

THE IMPACT OF INTERNAL CONTROL SYSTEMS ON
PROFITABILITY: EVIDENCE FROM PALESTINE STOCK
EXCHANGE LISTED COMPANIES

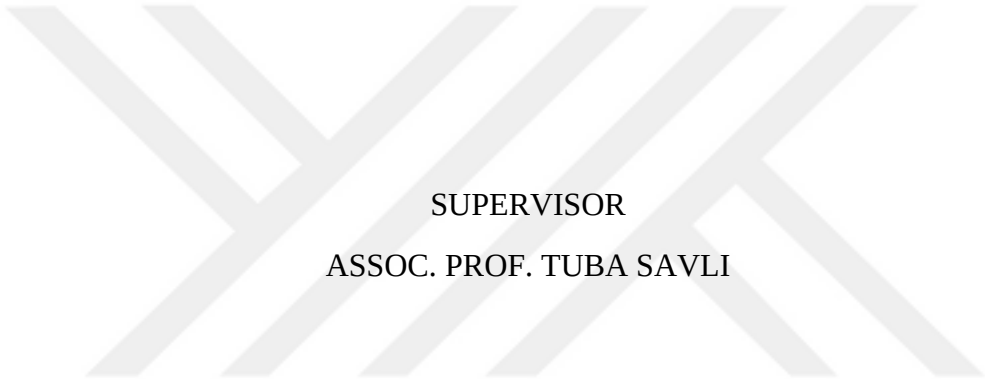


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İSTANBUL, 2023

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PROFITABILITY: EVIDENCE FROM PALESTINE STOCK
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İSTANBUL, 2023

PLAGIARISM

I hereby declare that all information in this document has been obtained and presented in accordance with academic rules and ethical conduct. I also declare that, as required by these rules and conduct, I have fully cited and referenced all material and results that are not original to this work.

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ABSTRACT

This study examines the impact of internal control systems on the profitability of companies listed on the Palestine Stock Exchange. The objectives of the research were to assess the commitment and effectiveness of internal control systems on these firms' profitability, determine the link between these systems and financial success, ascertain the degree of dedication and dependability of internal control systems, and highlight their components and characteristics. The findings reveal that there is no strong relationship between the efficiency of internal control systems and firms' profitability. While internal control systems play a crucial role in promoting good governance, risk management, and compliance, their impact on financial success appears to be influenced by additional factors beyond the internal control framework.

The study recognizes certain limitations, including the focus on the Palestinian market and the reliance on quantitative data analysis. Future research could include a broader sample and qualitative research methods to enhance the generalizability and depth of understanding. In conclusion, although there is no direct relationship between internal control system efficiency and profitability, the importance of implementing robust internal control practices cannot be understated. Organizations should adopt a holistic approach, integrating internal control systems with strategic management practices, to enhance overall performance. The findings contribute to the understanding of internal control systems and provide insights for practitioners, policymakers, and researchers seeking to strengthen internal control practices and foster sustainable financial success.

Key words: Effectiveness, Internal control systems, Profitability, Relationship.

ÖZET

Bu çalışma, iç kontrol sistemlerinin Filistin Menkul Kıymetler Borsası'nda işlem gören şirketlerin karlılığı üzerindeki etkisini incelemektedir. Araştırmanın amaçları, iç kontrol sistemlerinin bu firmaların karlılığı üzerindeki kararlılığını ve etkinliğini değerlendirmek, bu sistemler ile finansal başarı arasındaki bağlantıyı belirlemek, iç kontrol sistemlerinin adanmışlık ve güvenilirlik derecesini tespit etmek ve bileşenlerini ve özelliklerini vurgulamaktır. Bulgular, iç kontrol sistemlerinin etkinliği ile firmaların karlılığı arasında güçlü bir ilişki olmadığını ortaya koymaktadır. İç kontrol sistemleri, iyi yönetimi, risk yönetimini ve uyumluluğu teşvik etmede çok önemli bir rol oynamakla birlikte, finansal başarı üzerindeki etkilerinin, iç kontrol çerçevesinin ötesindeki ek faktörlerden etkilendiği görülmektedir.

Çalışma, Filistin pazarına odaklanma ve nicel veri analizine güvenme dahil olmak üzere belirli sınırlamaları kabul ediyor. Gelecekteki araştırmalar, genellenebilirliği ve anlayışın derinliğini artırmak için daha geniş bir örnekleme ve nitel araştırma yöntemlerini içerebilir. Sonuç olarak, iç kontrol sisteminin etkinliği ile karlılığı arasında doğrudan bir ilişki olmamasına rağmen, sağlam iç kontrol uygulamalarının uygulanmasının önemi azımsanamaz. Kuruluşlar, genel performansı artırmak için iç kontrol sistemlerini stratejik yönetim uygulamalarıyla bütünleştiren bütüncül bir yaklaşım benimsemelidir. Bulgular, iç kontrol sistemlerinin anlaşılmasına katkıda bulunur ve iç kontrol uygulamalarını güçlendirmek ve sürdürülebilir finansal başarıyı teşvik etmek isteyen uygulayıcılar, politika yapıcılar ve araştırmacılar için içgörü sağlar.

