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# THE ROLE OF INTERNAL AUDIT IN IMPROVING THE QUALITY OF FINANCIAL REPORTS

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## Abstract

The current research aims to test the impact of internal audit in improving the quality of financial reports within the sample of the study, 230 questionnaires were distributed to auditors and accountants working in companies listed on the Iraq Stock Exchange and were subjected to a set of statistical tests and concluded that the internal auditor has a significant role in improving the quality of financial reports and The importance of users of financial reports in making rational investment decisions and also metrics based on the main characteristics of financial reports are one of the most critical measures of the quality of financial reports.

**Keywords** Internal Audit, Quality of Financial Reports.

## INTRODUCTION

Internal audit plays a vital role in developing and enhancing performance and providing credibility, reliability, and impartiality to ensure the efficiency of improving the quality of financial reports with its money of great importance in adding value to its activities and improving its operations, mainly if it is characterized by efficiency and effectiveness, and the internal audit profession is currently receiving great global attention and support by boards Internal audit are distinct topics that also reflect the level of standardization of information and help in monitoring and tracking management performance, so the problem posed by this study revolves around a critical point, which is whether internal audit contributes to enhancing the quality of financial reports.

Internal Audit

The sources explained that the internal audit profession in general and internal audit, in particular, is an ancient profession, as the sources explained that internal audit predates the Christian era; at the end of the fourteenth century, the employer (owner), when he suspected of treason, appointed someone to verify the accounts so that the person was sitting with the accountant to listen to what he had to say about the Babylonian (about 3000 BC) and evidence indicates the existence of auditing activity, in Ancient China, Greece, Rome and the Latin meaning of the Word (auditor, he hears hearer or listener) because in Rome auditors work to hear declarations or statements of taxpayers from farmers about the results of their work, fees, and taxes owed to them to evaluate the results of currency and its actions and determine the effects reflected on those results to detect errors.

Many of the studies covered in this study indicate the impact of internal audits on the quality of financial reports. One of the studies conducted by (sepasi,2017)) entitled "Internal Audit Board of Directors and Financial Reporting Quality the goal the research indicates that it is expected that high-quality internal audit leads to the preparation of high-quality financial reports, as high-quality financial reports express themselves in the quality of profits, as well as profits have played a significant role in the capital market for a long time, as for the study conducted by (Ekonomi, 2018) entitled The Role of the Internal Audits to the Quality of Financial Reporting, there is a significant role of internal audit in the quality of financial reports, the quality of financial reports is higher if the role of internal audit has a role in achieving and understanding the objectives, management, scope of work, application of principles and implementation of the internal audit function.(Albawwa, 2021)) focused on the study entitled "The Relationship Between Internal Auditors Personality Traits, Internal Audit efficiency, And Financial Reporting Quality: Empirical Evidence from Jordan" that personal traits have indirect effects on the quality of financial reports through the effectiveness of the internal audit function and also that internal auditors with high scores in openness to experience, job stability and conscientious traits can be among the most important contributors to the effectiveness of the internal audit function and also that the personal traits of internal auditors can be considered as an intangible resource and the outsiders Departments, auditors, human resources and internal audit executives.

#### Literature Review

##### The Concept of Internal Audit:

Internal audit is an essential process that controls the accounting work of any economic unit, where

internal audit has been defined as a system for developing and measuring internal performance regarding the audit of inputs, processes, outputs and results, an independent evaluation function established within the economic unit for the purpose of examining and evaluating the activities carried out by this unit (Gurama & Mansor, 2018: 73), Raji pointed out that audits are generally tools for examining complex processes, to determine whether they are committed or not to comply with the economic units policy, standards and regulations that the "IEEE" standard for software development that complies with the units policy, standards or regulations, an audit is defined as an independent assessment of the conformity of software products and processes with regulations, standards, guidelines and specifications and reporting these results to management for the purpose of decision-making, established procedures and plans (Raji, 2020: 33).

