel (2015). Said that the term "layering" alludes to the creation of intricate transactions used to detach illicit funds from their source. That is the money laundering process' second phase. Illicit revenues are transported several times and to multiple locations during this procedure. This is accomplished by moving illegal proceeds across bank accounts and occasionally across international borders. The most popular destinations are those with lax laws prohibiting such unlawful activity, nations that disregard FATF guidelines, or those with ineffective anti-money laundering (AML) systems. Offenders can also purchase

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stocks and other financial assets with this money. Some criminals purchase items and then resell them to another nation in order to obtain lawful money. Layering is another term for this method of money laundering.

Stage 3- Integration

Integration is the process of reintegrating money obtained through illegal means into the economy in a way that makes it appear legitimate. This is the last and third method of money laundering. At this point, money starts to flow again, and the financial institution regains its legal status. The Chaikin (2017). Outlined how criminals participate in the economy by purchasing pricey goods or real estate. Criminals typically buy up or establish businesses or organizations in nations with tight laws and regulations. They can spend the money in this manner and avoid being discovered.

The Basic Stages of Money Laundering Operations

Table 1: *The Basic Stages of Money Laundering Operations*

Stage	Recruitment	Camouflage	Merge
Objective	Introducing illegal funds and investing them in the financial cycle.	Concealing the source of funds is illegal by diverting funds from their source to another state or in the same state	Show illegal money as legitimate and legal money
Methodology	Transferring illegal funds and re-collecting them and employing them in well-studied places in preparation for their legitimacy	The use of countries with tax money laundering entities, permissive banking systems, and non-strict laws to remove illegal funds from their source to make it difficult or prevent knowing their source	Giving a legitimate formula for illegal funds, re-employing them, and introducing them into the economic cycle to make them look like legitimate funds
The mechanism	Exchanging illegal cash for other forms of money through casinos, restaurants.	A number of lengthy, complex, and sequential processes are used, and at this stage the banking system (banks, financial institutions, and other financial activities) and the establishment of fictitious	Using advanced technologies by re-employing and investing money and introducing it into the economic cycle.

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		companies or investments in real companies.	
Properties	The most vulnerable and most dangerous stage. The length of the period between collection and recruitment. Its liquidity is very large.	Safer and less dangerous than its predecessor. Depends on the complicity of others, whether individuals or companies, or both. Looking for countries whose laws or regulations you can break	Safer, less dangerous, and more difficult detection can take several years and depends on the use of cutting-edge technologies in all fields, especially in information and communication technologies.

Source: Prepared by the Researcher

Negative Effects of Money Laundering Operations:

Money laundering is a serious financial crime that has many negative repercussions, including economic, political, social, and banking. (Idowu and Obasan, 2012) (Kelkaran and Rao, 2013)

1. **As for the Economic Effects:** The existence of purchasing power that does not come from real economic activity, which supports inflationary pressures in the country's economy, an increase in the general level of prices, and the emergence of distortions. It contributes to the distribution of resources and wealth in the economy and undermines the ability of government agencies to effectively implement economic policies. Decreased economic growth due to the diversion of funds into unnecessary investments at the expense of profitable ones, which led to a distortion of the economy. A picture of the financial markets, where the purchase of securities is not a real investment, but to end a certain stage of money laundering at a high cost.
2. **As for the Political Effects:** Damage to the state's reputation with regard to international aid organizations and donor credits, especially to developing countries, and the possibility of directing money laundering operations to finance terrorist organizations, which leads to destabilizing security and stability within countries, and the possibility of money launderers infiltrating state agencies and decision-making centers, leading to chaos Corruption and influence on state stability policies.

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3. **As for the Social Effects of Money Laundering, the Most Important of them are:** It creates an imbalance in the distribution of national income and social values because it increases the value of money regardless of its legitimacy, widens the gap between the rich and the poor and leads to social instability and lack of real jobs, which exacerbates the problem of unemployment.
4. **Regarding Banking Implications:** It can be said that sudden withdrawals and transfers related to money laundering lead to the creation of a liquidity deficit available to banks and thus cause the bankruptcy of the entire banking system and the spread of corruption in the banking system as a result of the temptation of money launderers that the employees of some banks neglect the money laundering operations that they carry out and the electric money laundering operations in banks, which leads to undermining confidence in banks and the banking system as a whole. This results in the reluctance of local and foreign investors to deal with the banking sector, which affects the reputation of the bank and exposes it to bankruptcy and complete collapse.