Anahtar kelimeler: İç kontrol sistemleri, Karlılık, Etkinlik, İlişki.

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1. INTRODUCTION

1.1. Overview:

Accounting organizations are more concerned in the past recent years with making sure that accounting data are both accurate and consistent. These concerns have inspired a burst of researches into the quality and accuracy of financial reports, particularly the assessment of profit quality and the factors which plays a role in generating these profits. However, it's known that for more than 40 years, researchers have been attempting to determine the information quality of reported profits based on their period aspects. Also, they wanted to analyze the relationship between reported earnings and dividend rates. In fact, findings were ahead of hypotheses and most of the financial terms were already known except for few, like for example, the concept of earnings quality which was unexpectedly vague, even among researchers, and its evaluation was also questionable. (Marinovic, 2013)

In this regard, concerns about the future of the raising companies and its continuity to support the economic system worldwide, as well as the hostile of business environment in today's economies, made companies struggle to assure survival and growth, and forced them to set strategic rules and procedures in order to attain comprehensive quality. Therefore, product quality in addition to stockholder interests and goals be accomplished. In parallel, risks and opportunities have become unpredictable factors that must be properly managed due to quick changes in the organization and operating environment. Consequently, risks and opportunities should always be evaluated and managed within the context of creating and accomplishing goals and objectives in order to improve managing risk and opportunity creation. (Gong, Yan, and Yang, 2020)

Due to a number of variables, including the escalating speed of global capital transfers, the prevalence of financial crises, and the succession of corporate scandals on the one hand, governance practices breakdowns, especially financial scandals, on the other hand, issues have been raising about the accuracy of financial information which are presented to shareholders, causing a loss of trust on the side of one or the other. As a result, studies emphasized that various precautions must be taken globally, starting in Europe in order to demonstrate global financial stability and restore public confidence in the markets, thereby, financial sector specialists and accounting academics started to

focus primarily on internal control effectiveness, along with the implementation of control weaknesses and their relationship to earnings control activities. Internal control systems along with corporate governance became the notions that stood out as a result of the breakthroughs. (Wali, 2020) Where basically internal control is a process that provides a reasonable guarantee regarding many issues, such as management's reaching its goals, protection of the management's assets, regulatory harmonization, the validity of financial statements, avoiding errors, cheating. While corporate governance is a management approach centered on equity, transparency, accountability, and responsibility principles and inconsistencies. However, managers' inadequacies indirectly raise doubts about management's competency and perspectives on financial reports when they develop and implement internal control systems. In fact, a poor internal control system could potentially endanger management attempts to further regulate business operations by limiting manufacturing costs, expenditure, and sales. (Güneş and Çiğdem, 2018)

Thereby, building a solid system of internal control is one of the strategies to eliminate external influences or economic risks. These internal control systems are normally built of five aspects that should help the firm to achieve its goals in the most efficient and possible way. These five internal control aspects are: First; *control environment*, which is concerned with management's internal control behavior. Second; *risk assessment*, which is linked with the recognition and assessment of risks. Third; *control activities*, which detects and prevent risks and correct them if they occur. Fourth; *information and communication*, which provides and passes information to stakeholders to support them in reaching their goals, thereby reaching the firm objectives. Fifth; *monitoring*, this side of the task involves ensuring that all internal control components are sufficient and operating correctly. While, the system of internal control must be closely monitored in order to determine performance over time, because changing circumstances necessarily require proper monitoring. Management on the other hand should aim to identify whether current internal procedures are still valid and capable of addressing emerging risks or not. (Bruwer, 2018)

Several evidence-based studies were conducted to identify the effects of internal controls on efficiency factors. Even though most of these studies confirm a strong connection between internal control systems and performance, others, on the other

hand, showed a low or non-existent relationship. Plus, the importance of a company's moral principles and honesty in maintaining effective management is frequently mentioned in accounting literature. Thus, internal control systems are significant obligations of the business board of directors in addition to its role in contributing to management performance. Finally, the integrated framework for internal control provided by COSO - one of the largest and globally accepted organizations that create standards for evaluating internal controls, risk management, and fraud prevention in companies - on false financial reporting made a major addition by highlighting ethics and high standards. In addition, the international federation of accountants has developed a document called the Code of Ethics to promote the independence of auditors and accountants across the world. (Ibrahim, 2017)

In this respect, it's worth noting that the COSO is the committee of sponsoring organizations of the treadway commission which is a joint effort of 5 private sector organizations: The American Accounting Association (AAA), The American Institute of Certified Public Accountants (AICPA), Financial Executives International (FEI), The Institute of Internal Auditors (IIA), And the Institute of Management Accountants (IMA). Thus, COSO by creating frameworks and guidelines for business managing risks, control systems, and fraud deterrence, demonstrates thought leadership. (Ejoh and Ejom, 2014)

