

# Employing the International Financial Reporting Standard IFRS1 in predicting the financial failure of commercial Iraqis banks

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**ABSTRACT:** The recurring economic crises created a tense atmosphere in the business environment, especially between management and the investor or the shareholder, so the investor became very careful about his money when entering or continuing in business and looking for modern ways to evaluate the performance of the company instead of the traditional methods of financial analysis, he is very keen to stop practising business that predicts failure.

The best way to predict financial failure is to use the Altman equation, and this equation requires financial information that is sometimes difficult to obtain due to the lack of full disclosure of the result of business and ownership of companies, so the IFRS1 financial reporting standard ensures obtaining the appropriate information to apply the Altman equation.

The mentioned equation was applied to a sample of Iraqi private banks listed in the Iraqi Stock Exchange, which are obligated to apply financial reporting standards by law and disclose the appropriate information specified by the standard and Iraqi legislation. The result was that the banks of the research sample enjoy a safe financial performance, and there are no Including banks threatened with financial failure according to the Altman model.

**Keywords** – Accounting standards, IFRS, performance evaluation, Altman, predicting, failure.

## I. INTRODUCTION

Attention to accounting standards has become one of the priorities of commercial work because of its beneficial aspects that guarantee the rights of management and the investor. Following them has become a management duty, especially in international companies that crossed continents and have multiple branches distributed between countries. Standard No. 1 of the financial reporting standards determines the level of disclosure required from Companies are financial statements that express the results of the companies' business and determine the ownership of the company due to its assets and liabilities.

Management and investors each of their fear that the company will be unable to fulfil its financial promises to others and thus fail to carry out its business. Therefore, each of them is looking for a way to evaluate the company's future performance and predict its financial failure and take decisive decisions to solve this problem before it falls into it. This assessment requires appropriate financial information that can be Obtained when disclosed per the Financial Reporting Standard

## Problem Description

How to predict financial failure and how to obtain appropriate information to predict financial failure following the disclosures of banks that follow financial reporting standards, Research problems can be identified through the following questions:

- What are the ways to predict financial failure?
- What information is appropriate to predict financial failure?
- Does IFRS 1 provide the appropriate information to predict financial failure or not?

## II. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

### A- Accounting standards.

An accounting standard is “a written statement issued by an official accounting or professional regulatory body. This statement relates to the elements of the financial statements or a type of operations or events related to the financial position and business results. It specifies the

appropriate method of measurement, presentation, disposal or communication” (Sharif, 1987: 157).

The accounting standard is a general decision rule derived from both the objectives and theoretical concepts of accounting, which guide the development of accounting methods (Belkaoui, 1981: 102). Consolidated financial statements of general-purpose and in order to reduce the potential risks of bias and reduce misunderstanding and ambiguity, the accounting profession has tried to develop standards with general acceptance and wide application.

Professional conditions and methods of using accounting information indicate the need to issue financial accounting standards to determine proper methods of measurement, events and conditions that affect the financial position of enterprises, and how to deliver appropriate and reliable information.

Below (Table #1) are the IFRS accounting standards, in effect according to the consolidated report in 2021 (the official version of IFRS in 2021)

Table #1 ( IFRS standard)

IFRS #	IFRS Standard
IFRS 1	First-time Adoption of International Financial Reporting Standards
IFRS 2	Share-based Payment
IFRS 3	Business Combinations
IFRS 4	Insurance Contracts
IFRS 5	Non-current Assets Held for Sale and Discontinued Operations
IFRS 6	Exploration for and Evaluation of Mineral Resources
IFRS 7	Financial Instruments: Disclosures
IFRS 8	Operating Segments
IFRS 9	Financial Instruments
IFRS 10	Consolidated Financial Statements
IFRS 11	Joint Arrangements
IFRS 12	Disclosure of Interests in Other Entities
IFRS 13	Fair Value Measurement

IFRS 14	Regulatory Deferral Accounts
IFRS 15	Revenue from Contracts with Customers
IFRS 16	Leases
IFRS 17	Insurance Contracts

According to what was stated in Standard No. 1, the lists that the company must disclose are:

1. Income statement
2. Financial position statement (Balance Sheet)
3. Statement of Change in Equity
4. Cash flow statement

The relevant information that can be obtained from these lists can be divided into the following groups:

- 1- revenue
- 2- expenses
- 3- Assets
- 4- Liabilities
- 5- Equity

#### B- financial failure

The concept of failure has been associated with Beaver, who is the first to use this expression, and stated that in practice, it is said that “the company failed when bankruptcy occurred, or in the event of non-payment of debts, or their interests, or non-payment of expense accounts, or non-payment of profits to shareholders.”