Handoyo explained that internal audit is a performance function within the economic unit and is similar to governance designed to increase value for the purpose of improving organizational performance, this activity can help achieve the objectives of the economic unit through a disciplined approach to improving and evaluating risk management processes control and governance through activities in the form of independent and objective consultation and assurance (Handoyo et al., 2021: 47), is a systematic process through which information and assurances are objectively obtained rational decision-making and action (Bandar et al, 2021: 1011).

The main objectives of the internal audit are to ensure the optimal use of the resources of the economic unit, protect assets from embezzlement and manipulation, ensure the correctness of the data, accuracy, and the ability to rely on them according to the plans set to achieve the objectives

of the economic unit and the internal auditor provides a neutral point of view requested by the board of directors and senior management to understand what is happening in the field with clients, as internal and external audits have significantly different goals, internal auditors generally do not spend much time searching for financial accounts, so internal auditors audit their companies over some time, a year and often months after. From another point of view, the objectives of internal audit are to ensure the reliability and integrity of information. The internal auditor should review the reliability and integrity of procedures, assess the economy and efficiency with which resources are used to achieve the set goals and objectives, take a deeper look at compliance with external and internal rules, and ensure that the policies and rules of the process are adequate, mitigate risks and effectiveness in terms of the appropriateness of the process about the achievement of overall objectives (Louwers et al., 2018, p. 684), and

(Kundinger, 2020: 16-17)

#### The Importance of Internal Audit

The importance of internal audit is one of the main functions of Management, which is a safety valve to preserve the resources of the economic unit and is an auxiliary factor in the allocation of human resources in terms of the implementation, control, or control process with the best possible efficiency (Hamdan & Wali, 2024, p. 372), inaccurate accounting reports that have not been audited conceal waste and inadequacy and prevent the allocation of scarce resources rationally. Therefore, the role played by the operational auditor on activities promotes the optimal use of resources, whether human or material (khanate, 2022: 27). The importance of internal audit is shown by the fact that it is activities within the economic unit carried out by individuals appointed by management for specific purposes, being a

control tool that helps employees effectively perform their functions. Internal audits attempt to achieve governance goals by enhancing accountability and transparency in financial management, reducing corruption, and reducing risks. The internal audit requires organizational independence, professional auditing standards, and adequate funding for controlled access (Fraser et al., 2021, p. 67).

#### Characteristics of Internal Audit

Internal audits are a mainstay of internal control, and some of their characteristics can be mentioned.

1-Independent evaluation activity: The internal auditor must be independent of the activities he audits and report administratively to the highest level in the economic unit's organizational structure, such as the board of directors or the audit committee (Al-ajili, 2022: 33).

2-an activity characterized by independence: Although internal audit is one of the functions of the economic unit, it is independent of other functions, so the auditor must be independent, professionally experienced, and characterized by efficiency and objectivity (Mohammed & Mohammed, 2022, p. 10).

#### Types of internal audit:

Many types of internal audit fall under the internal audit framework and achieve the same goals, but the differences appear in the audit perspective and performance levels that govern all types.

1.Compliance audit: An audit is conducted to determine whether the economic unit has complied with the applicable regulations and policies, whether those established by internal or external parties or to examine whether compliance with the rules and procedures established by the Competent Authority has been carried out by

individuals in the economic unit (Bohari, 2022, p. 17).

2. Financial audit: It is defined as the complete and systematic examination by the internal auditor of accounting financial statements and records and all operations related to those records to demonstrate and determine the extent to which they comply with the principles of generally accepted accounting and management policies of the economic unit (Dhu, 2018, p. 124).

3. The operational audit is the extent of control in selecting and evaluating operational and administrative processes and the performance results of various activities or units that exceed what the audit process requires (Koerniawan, 2021: 30). the operational audit identifies the activities subject to audit, after which the audit process is planned. After the audit process is carried out, the final report is written, and at the end, the response to what is contained in the Sent report is followed up. The operational audit definition is the extent of control in selecting and evaluating operational and administrative processes and the performance results of various activities or units that exceed what the audit process requires (Koerniawan, 2021: 30).