1.2. Research Problem:

While companies grow physically as a consequence of economic relations developing due to globalization, trades generated by business operations have become more complex and diverse, reducing the ability to check a company's operations directly from corporate management. In addition, financial scandals and failures in recent years have damaged trust in business administration and external audit companies and created a growing need for accurate and reliable data. (Akbulut, 2012)

So, Due to its structural and regulatory implications, systems of internal control are now crucial for enterprises. The COSO framework, -which is an approach for setting up internal controls that are incorporated into company procedures. Additionally, these controls offer an acceptable level of confidence that the business is conducting itself with integrity, transparency, and in accordance with generally accepted norms.-, was created specifically for the basic control model, assists in the enhancement of an internal control system that is based on solid principles. Essentially, businesses that fail

to implement an efficient internal control system may experience a variety of issues. Lack of management decision-making processes in organizations, a decline in effectiveness at all levels, a rise in diversity opportunities, difficulties harmonizing legal processes, and disregard for moral and ethical principles. (Şimşek, 2020)

In this respect, **Gao, Jia and Li (2020)** stated, that given the performance pressure from regular payments under financial liabilities and careful monitoring by debtholders, management prefers to avoid debt in the absence of discipline. Although there isn't always a lot of apparent information asymmetry in businesses, external parties become aware of internal control issues in the early stages, but even though, managers would have plenty of space to include personal preferences in financing decisions since internal control mechanisms aren't well monitored during this time. Therefore, undoubtedly, businesses have inferior reporting quality because poor internal control leads to inadvertent mistakes and makes accounting fraud easier. Factually, researchers have discovered, that companies with inadequate internal controls have lower profits quality, as shown by anomalous accruals. However, without understanding the internal controls of the company, outside investors might not be able to appropriately evaluate the significance of discretionary accruals. And according to experts, "the choice environment, determines the meaning and metrics of earnings quality." Discretionary accruals can serve as a stand-in for managing earnings. Alternatively, they are seen as a signal to communicate managers' confidential knowledge regarding the future of the company.

Companies with inadequate internal controls typically have weak governance. And as said managers are capable of incorporating their personal preferences into the financing decisions of their companies due to ineffective controls by avoiding debt in order to escape debt constraints. Plus, the board of directors and investors may reevaluate the risk and strengthen of management supervision, as a result of investor and public knowledge of enterprises' internal control issues. In fact, findings showed that one of the primary causes for this situation, in terms of the business and the parties involved in the business, is the lack of an efficient internal control system. Thus, Internal control has drawn a lot of interest from many business sectors worldwide as a tool for corporate governance. Also, the management of post-globalization complications increased the need for adequate internal control structures to reduce risks and improve organizational

performance. Not to mention that researchers from all across the world have examined the connection between internal control and profitability, performance, and revenue generation. So, to solve these growing issues, firms must take a constructive approach instead of a reactive approach to face challenges and opportunities in order to meet their goals and requirements and assure comprehensive quality. And for companies to assure that their objectives are being met and that complete effectiveness is achieved, businesses must develop, execute, and maintain an efficient system of internal control and they must be aware of its effect on all aspects of the company. (Mohammed, 2017)

1.3. Research Question:

The main question of this research will be:

Is There a Relationship Between Internal Control Systems Efficiency and Firms' Profitability?

However, firms' profitability will be calculated based on four metrics which were used in previous literature. So, according to that, the main question has been divided into four sub-questions as follows:

1. Is there a relationship between Internal Control Systems efficiency and Return on Assets?
2. Is there a relationship between Internal Control Systems efficiency and Return on Equity?
3. Is there a relationship between Internal Control Systems efficiency and Earnings Per Share?
4. Is there a relationship between Internal Control Systems efficiency and Net Profit Margin?

1.4. Importance of the Study:

By reviewing corporate scandals and failures from the final quarter of the twentieth century, it is clear that adopting systems of internal control, as well as the evaluation of their efficiency and effectiveness, are critical factors to the survival of economic businesses. Firm's failures due to control gaps not only result in bankruptcy, but also have a severe impact on other associated businesses, like financial institutions, and government agencies. Hence, internal control as a notion has become an essential criterion in business interactions as a result of these recent occurrences. In consequence,

firms must create and improve systems for internal audit, control, and risk management, and, they must include all employees in these systems to make it a company culture. (Bilgili, 2009)

According to **Ibrahim, Diibuzi and Abubakari (2017)**, Internal control is typically built on managers' ability to transfer duties, with a high degree of confidence that what they anticipate will occur. Basically, Internal control in the business world today is defined as a system. But in terms, it can be defined as the responsibility of all staff, from managers who plan, execute, and monitor controls to employees who also perform various control roles, such as accountancy, finance, and other reports. Respectively, control activities must be developed for each function in the company in a way to put all personnel under accountability. Thus, by definition, internal control clearly is a system that is connected with all other systems and its formed, managed, and analyzed at all organizational levels, taking into consideration that managers should take its lead. But business managers' capability to perform their own financial and managerial reporting requirements is indeed based on the design and efficiency of the procedures on the one part, and the protections it has implemented on accounting, financial, as well as other reporting on the other.

