

Audit and Risks Collaboration in Banking Sector

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Աուդիտի և ռիսկերի համագործակցության դերը բանկային ոլորտում

Պոգոսյան Ջեմմա Գ.

Ասպիրանտ, Կառավարչական հաշվառման և աուդիտի ամբիոն,
Հաշվապահական հաշվառման և աուդիտի ֆակուլտետ,
Հայաստանի Պետական Տնտեսագիտական Համալսարան (Երևան, ՀՀ)

Ամփոփագիր. Ձեռնարկատիրական գործունեության ցանկացած տեսակ գերծ չէ ռիսկերի ձևավորումից: Բանկային գործունեությունը նույնպես բացառություն չէ: Բանկային բիզնեսի համար կարևոր է ոչ թե ընդհանրապես խուսափել ռիսկերից, այլ կանխատեսել ռիսկերի հետևանքները և նվազագույնի հասցնել դրանց հետևանքները:

Բանկերը գործում են բարձր ռիսկային պայմաններում, ուստի անհրաժեշտ է կանխատեսել ռիսկերը և ձեռնարկել համապատասխան միջոցներ: Ռիսկերի կառավարման կարևոր գործիքներից է աուդիտը, որն ապահովում է թափանցիկություն, վերահսկողություն և արդյունավետություն, արդյունքում համընդհանուր մոտեցումն ու համագործակցությունը ստեղծում են միասնական և անվտանգ համակարգ:

Հանգուցաբառեր և բառակապակցություններ՝ բանկ, ռիսկ, գործառնական ռիսկ, աուդիտ, ներքին աուդիտ, արտաքին աուդիտ, ռիսկերի կառավարում, պաշտպանության գիծ, վերլուծություն, մոդելներ

Роль сотрудничества аудита и рисков в банковской секторе

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Аннотация. Любой вид предпринимательской деятельности не свободен от формирования рисков. Банковское дело также не является исключением. Для банковского бизнеса важно не избегать рисков в целом, а предвидеть последствия рисков и минимизировать их последствия.

Банки работают в условиях высокого риска, поэтому необходимо прогнозировать риски и принимать соответствующие меры. Одним из важных инструментов управления рисками является аудит, который обеспечивает прозрачность, контроль и эффективность, в результате универсальный подход и сотрудничество создают единую и безопасную систему.

Ключевые слова и словосочетания: банк, риск, операционный риск, аудит, внутренний аудит, внешний аудит, управление рисками, линия защиты, анализ, модели

INTRODUCTION. The risk management process is continuous, and its outcomes are embodied in decisions regarding the acceptance, mitigation, or elimination of risks that influence the achievement of organizational objectives. In the context of banking, the goal is not to completely avoid risks, but rather to anticipate their consequences and minimize their potential negative impacts. Banking is a dynamic business where new threats as well as opportunities are constantly emerging [3, p. 7]. Banks are involved in taking on risks, transforming them, and managing them. Risk management in banks involves a broad range of

procedures, from risk identification and assessment to the implementation of appropriate mitigation strategies. A particularly important component of this process is audit, which ensures transparency and enhances the efficiency of banking operations. The integration of risk management and audit serves as a critical tool and a highly effective approach that contributes to the early identification of risks and the continuous improvement of control and mitigation techniques within financial institutions. The purpose of this article is to examine the specific characteristics of the banking risk management system, to highlight the role of audit within this

framework, and to analyze modern approaches to risk prevention and control. The relevance of the topic is determined by the fact that, in the face of ongoing changes in global financial markets, increasing economic volatility, and the rapid pace of technological innovation, both risk and audit functions within banking governance are taking on new forms and complexities. In such an environment, effective risk management and auditing become not only central to the stability of individual banks, but also fundamental to the resilience and security of the entire financial system.

LITERATURE REVIEW. Risk management in the banking sector is a well-developed and multidimensional field, within which numerous academic studies and publications focus on assessing different types of risks, formulating risk management strategies, and examining the role of audit. Various theoretical and practical approaches in the literature emphasize not only the techniques for mitigating specific risks but also the long-term strategic objectives that arise from comprehensive risk governance. Facing multi-faceted and complex challenges in the modern world, banks need up-to-date, flexible and efficient risk management tools [9, p. 9]. The literature presents a wide range of tools and methodologies designed to assist banks in understanding the nature of their risk exposures, evaluating them effectively, and developing robust management frameworks. According to many authors, the risk-audit relationship is a critical component in this context, serving as a key mechanism for ensuring both transparency and accountability in the risk management process.