4. Performance audit: Performance audits contribute to improving efficiency, economy, and effectiveness and are a means of incorporating reforms into public sector practices through the recommendations contained in the auditors' reports (Torres et al., 2019, p. 431)

#### Quality of Financial Reports

Financial reports are viewed as the means by which information is provided by the management of the economic unit to users and are generally considered part of the communication process this is the description of the financial report within the report of the committee responsible for preparing financial reports, which was formed before the

well-known American Institute of Certified Public Accountants and based on the Jenkins report entitled (Improving the business reporting process) (according to, 2021: 40), and that the quality of financial reports is extremely important in maintaining the efficiency of financial markets, as the study indicated that the global financial crisis affected the quality of financial reports, as it led to a significant disruption in financial markets (Tambingon et al, 2018: 265), and because of the frequent financial crises, the need to produce high-quality financial reports has become a global phenomenon, as owners, stakeholders, board members and professional accountants raise more topics of interest to researchers, quality is defined as the achievement of something with a high degree of great value and good quality, and the Word quality comes from (presence), and the quality of the thing means good, and any good came from the thing in Word or deed, and the good is the opposite of the bad (Khadr, 2021: 50), and quality is defined by the convention that it is associated with this includes control and emphasis on the final output of the system by minimizing defects in performance (Hsu & Yang, 2022: 2), the quality of the financial report was defined as the accuracy of the information transmitted through the financial reporting process (Assad & Alshurideh, 2020: 255).

It is defined as the reports that express the truthfulness of the information in the items presented in those reports and related to all activities, which are characterized by their distance from bias, in addition to being non-misleading to be more beneficial to decision-makers and a measure of the nature of the work carried out by the economic unit (Khalaf, 2021, p. 324).

The Importance of the Quality of Financial Reports: The importance of financial reports stems from information and is an effective and essential means

of communication between management and users to provide all parties with the information they need to make appropriate investments. Therefore, the quality of financial reports of the economic unit is of great importance in the business environment (Neema & Khmaila, 2021, p. 23). The objectives of the quality of financial reports can be summarized as follows:

1-High-quality financial reporting enhances trust and transparency, which reduces information mismatches (Soyemi&Olawale, 2019, p. 449).

2-Accurate financial reporting can help reduce bad and ethical investment decisions and problems, allowing us to identify better investment opportunities and be good and effective (Al'alam et al., 2019, p. 40).

#### Financial Reporting Quality Metrics

1-Accounting information quality metrics: The accounting information quality characteristics model is a modern entry point for evaluating the quality of financial reports. The model examines the usefulness of the information contained in financial reports to facilitate the decision-making process by determining the quality characteristics of financial reports. According to the International Accounting Standards Board, accounting information characteristics are the basic principles for assessing the quality of financial reports. It relates to the credibility of the objectives and the quality of information disclosed in the financial reports of the economic unit. the usefulness of qualitative features facilitates the evaluation of the usefulness of financial reports, which ensures high quality (Hesarzadeh, 2019, p. 8)

2- Profit quality metrics: Over the decades, the conceptual framework of financial reporting has been guiding researchers and users on how to evaluate the quality of financial reports, in particular the quality of profits, and the profits are of high quality, as they provide additional

information about the financial performance of the economic unit and were relevant to the decision maker because the quality of profit is a crucial indicator of the accuracy of financial data used by interested parties such as creditors, lenders, investors, etc. it helps to provide a benefit to decision makers that the quality of profits is an essential term in economics and accounting, despite there are significant differences in measuring and quantifying them (Saleh et al, 2021, p. 3).

