

# **The Impact of the Internal Control System on the Quality of Financial Reports in Jordanian Government Institutions (Greater Amman Municipality case study)**

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## **Abstract**

This study aimed to demonstrate the impact of the internal control system on the quality of financial reports in Jordanian government institutions. The Greater Amman Municipality case study was chosen as a sample for the study, to represent the study community, which is the Jordanian government institutions, due to the diversity of their services.

To achieve the objectives of this study, the descriptive analytical method was used, where the questionnaire was used as a main tool for this study, which was specially prepared to answer the study questions and test its hypotheses. The questionnaire was distributed to the responding individuals in the Amman Municipality. The necessary statistical analyzes were performed to analyze the data, and to test the hypotheses using the SPSS program.

The study found a statistically significant effect at the significance level ( $\alpha \leq 0.05$ ) for the components of the internal control system (control environment, control activities, risk assessment, information and communication, control) on the quality of financial reports represented by appropriateness and honest representation.

The study recommended a number of recommendations of which are: Increasing attention to the control environment for building an effective control system and paying attention to setting procedures.

**Keywords: internal control system; quality of financial reports; Government Institutions; Greater Amman Municipality; Jordan; case study**

## 1. Introduction

The beginning of the third millennium witnessed a clear interest in internal control by organizations and institutions in the countries of the world, especially after the crises and financial collapses that a number of major companies and institutions were exposed to. As one of the most important causes of these crises and collapses was the weakness of the internal control system.

According to Samra (2017), the interest in control systems and the role they can play within the institution has increased after the separation of ownership from management, especially after a series of financial scandals suffered by many economic institutions in many countries of the world, which proved the failure of the internal control systems in them. And as a result, Sarbanes-Oxley Law was issued, which emphasized the necessity of institutions' accreditation of financial information through internal control systems.

Therefore, it was necessary to have an effective and strong control system; thus in order to avoid crises and collapses in global institutions; These crises have proven the importance of the internal control system for these institutions, and the impact of effective control on their performance and preservation of their assets and funds in a manner that ensures proper workflow and adherence to laws and regulations, and this makes their financial reports of high quality and credibility.

Governmental institutions are considered as part of the global institutions that are concerned with the internal control system, more specifically because of the large size of these institutions and the increasing responsibilities entrusted to them. Aiming at achieving services and welfare for the community, and for this, government institutions must have a developed and effective internal control system, for the purpose of preserving public resources and assets from embezzlement, neglect or squandering in order to maintain the continuity of their existence, and to produce financial reports of high quality and credibility, and thus improve the national economy as a whole.

According to Al-Samarrai (2016), the internal control system is the key part of the conduct and organization of companies' work and the achievement of their aspired visions and goals. And then being a system that helps preserve assets from squandering and loss, raise production efficiency and attract investors by reflecting clear information in the financial reports issued by it.

Hence, this study came to show the importance and impact of the internal control system on the quality of financial reports in Jordanian government institutions, specifically in the Greater Amman Municipality, due to the diversity of its services provided to various sectors of society and its members, in addition to the breadth of its borders, which made it deal with many ministries and companies, so The case study in this research will be devoted to the Greater Amman Municipality.

## **2. The study problem**

The Jordanian government sector seeks to reduce and stop unjustified spending, reduce financial and administrative deviations and reach high efficiency, and thus come up with more accurate and high financial reporting quality. Hence, the internal control of the Jordanian government institutions, where the problem of the study lies in knowing the impact of the internal control system on the financial reporting quality.

### **2.1. The study problem can be formulated in the following main question:**

What is the impact of the internal control system on the financial reporting quality in Jordanian government institutions (the Greater Amman Municipality as a case study)?

### **2.2. The following sub-questions are derived:**

- What is the impact of the internal environment on the financial reporting quality in Jordanian government institutions (the Greater Amman Municipality as a case study)?
- What is the impact of control activities on the financial reporting quality in Jordanian government institutions (the Greater Amman Municipality as a case study)?