Financial failure is a term used by researcher John Argenti in 1986, who defined it as “the process in which the company has begun to walk the long road that ends with the occurrence of financial hardship.”

Dun & Bradstreet s defined failure as “when there are operations or business of the company followed by the assignment of property or assets in favour of creditors, bankruptcy, or the loss of creditors after failed operations, or the inability to recover the mortgaged property or foreclosure on the property of the company before issuance Judging it, withdrawing and leaving the obligations

on the company unpaid, or placing the company’s property under judicial receivership, or reorganizing the company and creating settlement procedures between the company and its creditors (Al-Ghoussein, 2004, 21).

Altman’s work for the year 1968 is considered one of the first and most important works that tried to bypass the traditional method of analysis, which was used by the former in predicting the failure of companies, relying on simple statistical methods in analyzing financial ratios in choosing one financial ratio believed to be the best in distinguishing between failed. Non-failed companies ( Al-Rihan, 2006, 10), and Altman used in building this model a more complex statistical method than the old method called the discriminatory analysis method (pike and Neale, 1999, 374), where he was able to deduce a linear relationship between a set of variables that is the best In distinguishing between failed and non-failed companies (Jabal, 2004, 196).

Altman used a sample of 66 industrial companies divided into 33 failed companies and 33 non-failed companies similar to them in industry and the size of assets. Financial ratios are considered the best performance ratios, which can predict failure (Hamza et al., 2004, 45), and put them in the form of a discriminatory equation as follows (Altman, 2000, 8):

$$Z=1.2X1+1.4X2+3.3X3+0.6X4+0.99X5$$

The following table (Table #2 )shows the metrics used in the forecasting model to predict financial failure:

Table #2 ( Z Ratio)

#X	Ratio	Details
X1	net working capital ÷ total assets	This ratio reflects the relative importance of working capital to total assets. This ratio measures the company’s net liquid assets to total assets. This ratio is one of the critical financial and analytical

		indicators, as it expresses the relative importance of current operational assets compared to total assets.
X2	Retained Earnings and Reserves Ratio ÷ Total Assets	This ratio expresses the total amount of income (profits) that can be invested or accumulated losses, called the accumulated deficit. This ratio depends on the company's age. The older the company, the higher its retained earnings balance, and vice versa. Hence, this ratio is mainly related to the management's policy in distributing profits.
X3	profit before interest and taxes ÷ total assets	The use of this ratio is based on a logical basis that the effectiveness of assets in generating profits is measured by net profit before interest and taxes and not after because the total assets consist of shareholders' funds, as well as creditors' money and facilities granted by The state for the survival and continuity of the company's activity.
X4	the market value of shareholders' equity ÷ total liabilities	This ratio measures the amount of shareholders' equity coverage of the total liabilities of the company, as shareholders' equity is the margin of safety for creditors
X5	Sales ratio ÷ Total Assets	This ratio refers to measuring the extent to which assets are used to their maximum capacity. When this ratio is low, the organization does not carry out a volume of business commensurate with the volume of its investments in assets

		and vice versa.
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As for the coefficients (1.2, 1.4, 3.3, 0.6, 0.99), they represent the weights of the function variables as they express the relative importance of each variable depending on what the companies in question use.

(z) represents the value of the equation and compares it with the criteria set by Altman, which are (Lewis and pendrill, 2000, 406):

At this stage, several indicators appear that warns of the possibility of bankruptcy of the company, including:

- 1- Companies with (z) less than (1.81) are considered failed companies because their performance is low.
- 2- Companies that have (z) more than (2.99) are considered non-failed (successful) companies in the short term because their performance was high.
- 3- Companies that have a (z) between (1.81) and (2.99) have an average performance.