3 - Accounting reticence measures: The International Accounting Standards Board (ISAB) has shown that the concept of reticence is to exercise caution in the crisis provisions for the numbers of estimates included in financial reports under conditions of uncertainty, taking into account not to overestimate the valuation of assets and gains and not to underestimate the values of liabilities and losses. Research has increased in recent periods on the subject of accounting reticence due to the recent global financial crises, which have made banks more cautious in lending and borrowing and exert more accuracy in evaluating accounting figures(Hussein & Abdul Mustafa, 2019, p. 65) ,

#### The Components of the Quality of Financial Reports:

1-Internal Audit efficiency: where you understand the importance of internal audit in ensuring the compilation of high-quality and highly efficient financial reports and that internal auditors should take advantage of the basic knowledge, capabilities, and experience to carry out the Internal Audit Service efficiently according to a study conducted by the Institute of internal auditors (IIA), efficiency is appropriately defined as the ability to perform the task where internal auditors with long experience, competence and professional independence have many advantages of detecting errors in the financial report and



identifying the source of errors (Tambingon et al, 2018, p. 263).

**2-Efficiency of the Accounting Information System:** The accounting information system is an essential element and has a significant and robust impact on the quality of financial reports and is one of the factors contributing to the issuance of a high-quality and efficient financial report, on which financial reports depend inputs, processes and benefits resulting from the accounting information system. as the basis for new financial reporting systems, the three parts (inputs, processing, and outputs) are integrated and sustainable (TARSHI & Khalaf, 2020, p. 768).

**3-Human Resource Efficiency:** Human resources refer to the human capital of the economic unit. Human Capital also refers to the knowledge, skills, and abilities that can be applied to the production of professional services and economic activity and are a source of innovation and ideas. The better the quality of financial reports, the more efficient the existing human resources (Salah et al., 2021, p. 201).

#### **Research Methodology:**

The methodology of any scientific research is a roadmap in which the researcher presents the research problem that prompted him to research, the goals in order to solve this problem, the importance of research, the importance of solving the research problem, and the scientific research method used to solve the research problem, leading to a specific result that the study seeks to prove.

#### **The Problem of Research:**

The financial reports disclosed by economic units of different types are significant for decision-makers (investors in particular 9 to rationalize the decision to invest or not in that economic unit in light of the quality of financial and accounting information revealed by those reports and what

reveals the expected future of that economic unit, but promoting the adoption of :

Does internal audit contribute to enhancing the quality of financial reports

#### **Research Objective:**

The research aims to achieve the following:

1-Measuring the impact of internal audit on the quality of financial reports

2 Provide recommendations that the researcher considers essential for enhancing the quality of financial reports in the target units

3-Enriching the Arabic library with a research effort that can increase accounting knowledge

The importance of research: Research gains importance from the size of the impact of its variables (the role of internal audit in improving the quality of financial reports), where the internal auditor can improve the quality of financial reports. There is a growing concern about the reliability of financial reports as they may not accurately reflect the actual performance of the economic unit. Internal audits play a vital role in filling this gap and improving the quality of reports.