- Blaise Gnimassoun, Saqib Aziz, Samet Gunay (2019) in their study investigates 5,498 banks in 116 countries and finds that banks audited by Big Four firms exhibit significantly lower risk-taking, as reflected by higher Z-scores. The effect is more pronounced in countries with weaker institutional environments [3, p. 37-52].

- Alberto Pettinicchio (2017) in his study notices, that higher audit quality is associated with reduced systemic risk among banks. The effect is especially notable in jurisdictions with weaker regulation, indicating that strong audit standards can substitute for formal regulatory oversight [1].

- Barakat and Hussainey (2024)'s study on European banks reveals that a strong governance framework, including independent board members and active audit committees, significantly improves the quality of operational risk disclosure. Additionally, the presence of regulatory pressure and large shareholders enhances supervisory efficiency [5].

These studies demonstrate that audit quality, governance structures, and regulatory frameworks

have a significant impact on the effectiveness of risk management and risk disclosure practices in banks. Their role is particularly critical in countries where regulatory systems are weak or where the institutional environment does not support strong supervisory oversight.

RESEARCH METHODOLOGY. The bank develops a comprehensive risk assessment framework aimed at evaluating at least the following key types of risks [8, p. 10]:

1. Credit Risk
2. Market Risk
3. Liquidity Risk
4. Operational Risk
5. Reputational Risk
6. Strategic (Business Model) Risk

The risk management process within the bank is carried out in the following sequential phases [2]:

- Identification and Recognition
- Assessment and Analysis
- Mitigation and Control
- Reporting and Monitoring

These phases are consistent with internationally recognized best practices, such as ISO 31000, the global standard for risk management, which is widely implemented across various countries. ISO 31000 emphasizes the importance of structured risk management and outlines a number of guiding processes for effective risk identification and evaluation.

International experience has shown that sound risk management leads to greater organizational resilience and long-term success.

According to Basel III, the global banking system must maintain adequate resources to both identify and evaluate various risks. These risks should be managed using robust methodologies capable of forecasting potential threats and proposing solutions for their mitigation or elimination. In both international literature and banking practice, operational risk management is structured around the three lines of defense model [11], which ensures a comprehensive and accountable control environment:

1. First Line of Defense – All business units and operational departments of the bank that are directly involved in day-to-day activities where operational risks may arise. These units are responsible for identifying and managing their own risks and for reporting them to the risk management function.

2. Second Line of Defense – The risk management function, which oversees and coordinates operational risk management across the entire institution. This includes developing risk policies, monitoring adherence, and supporting risk owners in implementing mitigation strategies.

3. Third Line of Defense – The internal audit function, which independently evaluates the adequacy and effectiveness of the bank's entire risk management framework and internal control systems. Internal audit provides assurance to senior management and the board of directors regarding the integrity of risk management processes.

As the third line of defense, internal audit serves as an independent and objective assurance and advisory function aimed at enhancing the organization's overall operations and adding value [10]. It supports the continuous improvement of governance, internal controls, and risk management systems. An effective internal audit function in a bank involves at minimum the independent and impartial provision of assurance services focused on improving the performance and alignment of the bank's governance, risk management, and control processes. The bank must maintain an effective internal audit function, which entails the execution of independent and objective assurance activities aimed at enhancing the efficiency and effectiveness of the bank's governance, internal control, and risk management systems.

Internal audit typically performs the following three core responsibilities:

- Evaluate the organization's risk exposure and the effectiveness of internal controls;
- Ensure compliance with relevant laws, regulations, and internal policies;
- Recommend corrective measures to address control deficiencies or other issues identified during audits.

In fulfilling its mandate, internal audit is obligated to:

1. Conduct regular audits in accordance with the approved annual audit plan;
2. Perform targeted or comprehensive ad hoc audits and site inspections upon management's request, internal initiative, or in response to complaints received from bank employees;
3. Document all audit findings, including any identified deficiencies or deviations, and reflect them in formal audit reports;
4. Maintain the confidentiality of all information obtained during audit activities;
5. Ensure the security and traceability of all documents received from bank departments, guaranteeing their proper return;
6. Inform management about detected risks, irregularities, or deficiencies;
7. Carry out follow-up audits to verify the implementation of corrective actions;
8. Promptly notify the Head of Internal Audit about any obstacles hindering the audit function's activities;

9. In cases where legal or regulatory violations are detected, report these issues to senior management, along with recommendations to eliminate deficiencies and prevent recurrence.