It is difficult to predict definitively about its failure. Therefore a careful assessment study of the company's situation must be conducted in order to be able to identify its future position.

It can be noted that the ratios adopted by this model deal with the essential financial dimensions that must be studied in the enterprise, which are (liquidity, profitability, market, and activity) (Al-Ghagim et al., 2006, 208). The failed is (x3), which represents the profitability

measurement ratio, and this is logical since the most important goal that companies seek is profit, especially business companies in the private sector. If this goal is not achieved, it will expressly or implicitly indicate that the company cannot cover its costs. Then It is unable to pay its obligations to others, which determines whether the company is a failure or not (Al-Daihani, 1995, 299).

### C- Hypothesis.

According to a review of the above literature as well as the background provided on International Financial Reporting Standard (IFRS1) and financial failure, the research hypothesis can be formulated as a whole:

(IFRS 1 can be employed to predict the financial failure of Iraqi commercial banks)

## III. RESEARCH METHODOLOGY

### A. Statistical Society and Samples

The research community includes (banking sector) in Iraq, the Iraqi banking sector in Iraq contains 72 private banks, including 29 local Islamic banks, 25 local commercial banks, and 18 foreign banks, but 21 of these local banks are listed on the Iraq Stock Exchange and under its authority. They are divided into 6 of the Islamic banks and the rest commercial. On the data of the year 2020 for nine of the private

#	Banks name	X1	X2	X3	X4	X5	Z	Assess the situation
1	National bank of Iraq	0.2882	0.0594	0.0272	0.4393	0.6041	3.5323	successful
2	United bank	0.3041	-0.0101	0.0008	0.5375	0.0220	2.9167	average
3	Mansor bank	0.1932	0.0156	0.0063	0.2485	1.2244	3.7289	successful
4	Bank of Baghdad	0.1338	0.1969	-0.0039	0.1664	0.0427	2.5531	average
5	Mosul bank	0.4066	0.0164	0.0006	1.2635	0.0158	3.7856	successful
6	Sumer commercial bank	0.6931	0.0127	0.0038	2.2417	0.0239	5.1221	successful
7	Trans Iraq bank	0.6850	0.0104	0.0110	1.9517	0.0283	4.8483	successful
8	Commercial bank of Iraq	0.5604	0.0618	-0.0909	1.1181	0.0928	3.6442	successful
9	Investment bank of Iraq	0.4602	0.0082	0.0102	0.9968	0.0304	3.6210	successful

commercial banks after excluding Islamic banks as they apply Islamic accounting standards and have the Sharia board that monitors the progress of a business

Table #3 (Z score of Iraqi banks)

#### B- Variable measurements

Altman model (Z score) was applied to the financial statements of the research sample banks, and as we noted in the theoretical side that this model depends primarily on Financial metrics, as follows:

$$Z=1.2X1+1.4X2+3.3X3+0.6X4+0.99X5$$

X1 = Net working capital ÷ Total assets

X2 = Retained Earnings ÷ Total Assets

X3 = EBIT ÷ Total Assets

X4 = Market value of shareholders' equity ÷ total liabilities

X5 = Sales Revenue ÷ Total Assets

the table #3 shown the Z score of Iraqi Banks.

As it is clear from the results that have been reached, the research sample banks enjoy a good performance that keeps them away from financial failure and bankruptcy Fail.

It should be noted that the banks enjoy good liquidity and considerable capital. However, the profits they obtain are very few compared to their capital and the liquidity available to them, as the ratio of X3 compared to X1 was a very small percentage in the best banks of up to 9%. We also noticed a loss A bank and its lack of profit, which indicates poor financial performance and strategic planning for most banks.

#### IV. RESULT OF HYPOTHESIS.

When applying the model to a sample of Iraqi private banks listed in the Iraqi Stock Exchange and obtaining appropriate data from the financial statements disclosed by the banks to calculate the z score, and these banks are obligated to apply the financial reporting standards under the law, the result was that the banks of the research sample enjoy the financial performance in safety. None of them is at risk of financial failure. The results of the research hypothesis test are consistent with the research hypothesis.

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