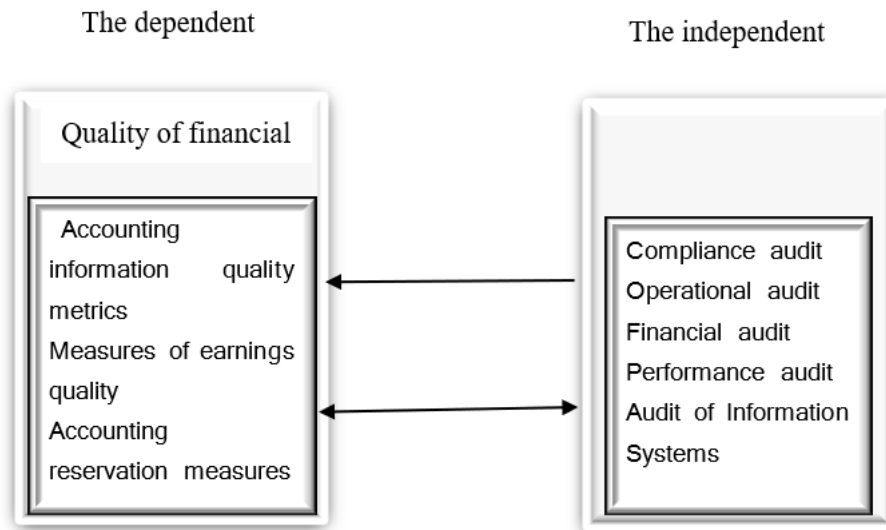
#### **Research Hypotheses:**

The current study is based on the hypothesis derived from a question that was asked

1-The first central hypothesis: There is a significant correlation between internal audit and the quality of financial reports)

2-The second central hypothesis: internal audit significantly affects the quality of financial reports

**Research Community:** The research community consists of a sample of auditors and accountants working in the economic units listed on the Iraq Stock Exchange, and 230 questionnaire forms were distributed.



**Figure (1-1) the hypothetical model of research**

**Source: prepared by the researcher**

The practical side : To properly test the study hypotheses and to ensure the accuracy of the selection of the quality of statistical tests and final results in order to reach the correct results, through which recommendations can be built that

contribute to the understanding of the study variables

First: measuring honesty and constancy: the researcher tested the honesty and constancy of the study scale according to the following table:

The fackronbach scale	Features
o.83	Internal audit
o.84	Quality of financial reports

**Table (1-2) test of honesty and constancy**

**Source: prepared by the researcher**

The above table shows that the facronbach values are higher than 0.70, and this indicates that the scale has a high stability.the apparent honesty of the scale was measured by displaying a set of arbitrators (appendix No. 1). the researcher took

all the observations.

Second: descriptive statistics of the study variables

The table shows the descriptive statistics of the study variables

**Table (2-2) class statistics of study variables**

standard deviation	Arithmetic mean	
1.16	3.77	1-compliance audit
1.22	3.62	
1.22	3.72	
1.24	3.59	
1.21	3.68	
1.21	3.68	2-operational audit
1.22	3.77	3-financial audit
1.27	3.58	
	3.57	
1.27		
1.25	3.64	4-performance audit

**Source: prepared by the researcher**

1-The arithmetic mean of the compliance audit dimension was 3.77, and the standard deviation was 1.16; this indicates the awareness of the study sample taken after the compliance audit in the field of internal audit

2-The operational audit achieved an arithmetic mean of 3.62 and a standard deviation of 1.22, which indicates the strength of the study sample's awareness to take this dimension in the field of

internal audit

3-The financial audit achieved an arithmetic mean of 3.72 and a standard deviation of 1.22, which indicates the strength of the study sample's awareness to take this dimension in the field of internal audit

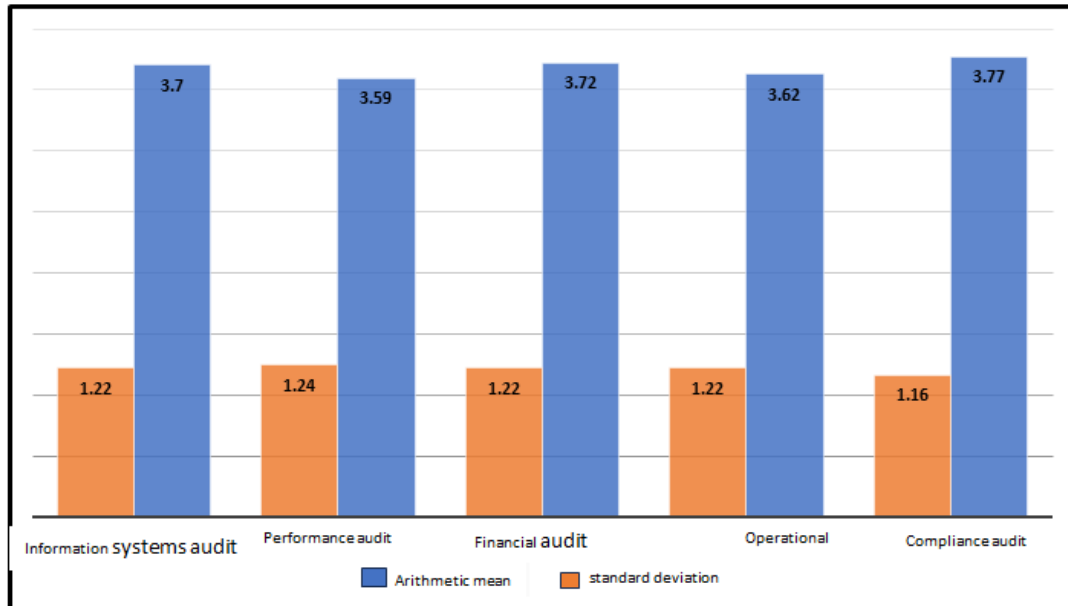
4-The arithmetic mean of the performance audit dimension reached 3.59 and a standard deviation of 1.24; this indicates the strength of the study