Internal audit is a cornerstone of institutional integrity, serving as a key mechanism for ensuring transparency, accountability, and continuous improvement in the bank's operational and risk environments.

Effective management of banking risks and the audit function are core components for ensuring the stable operation of financial institutions. Research in this area requires the application of multidisciplinary methodologies, incorporating both quantitative and qualitative analytical approaches. In order to improve risk-related processes, the study must be comprehensive and systematic, allowing for full-scale risk assessment and the development of effective risk mitigation strategies.

Aligned with the article's objective—to examine risk management in banks and the role of audit—the research is conducted through a combination of theoretical and applied methods, including:

1. Literature Review: The first phase involves an in-depth review of existing academic literature to identify prevailing methods and approaches in banking risk management and audit. This includes both domestic and international sources to ensure a well-rounded perspective.

2. Quantitative Analysis: Financial data is collected from banks' financial statements, market analyses, and other sources. Statistical and econometric models are employed to assess risk. For instance, logistic regression models may be used for credit risk assessment, while Value at Risk (VaR) models can be applied for market risk evaluation.

3. Qualitative Analysis: To complement the quantitative data, qualitative insights are obtained through expert interviews, surveys, and discussions with bank executives. This helps evaluate the practical effectiveness of risk management processes and identify areas for improvement.

4. Systemic Analysis: Methods of systems analysis are used to assess the risk management framework in banks, including process mapping, analysis of risk identification practices, and evaluation of strategy implementation efficiency.

5. International Benchmarking: The study explores global best practices in banking risk management and audit, with the goal of assessing their applicability in the local context. This includes the analysis of international standards, regulations, and successful case studies from other financial systems.

6. Data Integration and Synthesis: All collected data and findings are synthesized to create a

comprehensive overview of current practices in risk management and audit within banks. This enables the formulation of practical recommendations and an assessment of their potential impact on banking operations.

These research methods contribute to a holistic understanding of risk governance in the banking sector, where transparency, accountability, and effectiveness are essential. This integrated approach also supports the development of modern tools and strategies for risk prevention and mitigation.

FINDINGS, RESULTS, DISCUSSION. Risk management in the banking sector is crucial for maintaining financial stability and ensuring long-term success. Banks operate in inherently risky environments, necessitating the implementation of effective management methods to mitigate a wide array of risks. This article explores the impact of risk management systems on banking operations, particularly how banks utilize risk assessment models and audit processes to enhance financial stability and reduce financial losses.

Risk Assessment Models: Banks employ a variety of models to assess the level of risks and identify appropriate mitigation strategies. In international practice, accurate assessment of financial risks has been shown to reduce losses and improve operational efficiency. These models often include specialized tools tailored for specific risk types, such as market and credit risks:

- **Value at Risk (VaR):** This model estimates the potential loss a bank may incur over a specific time horizon under normal market conditions. It is particularly useful for market risk management, as it integrates data from various factors to identify potential exposures.

- **Stress Testing:** This model evaluates the bank's financial resilience under extreme scenarios, including market shocks or economic downturns. By simulating adverse events, stress testing enables banks to develop robust strategies and contingency plans for maintaining operations during crises.

- **Credit Scoring:** This model assesses credit risk based on borrowers' credit history and analysis. It allows banks to estimate the probability of default, playing a critical role in managing lending risks.

The Role of Audit in Risk Management: Audit functions are integral to a bank's risk management processes. Beyond conducting periodic evaluations, audits uncover latent risks and prevent management inconsistencies. Audits ensure compliance with local and international regulatory requirements, thereby minimizing legal risks. Banks may implement both internal and external audits. Internal audits provide in-depth analyses of financial operations and help identify areas for reform. Auditors can offer recommendations for improved risk monitoring and operational efficiency.

Operational Efficiency and Risk Mitigation: A bank's operational efficiency is strongly linked to how

well risk management is integrated into its processes. Effective risk assessment and control mechanisms help banks maintain financial stability and minimize unforeseen losses. Thus, banks must adopt the most effective risk management strategies tailored to their operational models to preserve competitiveness and resilience. Internationally, risk management in banking adheres to global standards aimed at enhancing the effectiveness of risk evaluation and mitigation. For instance, the Basel III framework promotes systemic monitoring of major risk categories—credit, market, operational, reputational, and strategic risks—to ensure financial system stability. These regulations, developed by the Basel Committee on Banking Supervision (BCBS), aim to ensure banks possess adequate resources to manage risks appropriately. Risk management systems in banks typically follow standardized procedures aligned with best practices, such as the ISO 31000 framework, which offers a unified risk management process adopted by many banks worldwide.

