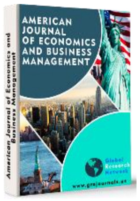

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The Impact of Governance and Internal Audit Quality on Performance Evaluation

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Abstract:

Governance has become of great importance at the world level at the present time, and there has recently been increased talk about it and its role in improving strategic performance. The necessity of implementing it and following up on its systems has emerged in most departments. To ensure the rights of shareholders, investors and society, and from this standpoint, the problem of the study came from the weak application of the governance system in commercial banks, which is considered one of the reasons for their failure and collapse, in addition to the fact that these banks do not have an effective control and audit system that supports the internal governance system, and also the lack of implementation The internal governance system leads to the concealment of a lot of financial information that directly and indirectly affects the position of banks, and thus the stock prices of these banks.

Keywords: governance, internal, quality, evaluation

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1. Introduction

When assessing the success of a business, governance and the caliber of internal auditing are crucial components. Business management uses internal audit as a critical instrument to accomplish goals through risk management, corporate governance evaluations, and internal controls [1]. Internal auditing has been shown to be a key component of company governance, helping to combat fraud, irresponsible risk-taking, and poor management [2]. Internal auditing now serves to improve company performance in addition to finding mistakes [3]. Furthermore, by guaranteeing the accuracy of financial accounts, adhering to standards, and offering guidance on operational efficiency, internal audit supports corporate governance [4].

Early risk detection requires internal audit, especially in the increasingly complex and digitally exposed company environment [5]. Research shows that internal audit's duties in contemporary company environments are growing, moving from a supervisory to a more developmental one within companies [6]. Offering focused solutions to enhance internal control, company governance, risk mitigation, and financial gains is made possible by internal audit [7]. Effective support for management processes, particularly risk management, is provided by incorporating internal audit into routine control flows [8].

Additionally, the effectiveness of internal auditing improves company activity efficiency and regulatory compliance and is correlated with corporate governance, corporate social responsibility, and financial reporting quality [9]. Policy frameworks, risk management implementation models, and training all have an impact on the success of risk-based internal audits [10]. A major component in accomplishing corporate goals is played by internal audit, especially when it comes to fraud detection and assisting with decision-making processes [11,12]. As demonstrated by its effect on the caliber of financial statements and the effective deployment of financial information systems, internal audit caliber can affect financial performance [13].

The linguistic origin of "governance" traces back to the ancient Greek word *kubernesis*, which denotes the skill of a ship's captain in steering the vessel. This term encompasses not only the technical expertise required to navigate the ship but also the moral virtues and ethical conduct necessary for safeguarding the passengers, cargo, and entrusted goods. A proficient captain, known as a good governor, demonstrates competence in overcoming navigational hazards and evading pirate threats, ensuring the safe arrival of the ship at its intended destination [14].

The connection between governance and the function of a ship captain as a good governor emphasizes governance's complex character, which includes effective decision-making, strategic direction, ethical leadership, and accountability. Organizational governance entails creating institutions, procedures, and practices that encourage openness, accountability, and ethical behavior.

Furthermore, the parallel to a ship's captain emphasizes the need of risk management in governance. Effective governance requires recognizing and reducing risks to ensure that the business accomplishes its goals securely. This is consistent with the expanding role of internal audit in current company contexts, where internal audit functions not only discover errors but also improve business performance, assist decision-making processes, and help uncover fraud.

2. Method

This study looks into how internal audit quality and governance affect performance evaluation using a literature review methodology. A thorough analysis of the body of scholarly literature, comprising reports from the industry, recommendations for regulations, and scholarly research publications, is part of the methodological framework. Reputable sources include academic databases, official publications from the government, and professional accounting magazines are used to collect data. Finding and combining pertinent research and empirical data about governance systems, the caliber of internal audits, and how these factors affect performance assessment procedures is the main goal. The study intends to get insights into the link between governance structures, internal audit effectiveness, and organizational performance evaluation through a methodical review of the literature.