sample's awareness to take this dimension in the field of internal audit

5-The Information Systems Audit achieved an

arithmetic mean of 3.68 and a standard deviation of 1.21-1.24, which indicates the strength of the study sample's awareness to take this dimension in the field of internal audit



**Figure (1-2) internal audit dimensions**

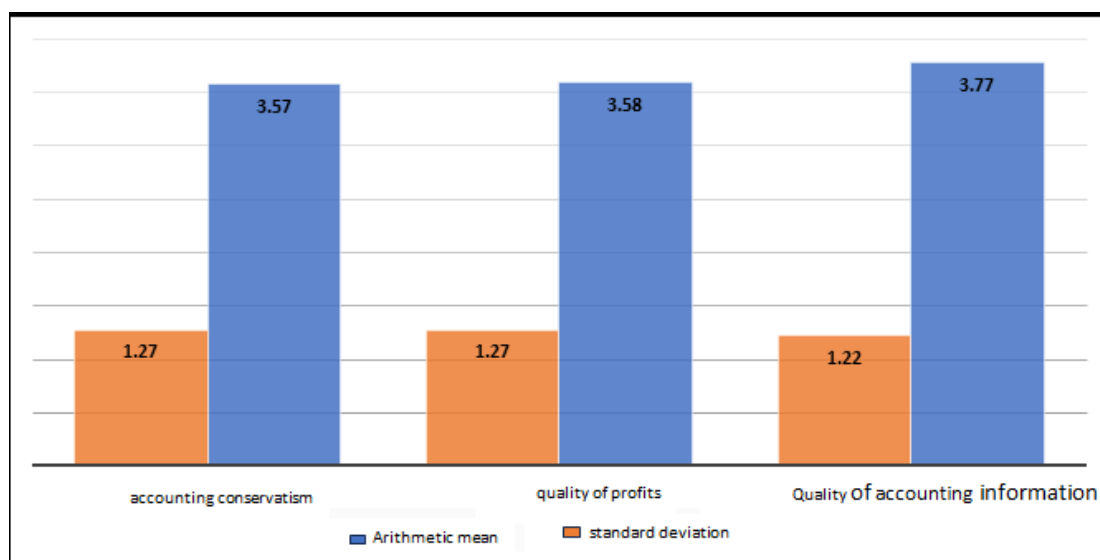
**Source: prepared by the researcher**

6-The arithmetic mean of the scale of accounting information characteristics reached 3.77 and a standard deviation of 1.22, which indicates the strength of the study sample's perception to take this dimension in the field of financial reporting quality

7-The earnings quality scale achieved an arithmetic mean of 3.58 and a standard deviation

of 1.27, which indicates the strength of the study sample's perception to take this dimension in the field of financial reporting quality

8-The arithmetic mean of the accounting reservation scale reached 3.73 and a standard deviation of 1.25, this indicates the strength of the study sample's awareness to take this dimension in the field of financial reporting quality.