Hence, without such internal control, preparing consistent and accurate accounting and other financial reports for creditors, shareholders, and other parties would be extremely challenging for most businesses, particularly those with several locations, activities, and procedures. In fact, no control system can ensure that accounting, financial, and operational reporting are free from potential inaccuracies or are not impacted by neglect. Still, internal control over managerial and financial reporting can help to limit the risk of such inconsistencies and inaccuracies in the financial accounts of the company. Survey results imply that corporate leadership and dedication to transparency and ethical conduct and their effect on work performance remains the most significant factors for efficient control, the importance of the control environment has been underlined because the control environment begins with company directors who execute the company's policies, practices, and good governance. Also, it is worth noting that false financial reporting is much more common in scenarios where the tone established by management is inadequate. Therefore, the goal of top management

nowadays is to evaluate some of the obstacles to create a modern, effective internal control system. (Ampofo, 2017)

According to **Bilgi, Mihaylova and Papazov (2017)**, internal control improves the organization's chances of achieving its strategic objectives. Another crucial element of the control system is that it should be cost-effective, meaning that the cost of installation should not exceed the advantages of having total control. Lower management levels, on the other hand, are likewise concerned in supervising because they provide guidance to the company's employees. However, mixed findings are discovered. For instance, several researches showed that while some businesses may initially have weak internal controls, after improving them, their profits management is inferior to that of businesses with weak internal controls. Others discovered a favorable correlation between managing accrual earnings and insufficient internal control. Additionally, previous researches revealed a correlation between inadequate internal control and poor inventory management as well as increased insider trading, indicating that internal control does have an "economically substantial influence on business operations."

Equivalently, some scholars asserted that enterprises might influence actual activities in the presence of a poor internal control environment by increasing output or reducing discretionary spending. This could lead to an anomalous increase in revenues or surplus cash flows. Moreover, they discovered that firms with weak internal controls manipulate genuine activities more frequently than firms with strong internal controls, which makes it more difficult even outsiders to notice or prevent. Therefore, researches indicates that organizations in financial trouble are more inclined to disclose major weaknesses, which serves as a proxy for the efficiency of internal controls. The claim is that adequate internal control needs both financial and managerial resources. Creating effective internal controls shouldn't be a top priority for businesses with bad financial standing because these businesses are more focused on merely surviving and remaining in operation. Plus, managers of struggling businesses might not have the time or resources to invest in effective controls. In recent researches, it was stated that businesses with inadequate financial standing would not have the capacity to carry out proper internal control testing, which would make them more unlikely to identify and reveal present internal control flaws. ([Li], Xiang, Djajadikerta, 2020)

Basically, the conclusions of this study will help to enrich the knowledge content and existing data regarding systems of internal control and their diverse impact on firms in Palestine, Turkey, and Worldwide, on the one hand, and it will add to existing literature information about the impact of internal control systems on profitability in all fields and sectors on the other hand, unlike the majority of studies which were focusing on the impact of internal control systems on financial reports and in one sector specifically like banks for example, finally, this research will help financial and general managers to draw a better understanding of their internal control systems in regard to its different aspects and components, and it will illustrate to them the effect of these systems efficiency on cost reduction, revenue generation and profitability.

1.5. Objectives Of the Study:

According to **Yakubu and Zakari (2020)**, Every organization wants to accomplish its core goals, whether it is profit-making or not, in order to retain its position as a continuing concern and ongoing existence. However, these organizations' formation and profitability are badly impacted by fraud and other misconduct committed inside them. In addition, as the firm grows, it can become more challenging, if not impossible, for management to monitor its resources and personnel as they go about their daily business. In order to verify that the goals are met effectively and efficiently, it is crucial to use appropriate check measures. Systems of internal control are the set of controls that was established for that reason. The phrase describes the entire system of accounting and other types of monitors put into effect by management to guarantee that business operations are conducted in a systematic and effective way, that management regulations are followed, that assets remain secure, and that records are as accurate and complete as possible.

Yakubu and Zakari (2020) added that, the primary objective of controls is to improve the organization's ability to successfully achieve its goals. Internal controls are also established by management to prevent staff from stealing resources. In fact, a strong internal control system minimizes the amount of audit work required by the independent auditors. And one of the most successful ways to prevent fraud is through the implementation of solid internal controls, such as the separation of roles. Internal controls, as they relate to fraud, are the methods, rules, and regulations that organizations use to safeguard assets and uphold the accuracy of financial reporting.