- What is the impact of risk assessment on the financial reporting quality in Jordanian government institutions (the Greater Amman Municipality as a case study)?
- What is the impact of information and communication on the financial reporting quality in Jordanian government institutions (the Greater Amman Municipality as a case study)?
- What is the impact of control on the financial reporting quality in Jordanian government institutions (the Greater Amman Municipality as a case study)?

### 3. The study importance

The importance of this study lies in the fact that it dealt with one of the most important contemporary and modern topics and is extremely important, which is to know the impact of the internal control system on the financial reporting quality, specifically in Jordanian government institutions. However, the internal control system is of great importance in light of the government sector's efforts to reduce and stop unjustified spending and reduce financial and administrative deviations, and in light of the Coronavirus (COVID-19) pandemic and its impact on the Jordanian economy.

### 4. The study objectives

The aim of this study is to identify the impact of the internal control system on the financial reporting quality in Jordanian government institutions, especially in the Greater Amman Municipality, where the objectives of the study can be summarized as follows:

- A- Knowing the role of the internal control, especially in the public sector, as it is the first line of defense for protecting public funds, ensuring optimal use of them, maintaining the safety of their funds, and protecting their assets, as well as its role in making decisions, planning and evaluating the performance.
- B- The government institutions can make use of the results of this study, by identifying the impact of the internal control system on the financial

reporting quality, and this may help in combating corruption and financial abuses and therefore develop the national economy as a whole.

- C- This study may contribute to encouraging the government sectors in supporting the honest representation of financial reports. Also, helps in producing credible and high quality of financial reporting, and thus develop the national economy.

## 5. The study hypotheses

### The main hypothesis:

**HO:** There is no statistically significant impact for the internal control system on the financial reporting quality in Jordanian government institutions at the significance level ( $\alpha \leq 0.05$ ).

### The following hypotheses are derived from it:

**HO1:** There is no statistically significant impact for the internal environment on the financial reporting quality in Jordanian government institutions at the significance level ( $\alpha \leq 0.05$ ).

**HO2:** There is no statistically significant impact for control activities on the financial reporting quality in Jordanian government institutions at the significance level ( $\alpha \leq 0.05$ ).

**HO3:** There is no statistically significant impact for risks assessment on the financial reporting quality in Jordanian government institutions at the significance level ( $\alpha \leq 0.05$ ).

**HO4:** There is no statistically significant impact for information and communication on the financial reporting quality in Jordanian government institutions at the significance level ( $\alpha \leq 0.05$ ).

**HO5:** There is no statistically significant impact for control on the financial reporting quality in Jordanian government institutions at the significance level ( $\alpha \leq 0.05$ ).

## 6. Literature review

There are many definitions about the concept of internal control, and these definitions include: COSO (2020) definition, which defined it as a process implemented by the facility's board of directors, management, and other employees and designed to provide reasonable assurance regarding the achievement of objectives related to operations, reporting and compliance with laws and regulations.

Shahat (2019) is a process of controlling risks and providing reasonable assurance that these risks are within the permissible limits, and this perspective from Shahat's point of view is considered a modern perspective, as control is no longer seen as a set of procedures and methods that prevent the occurrence of areas of fraud and errors, but rather control over them. and provide reasonable assurance that they are within the permissible limits. It was defined as a set of pre-designed means, procedures and policies, prepared by the administration, with the aim of protecting assets and property from theft and loss and reducing risks; To reach transparency and reliability in each financial statement, to ensure that what was planned is what has been implemented, and to detect deviations, if any (Sha'at, 2017).

The International Auditing Standards (315) defines internal control as: - a process designed according to the organization's management that helps in obtaining reasonable assurance about the financial statements, with the efficiency and effectiveness of operational processes and compliance with the regulations, laws and policies that have been achieved (Al-Thneibat, 2017).

Whereas, the internal control in Great Amman Municipality can be defined as a set of laws and methods aiming at monitoring and protecting its assets and properties from neglect and unjustified spending as well as reducing financial and administrative deviations. Also, ensuring the integrity of procedures and completion of tasks and services transparently, without bias or discrimination, and enhancing citizen confidence in Great Amman Municipality decisions, Thus, it enhances the quality and efficiency of its work and its outputs.