3. Results and Discussion

3.1. Definition of governance and its importance

Various definitions of governance have been proposed by scholars and researchers. Abu Al-Atta [15] characterized it as the "strengthening of contractual relationships among involved parties, including bank management, shareholders, bondholders, employees, stakeholders, and others, through the application of robust financial and accounting methodologies in alignment with disclosure and transparency standards." On the other hand, Al-Khudairi [16] defined governance as "the exercise of rationality and prudence, fostering trust, enhancing safety measures, optimizing resource utilization, increasing and enhancing value addition, promoting wisdom and judiciousness in managerial conduct and decisions, and safeguarding projects against elements of administrative corruption."

Yacoub [17] also defined governance as "a supervisory system adopted by business establishments to distribute powers and responsibilities among the various parties participating in it to set rules and procedures related to its affairs for the purpose of improving financial performance and preserving its economic reputation when making decisions related to serving shareholders, stakeholders, and society in an effective manner. It operates within a specific moral framework emanating from within the organization, functioning as a moral body with its own administrative systems and structures, independent of the authority or personal influence of any individual."

Similarly, Hindi [18] described governance as "the means that ensures to society that bank management takes care of the interests of the parties that matter to them."

Hassanein [19] offered a definition of governance as "a set of contractual relationships that link management, shareholders, and stakeholders through a set of mechanisms in the form of procedures and methods. These mechanisms are designed to manage banks and monitor their activities, ensuring the development of performance, disclosure, transparency, and accountability. This, in turn, maximizes the rights of shareholders in the long term while also considering the rights and interests of other stakeholders."

The significance of governance lies in its positive impact on the work environment and in protecting the interests of the transacting parties, particularly in the context of banks' relationships characterized by agency. Agency involves delegating matters to others and relying on them to act on one's behalf in various financial transactions such as sales, purchases, investments, financing, or speculation [20].

The importance of governance manifests in several key aspects:

1) **Financial Performance Review:** Governance ensures the thorough review of financial performance, proper utilization of bank funds, adherence to legal requirements, and oversight of the company's social responsibility practices in accordance with governance principles.
2) **Oversight and Accountability Procedures:** It establishes procedures for oversight and accountability to detect and address deviations and violations promptly.
3) Emphasis on Transparency: Governance places significant emphasis on transparency, both in financial and non-financial matters, aiming to provide comprehensive accounting information to facilitate informed decision-making.
4) **Risk Management:** Governance plays a crucial role in managing and monitoring risks, guiding banks away from unprofitable and high-risk investments. It underscores the importance of conducting feasibility studies for projects and maintaining a balanced investment portfolio.
5) **Preservation of Economic Reputation:** By upholding moral values and professional ethics, governance contributes to preserving the economic reputation of the company. It encourages adherence to sound and secure professional practices while complying with laws, regulations, and regulatory controls.
6) **Environment for Oversight:** Governance ensures an environment conducive to oversight by promoting adherence to auditing standards. It upholds independence in auditing practices, free from pressure from any external party.
7) **Evaluation and Monitoring:** Governance actively facilitates the evaluation and monitoring of the Board of Directors and Executive Management's performance. It underscores the role of the Audit Committee as a vital link between internal and external control mechanisms, ensuring the preparation of financial statements that disclose all necessary information to relevant stakeholders.

The economic significance of governance is underscored by the following factors:

1) **Enhancing Bank Value:** Governance endeavors to maximize the value of banks by bolstering their market stock prices and enhancing their competitiveness. Studies indicate that companies with robust governance structures typically yield higher returns on investments compared to those with weaker governance frameworks.
2) **Attracting Financing:** Effective governance facilitates the attraction of both local and foreign sources of financing, thereby expanding opportunities for growth and expansion.

3) **Efficient Resource Allocation:** Governance contributes to improving the efficiency of resource allocation and elevating performance levels within banks, fostering optimal utilization of resources.
4) **Developing Financial Markets:** Governance plays a pivotal role in developing financial markets and enhancing stability within them. By safeguarding investor interests and mitigating extreme market fluctuations, governance initiatives promote stability and foster economic progress.
5) **Efficient Privatization Programs:** Governance aids in the efficient implementation of privatization programs, steering towards optimal resource utilization and preventing corruption-related issues.
6) **Mitigating Financial Risks:** Governance safeguards companies from financial distress and collapse by bolstering supervisory roles, delineating and segregating powers, and minimizing conflicts of interest between owners and managers. This helps mitigate risks facing banks and their management, enhancing overall stability in the financial sector.