Many businesses claim that the internal controls in place are sufficient to prevent or even completely halt fraudulent activities. But because organizations evolve and additional people are hired for both newly created jobs and positions that have always been, some internal controls that entities adopted may not be as effective now as they were when they were first implemented. Therefore, adopting continuous monitoring for entities is a crucial management strategy while creating or updating internal controls. Indeed, organizational failure frequently stems from a lack of the elements of internal control. So, if there were no evidence of corporate fraud in the worldwide business environment, then there would definitely not be a need for corporate auditors or even the requirement for systems of internal control in organizations. The objectives of any given organization are to achieve speed of operations and effectiveness, accurate financial reporting, and complying with relevant laws and legislation. **(Omar, 2021)**

Thereby, the primary goal of establishing an internal control system might be characterized as ensuring that each organizational component operates effectively. Consequently, the efficient and effective accomplishment of goals is achieved. In turn, Organizational management is in charge of creating an internal control system and making sure the controls are applicable. The top management of the business, whether it be public or private, has been expressly given this role, with other parties like the external and internal auditors simply assisting by means of advice to assure efficiency. So, one of the management ideas addressing corporate operations is the internal control system. The existence of a strong internal control system, which serves as management's primary role in carrying out planning, organization, execution, coordination, and control activities, is crucial for this reason. In such a way the managers' ability to make sound judgments has been aided by the management's fundamental duties. **(Esmeray, 2016)**

Thus, this study intends to determine the degree of commitment and efficiency of internal control systems in the Palestinian market, as well as to evaluate the connection between internal control systems and financial success. This study will put the light on the relevance of systems of internal control and their influence on the firm's profitability, in addition to analyzing the risk for these businesses and determining the extent of the impact that these systems have on profitability. This study also seeks to ascertain the degree of dedication and dependability of internal control systems in

Palestinian businesses and the effect these systems have on those businesses' productivity and performance. Additionally, it will highlight the components and characteristics of internal control systems and shed light on their importance.



CHAPTER 2. INTERNAL CONTROL SYSTEM

2.1. Internal Control Definition and Importance:

Both those in charge of the entity's governance and management have major responsibility for the accomplishment of the corporation's goals. It is their obligation to create, execute, and, create an effective system of internal control that contains all elements and procedures that encourage all parts of the organization to operate in the organization's long-term interests. It may be maintained that any corporation's primary priority is its financial performance, which is calculated in terms of liquidity, solvency, and profitability. But, the health of businesses' finances will be evaluated only by performance. Also, the total financial well-being of companies can be viewed as a key factor of society's well-being, and indeed the well-being of interested organizations and individuals. In fact, since the beginning of shareholding corporations, regulators' thoughts and judgments have been impacted by concerns about financial well-being, openness, and trust. In addition, regulators' main worry over defending the interests of firms' stakeholders around the globe has been a driving force behind their interest in internal control systems since the formation of corporations. **(Thuneibat, Al-Rehaily and Basodan, 2013)**

The International Standard on Auditing (ISA) 315 describes internal control as a procedure developed, executed, and continuously sustained by those in charge of administration, oversight, and other staff to provide an acceptable degree of confidence concerning the accomplishment of an entity's goals in terms of the reliability and precision of its financial statements, its effectiveness and efficiency in functioning, and its complying with all relevant laws and regulations. Furthermore, Internal control system objectives are broad and interconnected, in the sense that they are all intended to contribute to the company's success. Hence, the accomplishment of operational effectiveness and efficiency is considered as the second primary goal of internal control. It is reasonable indeed to conclude that meeting consumers requests and reaching higher levels of sales as well as other earnings are the primary causes of higher profitability. **(Thuneibat, Al-Rehaily and Basodan, 2013)**

These objectives, and also the sources of funding to accomplish them, must be accompanied with effective resource management. This implies a cost-cutting strategy

and an upper limit on irrational expenses. So, Internal controls help to improve the effectiveness and efficiency of all activities. Which implies that internal controls should support the production of high-quality products and services, as well as the control of all operations to achieve good cost control. In other words, internal control goal is likewise focused on achieving financial goals. (Thuneibat, Al-Rehaily and Basodan, 2013)

According to **Collins (2014)**, internal control is a procedure that the administration, staff, and board of directors use to ensure that objectives are met based on criteria like financial reports accuracy, and also to evaluate the effectiveness and efficiency of activities, as well as ensure that laws and rules are being followed. However, many studies revealed that flaws in the internal control system cause functional issues in the institute, but that a robust system of internal control can lower managers' revenue manipulations and prevent them from impacting the business by pursuing their own objectives, and that maximizing the internal control quality for any institute will increase its earnings persistence, by allowing a better production for future earnings. Respectively, dividends and profits from operational activities, have been reported to be lower when there is a lack of quality internal control, whereas organizations that conduct internal control audits have greater quality earnings than those who do not. This indicates that, internal control system is critical in the discussion of a company's operating efficiency since it includes all measures taken by the administration to guarantee efficiency., effectiveness, integrity, and accuracy of corporate activities and information exchange.