The internal control system of the Jordanian government consists of many controls, procedures, and legislation in the financial field. Based on according to Al-Abadi (2014), these controls are: legislative controls, the general budget, regulatory controls, selection, and training of human resources.

Any system must have dimensions and components to be its basic starting base for its coetaneity of existence. However, The Committee of Sponsoring Organizations (COSO) is considered the leader in the areas of the internal control system. And for the purpose of the study, the basic components and dimensions of internal control will be adopted according to (COSO, 2016) in measuring the internal control system, which are as follows:

**First: The internal control environment:**

The regulatory environment is the backbone of the regulatory system, and serves as the basis for the other components, Thiba (2019), Ramhi (2016), Whittington (2015) and Stephens (2009).

**Second: Control activities:**

The actions and plans established through the policies and procedures used by departments to ensure that their directives are implemented and adhered to; In order to reduce the risks related to achieving goals and taking the necessary actions, Issa and Makki (2019) and Mushtahi (2015), Romney (2015) and Louwers (2012), at al

**Third: Risk assessment:**

It is the identification and analysis of the risks that may face the company's objectives, especially with regard to the information that is included in the financial statements, and the extent to which that information is compatible with generally accepted accounting principles, besides the management trying to maintain low levels of risks, Al Ramahi (2016), Ezzedine (2015) and Romney (2015).

**Fourth: Information and Communication:**

It is an effective internal control system that requires reliable information systems as to cover the entire activities of the economic unit,

besides the effective communication channels to ensure that all employees fully understand and comply with the control policies and procedures related to their work and responsibilities within the system, Al Ramahi (2016).

#### **Fifth: Control:**

This component monitors the internal control system directed to determine the extent to which the control is implemented, and whether it is appropriate and capable of addressing new risks, on a continuous basis, in line with the changes that occur in the facility, Al-Madhoun (2014).

Quality in general is the validity of the thing for the purpose for which it was prepared, and quality aims to achieve excellence in private and public institutions. As for quality in reports, it includes increasing emphasis on the final outputs of the accounting information system, by reducing defects and errors in performance and producing quality financial reports. The concepts of the quality of financial reports varied due to the multiplicity of opinions, including:

- The quality of reports is defined as those financial reports that fully and transparently reflect the quality of financial information; In order not to mislead or distort that information provided to investors, which helps them in making a decision (Achim & Chis, 2014) and (Shaaf, 2017).
- It is the transparent aspect of reports or financial statements that reflects the nature of the organization's work, which enables investors to make rational decisions (Hamada, 2014).

According to the previous concepts of the quality of financial reports, the quality of financial reports can be defined as: - Accuracy and credibility in preparing and communicating financial reports and information about the operations of institutions in general, and the expected cash flows in particular to investors, without bias or misleading from management and within the accounting and legal standards applicable in these Institutions to thus reflect their true reality and come up with reliable and appropriate information for users of financial reports.

The qualitative characteristics of information are a prerequisite for the preparation of high quality financial reports, so that the features that

make financial reports more useful to users of accounting information for decision-making are considered

The conceptual framework of financial reporting divides the qualitative characteristics of useful financial information into two groups:

- The first group is the basic qualitative characteristics and consists of relevance and honest representation, Hamidat & Khadash (2013), Salem & Ahmed (2013), Mirza, et al. (2008) & Achim, Chiş (2014), Al-Jaarat (2012) and Al-Hamid (2009).
- The second group is the characteristics that enhance or support qualitative characteristics and include comparability, verifiability, timeliness, and comprehension. Al-Arabi (2014), Sahloul (2014) and Jodeh (2021).

## **7. Methodology and Procedures**

### **7.1. Methodology**

This study is considered one of the field studies, in which the researcher followed the descriptive-analytical approach, with the aim of identifying the impact of the internal control system on the financial reporting quality in Jordanian government institutions and to analyzing the relationships between independent and dependent variables.

### **7.2. Study community**

The study population consists of Jordanian government institutions.