**Figure (1-2): Financial Reporting Quality Metrics**

### Third: Testing the Correlation Relationships Between the Study Variables

The first primary hypothesis states that (there is a significant correlation between internal audit and the quality of financial reports) and five sub-hypotheses have branched out from it, as shown below: -

1-There is a significant correlation between compliance audits and the quality of financial reports.

The second sub-hypothesis, which is equally significant, proposes a positive and significant correlation between the operational audit and the quality of financial reports. This finding underscores the impact of operational audits on the quality of financial reports.

3-There is a significant correlation between the financial audit and the quality of financial reports.

4-There is a significant correlation between performance audits and the quality of financial reports.

5-There is a significant correlation between the audit of Information Systems and the quality of financial reports.

The correlation matrix for the first main hypothesis, as shown in Table (3-18), reveals that all correlation relationships were positive and significant at the level of (1%). At the sub-level, the largest correlation was between operational audit and the quality of financial reports at (0.54), with a significant correlation at the level of (1%). The lowest correlation was between compliance audit and performance audit at (0.48), with a significant correlation at the level of (1%). The most significant finding, however, is the correlation between internal audit and the quality of financial reports (0.69), which is a significant relationship at the level of (1%). These results unequivocally indicate the acceptance of the first main hypothesis and its sub-hypotheses, reinforcing the idea that there is a significant correlation between internal audit and the quality of financial reports. This suggests that the more attention is paid to internal audits, the more it directly reflects on the quality of financial reports prepared by the audited economic units.

Quality of financial reports	Independence
**0.48	<b>Compliance audit</b>
**0.54	<b>Operational audit</b>
**0.57	<b>Financial audit</b>
**0.48	<b>Performance audit</b>
**0.49	<b>Information Systems Audit</b>
**0.69	<b>Internal audit</b>

**Table (3-2) testing the first main hypothesis**

**Source: prepared by the researcher**

Second: - Testing the Hypothesis of Influence between the Study Variables

In order to test the influence relationships between the study variables, the researcher used the multiple Linear Regression coefficient, as follows;

4-the Second Main Premise: (internal audit dimensions significantly affect the quality of financial reports).

Table (3-21) below shows the analysis of the fourth main hypothesis

**Table (2.21) testing the fourth main hypothesis**

Model	Unstandardized		Standardized			Collinearity	
	Coefficients		Coefficients			Statistics	
	B	Std. Error	Beta	t	Sig.	Tolerance	VIF
1 (Constant)	0.725	.210		3.45	0.001		
				2			
Compliance audit	0.172	0.053	0.181	3.226	0.001	0.727	1.375
Operational audit	0.166	0.054	0.189	3.088	0.002	0.608	1.644
Financial audit	0.226	0.050	0.273	4.557	0.000	0.634	1.578
Performance audit	0.122	0.045	0.158	2.735	0.007	0.684	1.462
Information Systems Audit	0.114	0.050	0.135	2.286	0.023	0.650	1.538
a. Dependent Variable:							
R <sup>2</sup> =0.50							
F=43							

**Source: preparation of the researcher based on the results of the calculator**

**The above table shows the following:**

1 - The audit of compliance positively affects by (0.172) the quality of financial reports if it is increased by one unit, which is a significant impact at the level of (1%) because the value of (t) calculated for the regression coefficient reached ((3.226, which is significant at the said level, and the value of the amplification coefficient (VIF), which measures the lack of self-correlation between the audit of compliance and the rest of the internal audit dimensions reached (1.375), which is less than ten the dimensions of internal audit, which enhances the accuracy of the results.

2 - The operational audit positively affects by (0.166) the quality of financial reports if it is increased by one unit, which is a significant impact at the level of (1%) because the value of (t) calculated for the regression coefficient reached ((3.088, which is significant at the mentioned level, and the value of the amplification coefficient (VIF), which measures the lack of self-correlation between the operational audit and the rest of the internal audit dimensions reached (1.644), which is less than ten the dimensions of the internal audit, which enhances the accuracy of the results.