Thereby, and according to **Collins (2014)** also, the quality of every firm's internal control system determines its survival, as it helps in meeting the company's major business objectives on schedule and within budget. Furthermore, the efficiency of the internal control system of the firm is linked to management's understanding of the critical role that internal control , performance analysis, risk evaluation, communication and information, and operational supervising plays in the discourse of operational performance. In fact, the internal control is a system that covers a company's integrity, moral ideals, and all operations. And it maintains a healthy balance while maintaining the highest-level standards. It's also a method of controlling the performance of the company, vulnerabilities, risks, and possibilities to achieve the intended company results.

So, despite the size of the firm, the value of the internal controls in ensuring sufficiency cannot be overestimated. It is a critical instrument for effectively raising finances in any business. (Gong, Yan and Yang, 2020) In this respect, the fundamental function of internal control in the business is to detect all regulations and requirements designed to ensure that accounting cycle is completely safe of frauds, misstatements, and inefficient management. It also enables the entity to react effectively and efficiently to modifications in the business world while attempting to manage the complexities of the corporate world. (Adegboyegun Et Al, 2020)

Umoffong and Udonsek (2019) stated that, internal control of an organization is a series of procedures to notify any predicted vulnerability that could produce a major error or omission, fabrication, or deception, as determined by management. Then continued, internal control is a system or a process that is implemented in a company to improve operational efficiencies, as well as to ensure accurate financial reporting and encourage adherence to applicable rules and regulations. And added, Internal control primary responsibilities are critical for increasing a business's ability and chances to accomplish its objectives. So essentially, an effective control system enables the organization's management to have effective and accurate information which is essential for making decisions that are efficient and necessary for keeping the company operating successfully.

In turn, **Yamer (2017)**, mentioned that as Internal control systems are essential in any organization to avoid and identify inefficiencies and enables the firm to meet its management goals. Their significance has been expressed in many different ways by various entities. For example, according to a COSO (Committee of Sponsoring Organizations of the Treadway Commission) recommendation, internal controls should be adopted to keep the business moving toward its revenue objectives. Then it became clear that internal controls seek to give an appropriate level of assurance regarding accomplishing a particular set of goals which are: *operational efficacy and efficiency, the dependability of financial reporting, and adherence to relevant rules and regulations*. Plus, it keeps the organization on track to meet its goals and objectives while being ready to face the unexpected in the way to achieve them.

Eventually, **Francis and Imiete (2018)**, emphasized that internal control systems determine that all interaction are correctly recorded, and all recorded transactions are:

real, have a value, are timely recorded, correctly classified, correctly summarized, and correctly posted. Plus, it prevents errors, waste, and fraud from occurring and detects the ones that have occurred. Furthermore, it safeguards the organization's assets and helps the organization utilize the limited funds to effectively and efficiently achieve its objectives.

2.2. Purposes And Objectives of Internal Control:

Internal control systems work constantly at all levels of the organization; these are not just a process or sets of rules that are adhered to occasionally. Where establishing the proper mindset to support an effective system of internal control and constantly assessing its effectiveness is the obligation of the company's board of members and executive administration. In actuality, the internal control system involves the boards of members, senior management, and every level of the staff members. Thus, internal control has more functions than just managing the order and accuracy of specific situations; it is also a way for recognizing the value added to a firm and reaching the organization's index of performance and profitability. Furthermore, it provides the ability to manage and change the company's planned, controlled, and targeted goals in the current condition for the long term and to put these goals in front of the firms' managers' eyes. It is worth noting that, managing the proper variable caused by dangerous circumstances makes it possible to deviate from the already accomplished and programmed state. (Yamer and Chekol, 2017)

Accordingly, **Yamer and Chekol (2017)** stated that, internal control has long been accepted in most organizations as one of the most crucial aspects for a company's and government agency's survival. As it protects the entities from financial and property loss, incorrect decisions, fraud, and lost earnings and assets. Moreover, internal controls help management to protect firm assets, eliminate income or resource loss, and make goal-oriented and accurate decisions. Thereby, failure to achieve corporate goals could be due to poor internal controls.

Aybar (2011), set the following categories which can be used to group the key goals of the internal control systems.

- First, *information objectives*: it includes the effectiveness and efficiency of operations; dependability, the accuracy, timeliness, and completeness of management and financial information.
- Second, *compliance objectives*: which means compliance with all relevant legislation and policies.
- Third, *performance objectives*: which includes the effectiveness as well as performance of the company's use of its equity and other resources, as well as its ability to prevent loss.

While **COSO (2013)** classification of the internal control process's goals was little different, where they used the following categories:

- First, *Objectives for operations*: are increasing financial performance, productivity, quality innovation, and customer happiness. Additionally, corporate objectives place a high priority on protecting assets, and these objectives go beyond risk assessment activities and improving mitigation measures to include more general objectives like avoiding waste and inefficiency.
- Second, *objectives for reporting*: either non-financial or financial reporting, as well as external or internal reporting, are all covered by reporting goals based on COSO framework. And these goals help stakeholders in companies to make wise decisions and have access to trustworthy, timely, and transparent information.
- Third, *compliance goals*: relate to adherence to the rules and laws that organizations must follow and implement. Which might be internal, such as adhering to corporate regulations and processes, or external, such as taxation and environmental preservation.