3.2. Governance principles

There are several principles of governance that can be clarified as follows:

1) **Availability of an effective governance framework:** We see in this principle the necessity of the governance structure working to raise the level of transparency and efficiency of markets, and it should be consistent with the role of the law and clearly define the division of responsibilities between the various bodies responsible for supervision, control, and commitment to implementing the law. He emphasized developing the governance structure, taking into account its impact on the macroeconomy, market integrity, and the incentives it provides to market participants, promoting market transparency and efficiency, and developing a clear legislative text that shows the division of responsibilities between different bodies while ensuring that the interests of the public are achieved.
2) **Disclosure and transparency:** This principle was established to ensure the achievement of disclosure and transparency in all basic matters related to banks, including the financial position, performance, ownership, and management of banks, and to conduct an annual review process by an independent auditor, with the aim of providing quality internal and objective auditing of the method used in preparing the financial statements. Availability of channels. Through which information can be obtained at the appropriate time and at the appropriate cost.
3) **Responsibilities of the Board of Directors:** The governance framework should ensure the strategic direction and guidance of the company, the effective oversight of the Board of Directors over the banks, and the Board of Directors' accountability for its responsibility to the banks and shareholders, through the members of the Board of Directors working on the basis of complete information and in good faith with due diligence. In the best interests of the company and shareholders.
4) **Rights of shareholders:** To protect shareholders and ensure that they are not exposed to any risk, governance practices affect the value of their shares or the value of the assets of the economic unit, and that these practices facilitate the exercise of their rights. This principle includes several aspects, including ensuring methods of registering, transferring or transferring ownership of shares and providing shareholders with adequate and timely information on all issues that require discussion and decision-making through meetings. To facilitate the exploitation of this complete information available in exercising the right to participate in meetings related to all topics and changes in the articles of association, offering additional shares, or merging with other institutions [20].
5) **Equal treatment for all shareholders:** Governance must take it upon itself to treat all

shareholders equally, including small (minority) shareholders, as well as foreign shareholders. In the event of a violation of the rights of shareholders, they should have the opportunity to obtain actual compensation and disclosure. Transparency in the trading of shares, as well as when there are any private interests of members of the Board of Directors or executives that prejudice the interests of the business unit [21].

6) **The role of stakeholders in governance:** This principle calls for encouraging effective cooperation between stakeholders and banks in order to make the banks successful, as well as creating new job opportunities, ensuring the continued strength of the company's financial position, respecting the rights of stakeholders stipulated by the law, and providing them with the opportunity to obtain appropriate compensation. In the event of violations of their rights and developing mechanisms for stakeholder participation in improving performance.

3.3. Basic components of governance:

Governance constitutes one of the basic steps towards finding and developing scientific and practical methodological methods for managing companies, and that governance is nothing but good management based in its essence on the following basic pillars [22]:

1) **Independence:** There are no undue influences as a result of pressures, and it is the mechanism that eliminates or greatly reduces conflicts of interest between the parties involved (the Board of Directors, executive management, auditors, owners, and other stakeholders).
2) **Accountability:** The ability to evaluate and evaluate the work of the Board of Directors and Executive Management, and not to neglect or tolerate any process of deception, falsification, corruption, manipulation, fraud, fraud, or causing harm, now or in the future.
3) **Discipline:** by following appropriate and correct ethical behavior and adopting laws, legislation and instructions that clarify rights and define duties, which is considered the main safety valve that guarantees governance.
4) **Transparency:** Providing a true picture of everything that is happening that shows the true conditions and assets in the banks and makes all parties fully aware of the truth of what is happening in these banks.
5) **Responsibility:** before all parties with an interest in banks in accordance with the assigned powers and specific duties.
6) **Social responsibility:** Looking at banks as a good citizen by raising social awareness and a high level of exemplary behavior and values for their employees. Therefore, governance maintains a balance between economic and social goals, and the goals of individuals and society. The goal is to bring the interests of individuals, companies, and society as a whole closer together.