3 - The financial audit positively affects the quality of financial reports by (0.226) if it is increased by one unit, which is a significant impact at the level of (1%) because the value of (t) calculated for the regression coefficient reached ((4.557, which is significant at the mentioned level and the value of the amplification coefficient (VIF), which measures the absence of self-correlation between the financial audit and the rest of the internal audit dimensions reached (1.578), which is less than ten this enhances the accuracy of the results.

4 - The performance audit positively affects the quality of financial reports by (0.122) if it is

increased by one unit, which is a significant impact at the level of (1%) because the value of (t) calculated for the regression coefficient reached ((2.735, which is significant at the mentioned level, and the value of the amplification coefficient (VIF), which measures the lack of self-correlation between the performance audit and the rest of the internal audit dimensions, reached (1.462), which is less than ten and the rest of the internal audit dimensions, which enhances the accuracy of the results.

5 - The audit of Information Systems positively affects by (0.144) the quality of financial reports if it is increased by one unit, which is a significant impact at the level of (5%) because the value of (t) calculated for the regression coefficient reached ((2.286, which is significant at the mentioned level, and the value of the amplification coefficient (VIF), which measures the lack of self-correlation between performance audit and the rest of the internal audit dimensions, reached (1.538), which is less than ten and the other dimensions of internal audit, which enhances the accuracy of the results.

6 - The value of (F), which measures the morale of the regression model, reached (43), which is a moral value at the level of (1%), and the explanatory power of the regression model(R<sup>2</sup>) reached (0.50), which means that the five internal audit dimensions explain (50%) of the changes that occur in the quality of financial reports, while the remaining (50%) are due to other variables not included in the model, which the researcher infers acceptance of the second central hypothesis in the sense of (internal audit dimensions the equation of multiple linear regression will take the following form

Quality of financial reports= 0.725 + 0.172 compliance audit+0.166 operational audit+ 0.226

financial audit+ 0.122 performance audit+0.114  
Information Systems Audit

It is noted from the above equation that the most influential type of audit in the quality of financial reports is the financial audit, followed by the compliance audit, then the operational audit, the performance audit, and finally, the audit of Information Systems.

### **CONCLUSIONS**

1-One of the internal auditor's most important priorities is to identify errors in administrative work and alert those responsible for them.

2-Financial reports are characterized by high quality if the main characteristics of accounting information are provided in them (assertiveness and impartiality) due to the importance they represent for users of financial reports in making rational investment decisions. Also, metrics based on the main characteristics of financial reports are one of the most critical measures of the quality of financial reports.

3-There is a weakness in comparing the results of the economic unit's work with internal and external systems to the rest of the tasks after the compliance audit.

4-There is a high awareness among auditors that their tasks are not limited to financial aspects but extend to technical aspects, even if this requires the use of experts

5-The method of preparing financial reports needs to be reviewed so that even a non-specialist in accounting matters can benefit from it

### **Recommendations:**

1-The need to raise stakeholders ' awareness of the importance of the role of the internal auditor in adopting any issues that raise doubts about the poor quality of financial reports or the ability of the economic unit to continue through scientific workshops and orientation lectures.

2-The need to follow up the actual performance with the planned performance, identify deviations and what are their causes, develop remedies for them, and follow up their implementation

3-The need for auditors to compare the performance results of economic units disclosure during the current audit period with the performance results during previous periods to notice the development or decline in performance by following up on the commitment of units to address previous observations

4 - The work of the auditor is not limited to financial aspects but must go beyond it to other aspects, and this requires the introduction of auditors' special courses in order to increase their skills and abilities

5-Enhancing the orientation of economic units towards supporting workers, providing work requirements, and achieving well-being, for example, providing free transportation for workers, providing nurseries for children, and providing health care.

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