At the international level, internal audit is recognized as a key component in evaluating the effectiveness of risk management systems. According to The Institute of Internal Auditors (IIA), internal auditors in banks are required to uphold high standards in ensuring proper risk governance. Internal audits not only evaluate control effectiveness but also highlight deficiencies that may lead to systemic crises or financial losses. The efficacy of internal audits worldwide largely depends on methodologies applied across banking systems. Entities such as the Financial Reporting Council [6] (FRC) and the International Auditing and Assurance Standards Board [7] (IAASB) focus on establishing global standards to ensure effective risk reviews, including in the banking sector. Internal audit empowers banks not only to understand their risk exposure but also to recommend improvements in risk management procedures. Leading governance systems incorporate internal audit as a preventive mechanism against escalating risks.

Key Issues and Recommendations:

Issue/Recommendation 1 – Enhancing Auditor Competency: From an internal audit perspective, one of the main challenges is the qualification of auditors. Improving audit effectiveness requires continuous professional education, which equips auditors with knowledge, resource management skills, and operational acumen. Banks should implement standards for regular training, certification, and international accreditation to raise overall institutional quality.

Issue/Recommendation 2 – Integrating Artificial Intelligence (AI) in Internal Audit: AI technologies can significantly enhance internal audit processes by delivering more efficient and accurate outcomes. Key applications include:

- **Data Analysis:** AI can rapidly and accurately analyze large volumes of data to detect risk factors that might otherwise be overlooked.

- **Automation:** AI can automate repetitive tasks, such as document checks and reporting, enabling auditors to focus on strategic assessments.

- **Risk Assessment:** AI can support the development of predictive models that identify potential risks and suggest mitigation measures.

- **Compliance Monitoring:** AI systems can automatically verify whether procedures and documentation comply with relevant standards and regulations.

AI-powered auditing not only improves precision but also reduces human error, ultimately boosting organizational performance. As noted by **PwC**, AI can revolutionize audit outcomes, and **Ernst & Young (EY)** highlights how AI helps banks conduct faster and more resource-efficient audits while improving risk foresight.

External Audit in the Armenian Banking Sector

In Armenia, the Central Bank holds exclusive authority over supervisory functions in the banking sector, as stipulated by the Law on the Central Bank of the Republic of Armenia. All banks and branches are required to comply with Central Bank inspections. Obstructing or interfering with lawful supervisory activities is strictly prohibited.

Additionally, a bank's board may engage an external audit firm at any time, at the bank's own expense. Audit contracts must include not only the standard audit opinion but also a management letter and verification of the accuracy of reports submitted to the Central Bank.

Issue/Recommendation – Transparency Through Centralized Platforms:

From an external audit perspective, it is recommended that the Central Bank establish a digital platform accessible to all banks, reflecting performance indicators as a percentage-based comparison, akin to international bank rating systems. Such transparency would foster competition, motivate improvements, and promote procedural enhancements and risk assessment accuracy across the sector.

CONCLUSIONS. This research demonstrates that accurate risk assessment and the implementation of effective management techniques are critical to the stability and efficiency of banks. By consistently applying specialized analytical risk models alongside audit procedures, banks can mitigate losses and improve their financial performance. All types of risk management methods should be integrated to support operational enhancements within banking institutions. Risk management and auditing play a fundamental role in ensuring the stability and success of an organization.

Auditing facilitates the identification and assessment of risks, enabling timely responses and minimizing potential adverse impacts. While internal and external audits serve different objectives, both aim to enhance organizational value. Internal audit provides the board of directors with an independent evaluation of the effectiveness of governance, risk management, and internal controls in achieving the institution's strategic objectives. In contrast, external audit delivers financial statement assurance to shareholders and the broader public, serving as a basis for informed decision-making by stakeholders. Both internal and external audits contribute to strengthening banks' risk management frameworks, thereby improving overall institutional performance. Globally recognized methodologies – such as the Basel III framework, ISO 31000, and standards issued by the International Auditing and Assurance Standards Board (IAASB) – play a vital role in maintaining financial system stability and preventing large-scale systemic crises.

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