3.4. Definition of audit quality and its importance

Various scholars and researchers have articulated diverse perspectives on the concept of audit quality. The International Federation of Accountants (IFAC) has provided a definition, stating that it entails "the policies and procedures adopted by the office to provide reasonable confidence that all audits conducted by the office have been carried out in accordance with the objectives and basic principles that govern the audit process set forth in international auditing standards." Similarly, the Arab Society of Certified Public Accountants has delineated audit quality as the means through which a firm can reasonably ensure that the opinions expressed in the audits it conducts consistently adhere to generally accepted auditing standards, legal or contractual requirements, or any professional standards established by the firm itself [23].

Moreover, it is underscored in paragraph [24] of the standard that auditors must factor in risk assessments when formulating the audit program. Specifically, auditors are required to consider estimates of inherent risks and control risks, as well as the requisite level of assurance to be provided by basic procedures [21].

The British Standards Institute (BSI) defined audit quality as: "An administrative philosophy that includes all the bank's activities through which the needs and expectations of the customer and society are met, and the bank's objectives are achieved in the most efficient and least expensive ways through the optimal use of the energies of all employees with a continuous drive for development" [25].

The significance of audit quality stems from the reliance placed on the outputs of the audit process, particularly the auditor's report, by numerous users in formulating decisions and devising policies. Consequently, audit quality emerges as an indispensable prerequisite for all stakeholders benefiting from the audit process. The importance of audit quality spans various domains, encompassing [26]:

1) **Bank Management:** The responsibility for preparing financial statements lies with bank management. Hence, conducting the audit process with high quality enables them to identify both strengths and weaknesses, facilitating the development of future plans. Furthermore, a favorable auditor's report elicits positive market reactions, potentially boosting demand for the bank's shares and enhancing its reputation among suppliers and stakeholders.
2) **Banks and Financial Institutions:** Banks and financial institutions heavily rely on audited financial statements, particularly in the context of granting loans and banking facilities. The quality of the audit process can significantly influence the quality of their decision-making processes.
3) **Investors:** External stakeholders, including investors—both current and prospective—rely extensively on a company's financial statements to make investment decisions. Consequently, the quality of the audit can positively impact investors' decision-making processes.
4) **Creditors:** Creditors depend on audited financial statements, authenticated by external auditors, to assess the creditworthiness of potential borrowers and to make informed decisions regarding credit facilities.
5) **Government Agencies:** Government entities utilize audited financial statements for various purposes, such as strategic planning, regulatory compliance, taxation, and subsidy allocation to specific industries. Ensuring the high quality of audit work is paramount for safeguarding economic activity and the interests of all relevant stakeholders.
6) **Professional Associations and Regulatory Bodies:** These entities play a pivotal role in enforcing standards that mandate a high level of audit quality. By promoting adherence to rigorous standards, they contribute to the professional development of auditors, enhance public trust, and mitigate the need for government intervention in auditing practices.

3.5. Elements of audit quality

The elements of audit quality are essential components that ensure the integrity, reliability, and effectiveness of the auditing process. These elements can be derived from previous definitions and encompass the following:

1) **Impartiality, Honesty, and Objectivity:** Auditors must maintain impartiality and independence while expressing their opinion on the fairness of the financial statements. They should conduct their professional services with honesty and adhere to objectivity, ensuring fairness and freedom from conflicts of interest or external influences [27].
2) **Personnel Management:** This involves establishing policies and procedures to

ensure that auditors possess the necessary qualifications and skills to perform their duties effectively. It includes allocating work to individuals with appropriate technical expertise and providing ongoing training and professional development opportunities. Evaluation of auditors' performance should be conducted based on their qualifications and competence in completing assigned tasks [28].