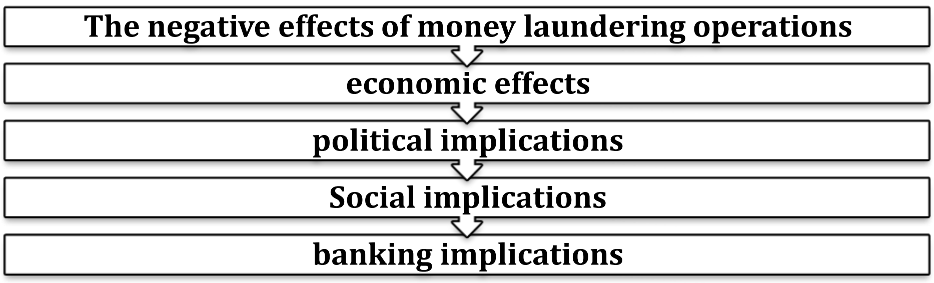

Figure 2: The negative effects of money laundering operations

Internal and External Audit Concept:

An organization's internal control, comprising its governance in accordance with legal requirements and its internal financial accounting procedure, is assessed by an internal audit. According to Shahimi *et al*., (2016), internal auditing is an essential management technique that helps businesses maintain timely and accurate financial reporting while increasing operational efficiency.

An external audit is a review of a company's financial accounts carried out by impartial accountants. According to Alzeban and Gwilliam (2014), the external audit makes sure that the company responds properly to its financial performance and is free from fraud.

The roles of external and internal audits are complementary. While an external audit can provide honest, accurate, and unbiased comments on the financial reports supplied, an internal

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audit is in charge of execution within a firm. Furthermore, it is simpler for internal auditors to voice their ideas and proposals since they may gain from external audit efforts (Arens *et al*., 2012).

An internal audit's main goal is to manage risk and evaluate the organization's internal governance so that its internal control system can function as intended. The role of internal auditing assists in coordinating internal policies with the goals and objectives of the company. In contrast to external audit consultancy, the internal audit department carries out a more thorough examination of the business's experiences and offers unbiased perspectives on its operational efficiency. Muthui *et al*., (2014). Building a bridge between the company and all stakeholders is what an internal audit does.

Alignment between the Internal Auditor and the External Auditor:

However, the MoF must get specific approval for all such activities. The decentralization of the ministry's activities appears encouraging and hopeful, but a number of analysts are dubious of the authority's ability to support and facilitate the success of market forces and to enable the private professional body to embrace them. According to Dai *et al*., (2000), the public's persistent requests for the CICPA to operate as an independent organization, particularly from stakeholders and requesters, have resulted in a slow and frustrating journey toward achieving complete autonomy.

Due to the internal audits' steady expansion over time, external audits now primarily rely on internal audit work for their operations (Schneider, 2009). When internal audit efforts satisfy certain requirements, external auditors are permitted to depend on the internal audit function under the Public Company Accounting Oversight Board (PCAOB) Auditing Standard No. 5 (AS5). When depending on the work of the internal audit, external auditors would be more successful (PCAOB, 2007). Xu (2005) contends, however, that there are four different kinds of relationships that exist between internal and external audits: information sharing, partnership relationships, cost-benefit relationships, and no relationships at all. The connection based on information exchange was the most successful, in his opinion.

According to Zhuang & Wang (2007), a strong internal control framework is necessary to support the external audit function. The work of the internal audit department can help external audit companies, and the execution of an independent audit is more successful if the company's general manager and chairman have distinct duties. Using information from industrial businesses listed on China's share market between 2005 and 2008, Cai (2009) investigated the

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impact of internal audit quality on audit pricing and earnings management. He discovered that there was a negative correlation between the quality of the internal audit and unanticipated audit expenditures, as well as a negative correlation between the quality of the internal audit and positive but not statistically significant earnings.