However, **Aybar (2011)** mentioned that the procedure for internal control aims to guarantee that all employees are working to fulfill the organization's objectives with accuracy and efficiency, without unintentional or extra expense or prioritizing other goals, such as those of the company's customers or employees. Additionally, one of the information objectives is to cover the requirement for trustworthy annual reports, other financial statements, as well as additional reports and disclosures to investors, managers, and different other individuals. This means that the information that

managers, shareholders, supervisors, and boards of directors receive should be trustworthy and of a high enough standard that its receivers can depend on it when making decisions. Plus, when referring to financial statements, the phrase "reliable" denotes the creation of accounts that are honestly presented and based on detailed and clearly stated accounting concepts and procedures. In addition, compliance goals make sure that all firms operations adhere to the organization's policies and processes, as well as any laws and rules that are applicable. Factually, to safeguard the reputation and franchise of the firm, this goal must be accomplished.

2.3. Components Of Internal Control:

Several regulatory bodies, including COSO, have released internal control systems frameworks. In contrast, the COSO structure for integrating internal controls has five aspects: *control actions, monitoring, control environment, information and communication, risk assessment*. Additionally, 17 pertinent concepts, 77 points of emphasis, and advice for businesses on the development, execution, and use of internal control systems were included. Utilizing this approach, firms may develop internal control frameworks to identify unforeseen risks from inside as well as outside business settings. (COSO, 2013) While, **Ibrahim, Diibuzie, and Abubakari, 2017** claimed that despite the fact that the framework provides a path for developing an efficient system of internal control. The structure didn't succeed to offer appropriate approaches or tools for effectively utilizing the roadmap. While, internal control aspects such the monitoring, control activities, information and communication, and risk assessment have remained operational instruments for organizations to fulfill diverse organization objectives, primarily profit making and survival.

2.3.1. control environment:

The control environment lays the groundwork for all other aspects of internal control that provide structure and direction. It also establishes the tone of the company by influencing its employees' control consciousness. Additionally, it claims that the phrase "tone at the top" is frequently used to characterize the control environment, suggesting that the organization's members ought to pay greater attention to the components. Additionally, it was found that the control environment is efficient if top administration promotes honesty and ethical principles in order to achieve corporate goals and if they establish clear standards of ethics in order to have an impact on behavior, actions, and

decisions. In actuality, the actions of the directors' board or audit committee regarding organizational goals, as well as their adherence to honesty and moral principles, dedication to staff competency, the management's views and working tone, the structure of the company, guidance of leadership and accountability, and human resources policies and practices, are all elements that have an impact on control in the organization. (Demirbaş, 2005)

2.3.2 risk assessment:

Analyzing and identifying internal and external threats that might affect the administration, financial disclosure, and conformity are steps in the risk evaluation procedure. Risk evaluation is used to determine how to handle hazards as well as to identify and analyze risks that may have an effect on the objectives and aims. As a result, the board of executives should conduct risk assessments often to spot potential trouble spots. The duties of society's officers and personnel should be listed as a risk classification according to ethical risk areas. The degree of risk should then be meticulously documented so that a plan for risk management may be developed. (Shabri, Saad, and Abu Bakar, 2016)

2.3.3 control activities:

Control activities take place across all organizational departments and levels. Internal controls are the procedures and regulations that different companies use to guarantee that management orders are followed and that the proper actions are taken to minimize risks and accomplish various objectives. The nine fundamental aspects of control functions in organizational governance are permission, separation of responsibilities, processing of data, physical controls, proper documentation, confirmation, consensus, evaluation of operations, and supervision. As a result, improving control activities may aid the entity in achieving its objectives. Additionally, to handle threats, every necessary measure should be done. (Ndiaye, Bo, Y.Y and K.M, 2019)

2.3.4 information and communication:

All companies must locate, get, and gather essential data to enable personnel to carry out and complete their jobs. To effectively carry out, control, and regulate its activities while control measures are being carried out, an entity has to be able to receive and communicate data. Information systems are also required to control how the company

is run. It has been demonstrated that the better internal control activities are carried out to accomplish desired outcomes in the end, the more data and communication there is. The individual who is responsible for internal control operations must also find, analyze, evaluate, and record sufficient data. And enterprises need an adequate communication and information process to acquire and transmit crucial information for decision-making, customer service, and commercial activities. (Adegboyegun et al, 2020).