3) **Acceptance and Continuation of Client Engagement:** Policies and procedures should be in place to evaluate the extent to which a client should be accepted or retained. These measures aim to mitigate risks associated with dishonest clients and ensure that audit engagements are undertaken only when they can be performed with professional competence.
4) **Conducting the Audit Process:** Policies and procedures should ensure that audit activities are conducted in accordance with professional standards, regulatory requirements, and internal quality standards. This involves maintaining consistency and rigor in audit procedures to uphold the integrity and quality of the audit process [29].
5) **Follow-Up or Monitoring:** A monitoring program should be established to evaluate and continuously review the effectiveness of the office's policies and procedures related to audit quality. Regular assessments should be conducted to ensure compliance with established quality standards and to identify areas for improvement [30].

The International Auditing Standard (ISA) 220 outlines the key elements of control over audit quality, which are crucial for ensuring the integrity and effectiveness of the audit process. These elements are as follows [31]:

1) **Professional Requirements:** Audit firms must uphold the principles of independence, honesty, objectivity, confidentiality, and professional ethics among their employees. Adherence to these professional standards is essential for maintaining the integrity and credibility of the audit process [32].
2) **Skill and Competence:** Audit firms should ensure that individuals appointed to perform audit work possess the necessary academic qualifications and practical experience to execute their duties with due professional care. Competence in auditing techniques and standards is paramount for conducting thorough and effective audits.
3) **Task Allocation:** Assigning audit tasks to a proficient work team with appropriate levels of training and professional competence is essential. The allocation of tasks should be based on the specific circumstances of the audit engagement to ensure optimal performance and adherence to quality standards [32].
4) **Supervision:** Supervision and oversight of audit work at all levels are crucial for ensuring that the work meets the required quality standards. Supervisors must provide appropriate guidance and support to audit teams to maintain the integrity and rigor of the audit process.
5) **Consultation:** Consultation with individuals possessing relevant expertise, either within or outside the audit firm, should be conducted as needed. Seeking advice and guidance from knowledgeable sources can help address complex audit issues and ensure the accuracy and completeness of audit procedures [33].
6) **Acceptance or Termination of Client Engagements:** Audit firms must establish procedures to evaluate potential clients before accepting new engagements and continuously monitor relationships with existing clients. Consideration should be given to factors such as independence and the ability to serve the client effectively.
7) **Oversight:** Continuous monitoring and evaluation of the effectiveness of audit quality policies and procedures are essential for maintaining high standards of audit quality. Oversight mechanisms should be in place to assess the suitability and effectiveness of the audit firm's quality control system [29].

By adhering to these elements of audit quality, auditing firms can uphold the highest standards of professionalism, integrity, and effectiveness in their practice, thereby enhancing trust and confidence in the audit process and financial reporting.

3.6. Audit quality requirements

Increasing public awareness of the pivotal role played by auditors can catalyze significant advancements within the profession. This heightened awareness can foster an environment conducive to development, both directly and indirectly. It can lead to the establishment of comprehensive laws, regulations, and standards that govern the auditing profession, ensuring adherence to best practices and ethical standards. Additionally, it can prompt the implementation of robust education and training programs to equip auditors with the necessary competencies and expertise.

Key stakeholders within the auditing profession have identified several main elements for enhancing its effectiveness and role [24]:

1) **Establishment of Professional Standards:** Developing objective and universally accepted professional standards or guidelines is essential. These standards should be endorsed by all members of the profession and regulatory bodies, ensuring consistency and quality in auditing practices.
2) **Preparation of Competent Members:** It is imperative to ensure that auditors possess both academic qualifications and practical experience. They must be fully cognizant of their professional obligations towards stakeholders and understand the scope of their responsibilities. Furthermore, they should be aware of the repercussions of any shortcomings in fulfilling these obligations [34].
3) **Formation of Oversight Bodies:** Responsible oversight bodies, whether internal or external to the profession, should be established. These bodies are tasked with monitoring the work of auditors, holding them accountable for their actions, and imposing penalties on those who violate professional standards and ethical norms.

By implementing these measures, the auditing profession can enhance its effectiveness and uphold its responsibilities towards clients and stakeholders, thereby fostering trust and confidence in financial reporting practices.