### **7.3. Study sample**

A case study of the Greater Amman Municipality, represented by the respondent individuals, who are the employees of the Department of Finance, the Internal Audit and Control Department of the Greater Amman Municipality, whereas the number of active employees in these departments is (200) employees. Hence, a special questionnaire was designed for this study and distributed to the (200) respondents, of which (100) were returned, (40) questionnaires were invalid and incomplete data were excluded, and (60) questionnaires were adopted, namely, representing 30% of the respondents.

To conduct this study, two independent samples were selected from the responding sample.

### 7.3.1. The survey sample

It is a sample that was selected from the responding individuals, and it isn't among the primary sample, with the aim of verifying the validity and reliability of the study tool. Mainly, the questionnaire was distributed in its final form to the exploratory sample, the size was (11) respondents from managers, heads of departments, and effectively working accountants, all of whom work in the Department of Finance, the Internal Audit and Control Department at the Greater Amman Municipality.

Therefore, the Kolmogorov-Smirnov test was used, in order to verify that the data of the exploratory sample follows a normal distribution since the size of the exploratory sample is less than (30). The table of the normal distribution test for the exploratory sample demonstrates that the data of the exploratory sample follows the normal distribution, as the probability value (0.2) is greater than the significance value (0.05).

### 7.3.2. The core sample

The core sample of the study consists of (60) respondents, who are managers, heads of departments, and effectively working accountants, all of whom work in the Department of Finance, the Internal Audit and Control Department at the Greater Amman Municipality, though they were chosen by the access method, and the equation (community size X 0.3) was used to obtain the basic sample size.

## 8. Data collection sources

Data was collected from two sources:

- A- Secondary sources: by referring to relevant Arab and foreign books, references, periodicals, articles, reports issued by official authorities, previous research and studies, and the particular readings on the websites aiming at completing this study.
- B- Primary Sources: The main measuring tool for the variables of this study was through the design of a special questionnaire for the subject of this study to reflect the impact of the internal control system on the financial reporting quality in the Greater Amman Municipality. The internal procedure in the Greater Amman

Municipality, where the questionnaire included (49) items to verify the hypotheses and answer its questions.

### **8.1. Study Tool**

#### **The study tool (the questionnaire) consists of three parts:**

The first part: It is related to the demographic variables of the study sample members and thus through the following (5) variables: academic qualification, specialization, job title, scientific experience, and professional certificates. These variables are used for the purpose of describing the characteristics of the study sample.

The second part: included the measure of the internal control system across five main dimensions, according to the (COSO) measure of internal control, which are (control environment, control activities, risk assessment, information and communication, control).

The third part: included the measure of the financial reporting quality through two main dimensions, namely (appropriateness and honest representation).

Whereas, the Five Likert Scale was used to measure the respondents' answers to the questionnaire items, and thus the questionnaire (the study tool) in its final form consisted of (49) items on the Five Likert Scale. Broken down by dividing the product of the difference between the highest value of scale (5) and the lowest value in it (1) on three levels (1 to 2.33, low), (2.34 to 3.67, medium), (3.68 to 5, high).

### **8.2. Hypothesis testing and the results of the statistical analysis of the study**

#### **8.2.1. Analysis of the questionnaire paragraphs**

In order to identify the responses of the study sample to the items of each component in detail, the maiden and standard deviations of the study sample responses to the items were calculated, as shown in Table 1.

Table 1: The maiden and standard deviations of the study sample responses

Statement	maiden	Standard deviation
<b>Elements of internal control system:</b>		
Internal environment component	3.56	0.748
control activities component	3.69	0.701
Information and communication component	3.77	0.554
Risk assessment component	3.64	0.604
Control component	3.38	0.680
<b>Core elements of financial reporting quality:</b>		
Appropriateness	3.83	0.606
Honest representation	3.81	0.568

## 8.2.2. Hypothesis testing and statistical analysis results

### 8.2.2.1. The main hypothesis

**HO:** "There is no statistically significant impact for the internal control system, on the financial reporting quality in Jordanian government institutions at the significance level ( $\alpha \leq 0.05$ )."

With the aim to verify the validity of the main hypothesis, the Multiple Linear Regression was used to form a linear relationship between the independent variables (Internal environment, control activities, risk assessment, information and communication, control), and the dependent variable (the financial reporting quality), as shown in Table 2.

