

MITIGATING OPERATIONAL AND CREDIT RISK: INTERNAL AUDIT AS A DECISION-MAKING TOOL IN NBFCs AND HFCS IN VIDARBHA

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ABSTRACT

In order to reduce operational and credit risks in NBFCs and HFCS in the Vidarbha area, this research looks at the function of internal audits as a strategic choice-making tool. The study emphasises how internal audit departments improve risk management, efficiency in operations, and regulatory compliance by using a descriptive research approach and data gathered from 100 professionals using structured questionnaires. Results show that internal audit procedures significantly improve the number of loan defaults and operational errors, highlighting their significance for long-term financial control. To improve institutional resilience, the report suggests implementing risk-based internal inspection frameworks and fostering more cooperation between the audit, risk, and regulatory departments.

Keywords: Internal Audit, Operational Risk, Credit Risk, NBFCs, HFCS, Risk-Based Internal Audit, Decision-Making, Etc

1. INTRODUCTION

The emergence of NBFCs and HFCS, especially in underdeveloped areas like Vidarbha, has significantly changed the Indian financial environment. These organisations provide essential financial services to small and medium-sized businesses, independent contractors, and those looking for affordable housing, filling the credit gap left by traditional banks. Significant exposure to operational and credit risks, the latter from borrower defaults and the former from malfunctions in internal systems or processes, is a consequence of this expansion (RBI, 2021).

Strong internal governance procedures are required due to the growing complexity and diversity of financial activities in NBFCs and HFCS. A crucial element of this framework is internal audit, which has evolved from its historical functions of compliance monitoring to become a vital instrument for strategic decision-making (Gramling, Maletta, Schneider, & Church, 2004). It gives senior management confidence in the efficiency of operational procedures, risk management techniques, and internal controls, enabling them to make more proactive and well-informed choices. An efficient internal audit function can be crucial to preserving institutional resilience and stakeholder confidence, especially in areas like Vidarbha where borrower variety and market uncertainties increase risk (Sawyers, Jackson, & Jenkins, 2012).

In addition, the RBI has emphasised the changing function of internal audit and encouraged NBFCs and HFCs to implement RBIA frameworks that complement their operational scale and strategic goals (RBI, 2021). This study intends to investigate the degree to which internal audit functions as a useful decision-support tool in NBFCs and HFCs in Vidarbha and helps to mitigate operational and credit risks in these organisations.

2. LITERATURE REVIEW

An increasing amount of research backs up internal audit's position as a key component of financial institutions' risk management framework. According to Gramling et al. (2004), internal audit provides unbiased confidence of the efficacy of risk management and control procedures, which helps with governance. Financial institutions are better equipped to foresee and address new risks because to this twin role of compliance monitoring and advice.

According to the COSO (2017), internal audit is essential to integrated corporate risk management, especially when it is set up as an ongoing, feedback-driven procedure. This becomes critical in the case of NBFCs and HFCs since borrower heterogeneity and quick loan disbursement cycles increase the risk of system breakdowns and defaults. According to research by Al-Tamimi and Al-Mazrooei (2007), banks and other financial institutions with clearly defined internal audit systems showed more flexibility in managing credit risk and frequently made proactive adjustments to their loan portfolios in response to audit findings.

Furthermore, Sawyers et al. (2012) stress that in order to optimise their strategic value, internal audit results need to be tightly related to decision-making procedures. According to their study, audit-informed governance leads to better operational budgeting, more robust capital management, and enhanced credit evaluation techniques. The idea that internal audit should develop into a tool that facilitates strategic foresight rather than just uncovering previous errors has been reinforced by RBI (2021) recommendations, which in the Indian context have advocated a move from process audits to risk-based methods.

Together, these studies indicate that internal audit may greatly improve the quality of decisions made by NBFCs and HFCs working in dynamic contexts such as Vidarbha, while also reducing vulnerabilities linked to operations and credit.

2.1. OBJECTIVES

The purpose of this study is to evaluate the effectiveness of internal audit in identifying and controlling risks, to investigate its role in improving managerial decision-making and regulatory compliance, and to investigate how it works as a strategic tool for reducing functioning and credit risk in NBFCs and HFCs in Vidarbha.

3. METHODOLOGY

In order to examine how internal audits help NBFCs and HFCs in Vidarbha reduce operational and credit risk, this study uses a descriptive research approach. A standardised questionnaire was used to gather data from 100 respondents, who were professionals in risk management and auditing. To guarantee pertinent and knowledgeable replies, a purposive sample strategy was used.