3.7. Factors affecting audit quality

These factors can be explained as follows:

1) **Auditor independence:** The independence of auditors stands as a fundamental requirement that sets the auditing profession apart from others and serves as the cornerstone of confidence in financial statements. According to Rule (101) of the Rules of Professional Conduct established by the American Institute of Certified Public Accountants (AICPA), auditor independence is defined as maintaining an impartial perspective throughout audit procedures, reporting findings, and issuing audit reports. It emphasizes the necessity for auditors to remain unbiased and neutral, particularly when conducting audit tests and communicating results. Any compromise in auditor independence can lead to audit failures, as auditors may overlook critical errors or inaccuracies in financial statements, undermining the reliability and integrity of the audit process [35].
2) **Experience and scientific qualification:** Ensuring the experience and scientific qualifications of the audit team is paramount in conducting effective audits. This entails ensuring that team members possess the necessary expertise, technical competence, and knowledge to execute their audit responsibilities proficiently. Scholars have offered two perspectives on defining expertise in auditing. The first perspective views expertise as the ability to perform audit tasks at the highest level of proficiency, while the second perspective defines it as the accumulated experience gained over time in a specific role or task.

To meet these requirements, audit firms must employ personnel who possess the requisite experience and skills essential for carrying out audit functions effectively. This involves developing recruitment programs tailored to attract individuals with the necessary competencies, forecasting workforce needs, establishing clear hiring objectives, and delineating the qualifications expected of those entrusted with recruitment tasks. The International Federation of Accountants (IFAC) has delineated professional experience as "the practical work experience acquired by an aspiring or qualified auditor, deemed appropriate for auditing work." Experience programs facilitate the development of professional competence, including ethical conduct, in the workplace, and provide a platform for individuals to demonstrate their professional aptitude [36].

3) **Supervision of auditing team:** Supervising the audit team, particularly assistants, is a critical responsibility typically entrusted to auditors holding senior positions within the organizational hierarchy. These individuals are tasked with training, guiding, and overseeing assistant auditors, particularly in complex audit scenarios. International Standard on Auditing No. (300) underscores the significance of directing, supervising, and monitoring. Accordingly, auditors are required to meticulously plan the nature, timing, and extent of direction and supervision of engagement team members, as well as review their work.

   The approach to directing and supervising engagement team members, as well as reviewing their work, is contingent upon various factors. These include the size and complexity of the banks under audit, the audit's scope, the risks of material errors, and the capabilities and competence of the audit team members. Auditors must meticulously plan the nature, timing, and extent of direction and supervision of engagement team members based on the assessed risk of material misstatement. As the assessed risk of material misstatement increases, typically necessitating a broader scope of audit risk, auditors are compelled to enhance the extent and continuity of direction and supervision of engagement team members and conduct more extensive auditing [37].

4) **Communication between the audit team and the client:** Communication between the audit team and the client is a vital aspect of the audit service, predicated on a bilateral and direct relationship between the audit firm and its clients. This relationship is purposeful and limited in scope, tailored to the specific needs and objectives of the audit engagement.

   Effective communication between the client and the audit firm serves a distinct purpose, facilitating the exchange of essential information necessary for the audit process. Auditors often rely on personnel within the client organization to provide insights into the nature of their operations and furnish evidence that may not be readily accessible through document examination alone. International Auditing Statement (1007), issued in March 1994, underscores the importance of the communication process between auditors and bank management.

   The communication process typically unfolds throughout the audit process or upon its completion. During the audit, auditors may engage with management to discuss various matters, including the nature of the bank's operations, the audit plan, the impact of new legislation or professional standards, information required to assess audit risks, and any observations or recommendations regarding operational efficiency or long-term strategies of the bank. This ongoing dialogue ensures that auditors have access to pertinent information and insights essential for conducting a comprehensive audit [37].

4. Conclusion

The internal governance system within banks plays a pivotal role in managing and controlling the flow of financial information. However, in some cases, this system may lead to the suppression or concealment of crucial financial data. Such practices can have far-reaching implications, affecting not only the internal operations and performance of banks but also exerting an influence on their external perception and market valuation. Consequently, investors may face challenges in accurately assessing the true financial health and stability of banks, potentially leading to fluctuations in their stock prices.

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