Moreover, both internal and external auditors consider it significant that internal audits participate in the external audit process (Smith *et al*., 2010). According to Al-Twaijry *et al*., (2004) research, the degree to which the external auditor relies on the internal auditor's work changes based on how well the internal audit department is thought to be doing. Additionally, research on non-financial sector businesses listed on the Hong Kong Stock Exchange was done by Ho and Hutchinson (2010) to offer early evidence in favour of the idea that the internal audit role lowers the work and costs associated with external audits.

According to Schneider (2009), the internal audit function is a valuable component of the company's entire internal audit system that external auditors may depend on. The internal audit work previously completed on the auditing of accounts, trans-audits, or internal audits on internal audits, however, can be relied upon by the external auditors. Furthermore, as per the empirical research carried out by Al-Twaijry *et al*., (2004), several criteria, such as objectivity, competency, and work experience, impacted the external audit's reliance on the internal audit. Internal and external auditing standards serve as a reference for organizing the activities related to finishing the financial statement audit.

ANALYSIS OF THE RESULTS

This section aims to test the research hypotheses by examining the correlations between the variables of the study, as well as the scope of influence of the independent variable (forensic accounting) and its sub-measures on the dependent variable (money laundering).

Correlation Test

Used the Pearson correlation measure between the two research variables and the dimensions of the independent variable (forensic accounting) as dimensions independent of the dependent variable (money laundering) to test the first main hypothesis and its sub-hypotheses, as the value of the correlation lies between (1,1-), as the positive answer indicates the directness of the relationship and indicates The negative sign indicates the inverse of the relationship, and whenever the value approaches the positive or negative one, this indicates the strength of the

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correlation, and whenever the value approaches zero, this indicates a weak relationship between the variables, as shown below:

Table 2: *Matrix of Pearson Correlation Coefficients between Research Variables and their Sub-Dimensions*

Dimension/Variable	Money Laundering
internal audit	0.24*
External audit	0.02
Reasons for money laundering	0.25*
The perfect effect	0.12
Intellectual consulting	0.42**
individual considerations	0.36**
Using modern methods in internal and external auditing	0.41**

Source: Prepared by the researcher Based on the outputs of the program (SPSS: 26)

The sign (**) indicates that the correlation is significant below the level of (0.01), while the sign (*) indicates that the correlation is significant below the level of significance (0.05), and the absence of one of the two signs indicates that the correlation is not significant.

There is a significant correlation between internal auditing and the money laundering variable, as the value of the Pearson correlation coefficient between them was (0.24), and this is a direct, acceptable, and significant relationship below the level of significance (0.01), There is no statistically significant correlation between the direction of using modern methods in internal and external auditing and the money laundering variable, as the value of the Pearson correlation coefficient between them was (0.02), which is a non-significant correlation lower than the levels of significance (0.05). There is a significant correlation between external auditing and the money laundering variable, and the value of the Pearson correlation coefficient between them was (0.25), which is a direct, significant, and acceptable relationship less than the significant level (0.01). There is statistically significant correlation between the internal and external auditing and the money laundering variable, as the Pearson correlation coefficient between them was (0.12) less than the level of significance (0.05) is not significant. There is a significant and significant correlation between the ideal influence and the money laundering variables, with the Pearson correlation coefficient between them (0.42), which is a direct, moderate, and significant relationship that is less than a significant level (0.01). There is a

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significant correlation between intellectual counseling and the money laundering variable, as the Pearson correlation coefficient between them reached (0.36), At the macro level, a significant correlation was found between the variable using modern methods of internal and external auditing in general and the anti-money laundering variable, where the Pearson correlation coefficient between them was (0.41), which indicates the presence of a direct, medium, and significant relationship below the level of significance (0.01).