Table 2: Summary of the regression model for the dependent variable (financial reporting quality)

Model	Correlation Coefficient	Squared Correlation Coefficient	Modified- Squared Correlation Coefficient
1	.802	.644	[[.611

Table 2 demonstrates that the five independent variables explain a rate of (64%) of the change in the dependent variable (the financial reporting quality). And in order to check whether this change was statistically significant at the significance level (0.05), a one-way analysis of variance (ANOVA) was used. See in the Table 3.

Table 3: One-way analysis of variance (ANOVA)

Model		Total squares	Freedom degree	Squared averages	F	P-value
1	Regression	12.198	5	2.440	19.529	.000 <sup>a</sup>
	Extra	6.746	54	.125		
	Total	18.944	59			

It can be seen from Table 3, there is a statistically significant impact at the significance level ( $\alpha \leq 0.05$ ), whereas the probability value is (0.000) which is less than (0.05).

Therefore, to establish a linear relationship between the independent variables and the financial reporting quality, Table 4 shows the coefficients of the five independent variables.

Table 4: Transaction values for the dependent variable (financial reporting quality).

Model		Non-standard coefficients		Standard coefficients	T	P-value
		B	Standard error	Beta		
1	(Constant)	1.183	.328		3.608	.001
	Internal environment	.256	.099	.338	2.591	.012
	Control activities	-.001-	.114	-.001-	-.007-	.019
	Risk assessment	-.083-	.148	-.089-	-.560-	.047
	Information & communication	.196	.142	.191	1.377	.017
	Control	.383	.127	.460	3.008	.004

As shown in the Table 4 , the coefficients of the independent variables. Also, the table shows the presence of a statistically significant impact for the components of the internal control system (internal environment, control activities, risk assessment, information and communication, control) on the financial reporting quality at the significance level ( $\alpha \leq 0.05$ ), where the p-values are less than the significance level (0.05).

### 8.2.2.2. The first sub-hypothesis

**HO1:** "There is no statistically significant impact for the internal environment on the financial reporting quality in Jordanian government institutions at the significance level ( $\alpha \leq 0.05$ )."

So, in order to verify whether there is a statistically significant impact of the "internal environment" component on the two financial reporting quality dimensions (appropriateness, and honest representation) as well as on the quality of the financial reporting as a whole, however, Multi analysis of variance MANOVA was used.

Meanwhile, it was also found that there was a statistically significant impact for the variable (internal environment) on the appropriateness at the significance level ( $\alpha \leq 0.05$ ), and it was found that there was a statistically significant impact for the internal environment variable on honest representation.

### 8.2.2.3. The second sub-hypothesis

**HO2:** "There is no statistically significant impact for the control activities on the financial reporting quality in Jordanian government institutions at the significance level ( $\alpha \leq 0.05$ )."

Hence, to verify whether there is a statistically significant impact of the (control activities) component on the two dimensions of financial reporting quality (appropriateness, and honest representation) as well as on the financial reporting quality as a whole, however, Multi analysis of variance MANOVA was used.

It was also found that there was a statistically significant impact for the variable (control activities) on the appropriateness at the significance level ( $\alpha \leq 0.05$ ), in addition to that, there was a statistically significant impact for the variable (control activities) on honest representation.

### 8.2.2.4. The third sub-hypothesis

**HO3:** "There is no statistically significant impact for the risk assessment on the financial reporting quality in Jordanian government institutions at the significance level ( $\alpha \leq 0.05$ )", and for the purpose of checking whether there is a statistically significant impact of the (risk assessment) component on the financial reporting quality and its two

variables (appropriateness, and honest representation), whereas, Multi analysis of variance MANOVA was used.

It was also found that there was a statistically significant impact for the variable (risk assessment) on the appropriateness at the significance level ( $\alpha \leq 0.05$ ), and it was found that there was a statistically significant impact for the risk assessment variable on honest representation.

#### **8.2.2.5. The fourth sub-hypothesis**

**HO4:** "There is no statistically significant impact for information and communication on the financial reporting quality in Jordanian government institutions at the significance level ( $\alpha \leq 0.05$ )."