3.1. DATA ANALYSIS

The descriptive method and inferential methods were used to analyse the information gathered from 100 respondents who worked in NBFCs and HFCs in Vidarbha via standardised questionnaires. The goal was to assess how well internal audit was thought to support managerial choices and reduce operational and credit risks.

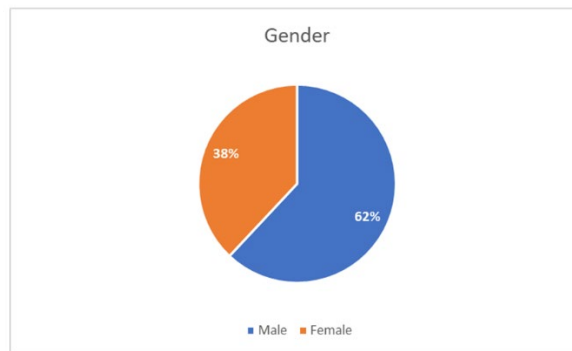


Figure 1 Gender

Out of the total respondents, 62% were male and 38% were female, this indicates that participation of male in the internal audit process is more as compared to female.



Figure 2 Designation

According to the responder profile, 25% of participants are compliance officers, 35% are risk managers, and 40% are internal auditors. This distribution ensures that the insights collected are pertinent and reliable for assessing internal audit effectiveness in NBFCs and HFCs by reflecting a well-balanced representation of important experts who are involved in the auditing process, risk management, and regulatory compliance.

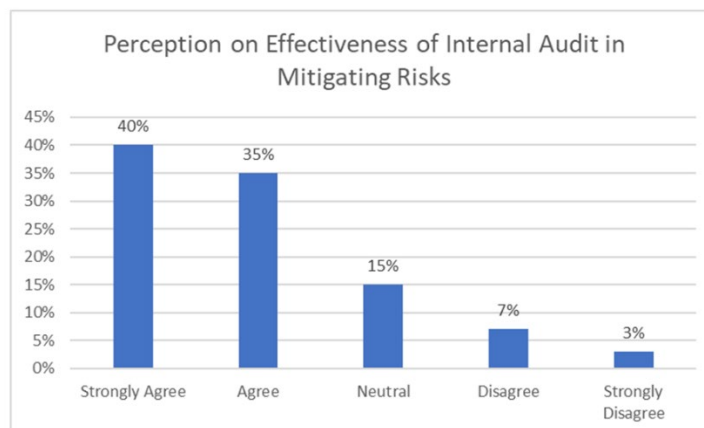


Figure 3 Perception on Effectiveness of Internal Audit in Mitigating Risks

75% of those surveyed agreed or very much agreed that performing internal audits is important for reducing credit and operational risks. This indicates that internal auditing functions are highly regarded.

Table 1 Chi-Square Test Internal Audit vs Reduction in Credit Risk

Response Category	Observed (O)	Expected (E)	(O-E) ² /E
High Reduction	38	25	6.76
Moderate Reduction	40	50	2.00
Low Reduction	22	25	0.36
Total	100		9.12

Chi-Square Value (χ^2) = 9.12

Degrees of Freedom (df) = 2

Critical Value at 5% significance level = 5.99

χ^2 (9.12) > critical value (5.99), thereby rejecting the null hypothesis. This suggests that there is a strong connection between internal auditing and lower credit risk in NBFCs and HFCs.

4. CONCLUSION

According to the study's findings, internal audit is crucial and strategically important for reducing operational and credit risks in Vidarbha region's NBFCs and HFCs. Internal audits boost decision-making processes, increase operational efficiency, and raise risk awareness, according to the majority of respondents. A strong correlation between internal audit procedures and risk reduction results was further supported by inferential analysis. The necessity of integrating internal audit tasks into the main governance framework is highlighted by the presence of certified internal auditors, risk managers, and compliance officers. Using internal audit as a proactively and dynamic risk administration tool is crucial for institutional continuity and stakeholder confidence as regulatory demands grow and financial conditions become more complicated.

5. RECOMMENDATIONS

In order to match audit operations with important risk areas, it is advised that NBFCs and HFCs in Vidarbha implement a RBIA framework in light of the results. To stay up with changing financial and regulatory dynamics, organisations should make sure audit professionals receive regular training and capacity building. The results of internal audits must be incorporated into strategic decision-making procedures and promptly remedied. In order to manage risks more effectively, businesses should also increase the frequency and breadth of internal audits and use automation and data analytics technologies. Lastly, a more comprehensive and robust approach to risk oversight may be promoted by improving collaboration amongst compliance officers, risk managers, and internal auditors.

CONFLICT OF INTERESTS

None.

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