Testing Hypothesis

In addition to testing and analyzing the hypotheses of the correlation relationship between the research variables, this section, the results of the statistical analysis to test and measure the effect of the independent variable (using modern methods in internal and external auditing) and its sub-dimensions as independent variables affecting the dependent variable (money laundering), where multiple regression analysis has used the linearity of the second main hypothesis test and its sub-hypotheses are as shown below:

Table 3: *Results of impact analysis (multiple linear regression) at the aggregate level*

Dimensions of the dependent variable (using modern methods of internal and external auditing) combined	**The independent variable (money laundering)**		
	a test (F)	Sig.	The coefficient of determination (R2)
	7.27	0	32%

Source: Prepared by the researcher based on the outputs of the program (spss v26)

It is clear from the above table that there is a significant (statistically significant) effect when the value (sig) is at the minimum probability of (0) and it is associated with the calculated test value (F), that is, assuming the acceptance of the second main hypothesis which states (there is a significant correlation with Statistically significant use of modern methods of internal and external auditing (with common dimensions) on money laundering in commercial banks researched) and the coefficient of determination was (32%), which shows the effect of the independent variable on the dependent variable, but at a detailed level and for the purpose of testing the hypothesis The second main sub-hypothesis is used Test (t) to show the test result for each hypothesis, as shown in the table below:

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Table 4: *Results of impact analysis (multiple linear regression) at the micro level (sub-dimensions)*

Dimensions of the independent variable (using modern methods in internal and external auditing)	dependent variable (money laundering)	
	test value (t)	Sig
internal audit	**2.92	0
External audit	1.42	0.16
Reasons for money laundering	-1.08	0.28
The perfect effect	*2.66	0.01
Intellectual consulting	-0.36	0.72
individual considerations	**3.65	0

Source: Prepared by the researcher Based on the outputs of the program (spss v26)

The sign (**) indicates the highest value (t) indicates that the effect is significant below the level of (0.01), while the sign (*) indicates that the effect is significant below the level of significance (0.05), and the absence of one of the two signs indicates that there is no statistical effect.

CONCLUSION

Money laundering is one of the most serious organized and financial crimes in terms of direct economic, social, political, and moral repercussions at the individual and societal levels, despite the efforts made locally and internationally to combat this crime, it has not been possible to eradicate it or limit its negative effects.

Money laundering operations go through several stages that may eventually form an integrated life cycle, starting with illegal money and ending with legal money, despite the international efforts made at the global level, they have not yet been able to eradicate this phenomenon and limit its spread, the crime of money laundering has negative effects on all sectors that play an important role in the financial process of society. Money laundering is not modern, so its methods have evolved until it has become difficult to eradicate it.

Banks play an important role in integrating a risky operation through the transfer, use, or mixing that they undertake to hide the source of illegitimate funds. This study is considered complementary to the administrative literature in general and to combat the manifestations of

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financial corruption in particular through its presentation, and the existence of administrative and banking difficulties in identifying money laundering operations in banks, including the absence of controls to obtain information on funding sources.

The emergence of the use of modern methods in internal and external auditing and the increasing demand and spread thereof is due to the increase in fraud and financial fraud, including money laundering, to meet the need for specialized experts to provide advice and submit their reports on financial irregularities.

RECOMMENDATIONS

In light of the conclusions reached, we can recommend the following points:

1. The use of international money laundering expertise in the capital, Baghdad, especially in the banking sector.
2. Strengthening banking departments in the region with local and foreign banking and administrative skills with many years of experience in combating money laundering and increasing interest in training employees to improve banking and administrative skills.
3. The need to require financial institutions in general and banks, in particular, to enter into agreements with accounting firms that have experience in internal and external auditing through the use of modern methods.
4. It is necessary for banking services to open relations between management and banks among themselves in order to benefit from the experience of some, exchange information, and thus reduce the process.
5. Developing the necessary legal systems to combat money laundering, by adopting the necessary measures to enact the necessary legislation and updating existing legislation, because the impact of money laundering crime is not limited to geographical borders. of countries, instead, it extends and covers many countries, so money launderers are looking for more tolerant and tolerant countries and fewer countries to carry out their criminal activities.
6. Establishing an anti-money laundering department in each bank, whose presence is not limited to the bank’s management, as recommended by many international conferences, including the United Nations, and the directives of the Central Bank of Iraq in 2004 to investigate suspicious transactions and the need to provide banks with a clear sample. qualified legal and accountant staff.

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7. Cooperation and coordination between banks, financial institutions, and legal entities with regard to exchanging information and unifying banking and judicial procedures to detect money laundering and fraud and limit their spread.

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