Intentionally, in order to verify whether there is a statistically significant impact of (information and communication) component on the financial reporting quality and its two dimensions (appropriateness, and honest representation), the Multi analysis of variance MANOVA was used. Actually, there was a statistically significant impact for the variable (information and communication) on the appropriateness at the significance level ( $\alpha \leq 0.05$ ), also, it was found that there was a statistically significant impact for the information and communication variable on honest representation.

#### **8.2.2.6. The fifth sub-hypothesis**

**HO5:** "There is no statistically significant impact for control on the financial reporting quality in Jordanian government institutions at the significance level ( $\alpha \leq 0.05$ )," and with the aim of checking whether there is a statistically significant impact of (control) dimension on the financial reporting quality and its two dimensions (appropriateness, and honest representation) where the Multi analysis of variance MANOVA was used.

It was also found that there was a statistically significant impact for the variable (control) on the appropriateness at the significance level ( $\alpha \leq 0.05$ ), also there was a statistically significant impact for the variable (control) on honest representation.

## 9. Discussing results

The most important results of the study and their interpretation according to the sequence of its questions

### 9.1. The descriptive results of the study variables

- 1- The results of the study showed that the level of the internal environment in the studied government institutions and thus the study sample's point of view was average, and this points out that the internal control system needs paying more attention in the event of upgrading the internal environment in government institutions.
- 2- The results of the study showed that the control activities' level in the studied governmental institutions and from the study sample point of view was average; This indicates that the internal control system needs to be addressed and attention must be increased to raise the level of control activities in government institutions.
- 3- The results of the study showed that the level of risk assessment in the studied government institutions from the study sample's point of view was moderate; This sheds the light on the need to address the internal control system and more attention must be paid in order to develop the level of risk assessment in government institutions.
- 4- The results of the study showed that the level of information and communication in the studied governmental institutions and thus from the study sample's point of view was high, while the (information and communication) level achieves the average, Additionally, they need to be dealt with or increase the paid attention toward it.
- 5- The results of the study showed that the level of control in the studied governmental institutions from the study sample's point of view reached the average; This suggests the need to tackle the internal control system and increase the attention aiming at advancing the level of control in government institutions.
- 6- The results of the study showed that the level of financial reporting appropriateness in the studied government institutions from the study sample point of view was high, while the focus of the financial reporting appropriateness reached approximately a close level to the average, taking

into account that this dimension needs to be talked about or more attention must be increased.

- 7- The results of the study also showed that the level of honest representation of financial reporting in the studied government institutions, and from the study sample point of view was high, however, the concentration of honest representation of financial reporting approximately reached the average. Also, it is required to deal with or give more attention to it.

### **9.2. The results of testing the study the hypotheses of the study**

- 1- There is an impact of the internal control system on the financial reporting quality in the Greater Amman Municipality.
- 2- There is an impact of the internal control system with its five components separately on the adequacy of the financial reporting in the Greater Amman Municipality.
- 3- There is an impact of the five components of the internal control system one at a time on the honest representation of financial reporting in the Greater Amman Municipality.

## **10. Recommendations and suggestions**

- 1- Increase the attention concerning the internal environment, as it is the basis for building an effective control system in order to combat violations and abuses, create ethical values that motivate employees to work in an impartial manner, too.
- 2- Pay better attention to complaints and activate them as a control tool so that they are dealt with objectively and impartially, also, provide communication channels that enable employees to communicate information about any violations and abuses.
- 3- Consideration must be given to information and communication as well as keep them updated on a continuous basis, additionally, attention must be paid to the electronic monitoring system within the government institutions.

- 4- Increasing the number of internal control workers in the government institutions, particularly in the Greater Amman Municipality, due to the expansion of its borders and services, and the multiplicity of its departments.
- 5- Give more interest to the issue of holding training courses related to preparing and developing public sector employees on a periodic basis in the internal control system.
- 6- The necessity of conducting more studies regarding the impact of the internal control system on the financial reporting quality, and improving the internal control system in the government sector, due to its important role in enhancing the financial reports quality.

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