2.3.5 monitoring:

The internal control system's continued correct operation is ensured by the fifth and final component, monitoring. However, administration, inner auditors, and external auditors should regularly examine the efficiency of internal controls as part of the monitoring procedures for the financial system. From the beginning to the completion of the process, these evaluations should be conducted. In addition, management should conduct a separate audit process to track the customer's actions, which may be used, for example, as a supervisory tool. As a result, it is necessary to include monitoring components in both the firm and the boards to keep an eye on management's performance, set long-term strategic objectives, evaluate management's proposals, and track the company's finances and strategic actions. Since the introduction of monitoring components completes a circle that enhances information systems, control activities, as well as control environments, it is possible to evaluate the efficacy of overall internal control systems thereafter. (Yamer and Chekol, 2017)

2.4 Internal Control Systems in Palestine:

Companies today are interested in broadening their company horizons and using the continuity principle. Keeping up with changes in a variety of technological, economic, and social domains, this can only be done when a company has a basis of operations on which to build its management-set plans. However, mismanagement, the incidence of numerous wrongdoings, either financial or operational, including the falsification of data and information in their yearly reports to meet predetermined objectives are some of the challenges and issues that private enterprises must deal with. Also, for example when it is discovered that a specific profit was manipulated to mislead investors, either due to the laxity of regulatory law or the criteria on which they base their decisions on, which is precisely what happens when managers abuse their position of authority to further their own interests. Private firms don't respond to that due to individual decision-

making authority, which may cause terrible consequences for the company and the market, even at the level of publicly traded firms that should be governed by laws and rules, which gives them legal authority. The same thing happens. Plus, its terms are not carried out, because publicly traded companies' stockholders or the relevant authorities exercised insufficient monitoring. **(Al-Samarrai, 2016)**

Palestinians have been dealing with a number of issues that call for looking for solutions to enhance the efficiency of their economic fields, which can lessen their suffering across the board. For example, weak domestic investments brought about by the country's weak economy led to high costs of materials as well as the purchase, upkeep, and use of equipment. And due to strong price rivalry, the inability to continue operations, and capital degradation caused by the accumulation of losses without adequate recompense, construction enterprises in Palestine frequently fail financially or file for bankruptcy. **(Abu Naser, al-Shobaki and Ammar, 2017)** Knowing that 11.8% of Palestinian employees are employed in the construction industry, making it the largest in terms of yearly investments. So, considering the harsh circumstances imposed on Palestine, like, the political and economic unrest, the country's limited sovereignty over its territory, the significant risk involved, and the lack of a national currency for Palestine which have a negative impact on all facets of life, particularly the performance of businesses engaged in various industries. There was a need for procedures to help ensure the success of these businesses. **(Palestinian investment promotion authority, 2010)**

Therefore, internal control systems can play an important part in organizations of all sizes and across various industries. They are created to guarantee operations effectiveness and efficiency, the accuracy of financial reporting as well as adherence to regulations and laws. Plus, internal control systems are essential for entities to fulfill their goals effectively and efficiently. By safeguarding assets, managing risks, ensuring financial integrity, improving operational efficiency, promoting compliance, preventing fraud, and enhancing accountability, these systems contribute to the overall success and sustainability of any organization, especially in unstable economies like the Palestinian economy. As for transparent guidelines in the area of internal control and how they impact a company's financial performance in Palestine, transparent guidelines have a profound impact on firm's financial performance. They promote clarity, fraud prevention, reliability of financial reporting, adherence to regulations and

laws, efficiency, risk mitigation, and stakeholder trust. By establishing and adhering to these guidelines, companies can enhance their financial performance, minimize risks, and maintain a strong foundation for sustainable growth. **(Shaath, 2017)**

Consequently, to gain development, and stability, and to assure the fulfillment of the goals of financial activity, it is necessary to safeguard the money in this respect and to employ the greatest economic resources at hand. One of the most important subjects that affect economists, investors, accountants, attorneys, and administrators is control. Internal control systems concept have undergone continuous development, starting with a review of their importance in avoiding asset theft, and misuse, making sure the information is accurate, and identifying irregularities and wastage, moving through to the wider concept, which includes enhancing operational efficiency and a commitment to enforcing existing laws and legislation as well as enhancing the credibility and scale of financial statements, and ending recently with a concept that includes the capability of internal control systems to reduce the financial audit work and lost time, in addition to cutting costs and losses. **(Abu Naser, al-Shobaki and Ammar, 2017)**

Thereby, any business internal control system is its first line of defense against threats to the interests of its shareholders and other associated parties, by helping in safeguarding the ability to produce accurate financial information and make sound investment and credit choices. In certain nations, it is also becoming a legal obligation as a result of the financial crises, breakdowns, and impasses that affected their economy. Plus, a number of worldwide professional groups have expressed a keen desire in internal control systems and published multiple publications and studies that have been written to define the significance of the internal control system. **(Al-Samarrai, 2016)**

Broadly speaking, internal control systems include all checks and balances relating to commercial, administrative, and strategic management processes, and operational expansion to include corporate law. Respectively, studies have shown that internal control is crucial to the business but they also showed that internal controls might have flaws as well and these flaws could cause serious damage to the company. For example, internal information might raise the risk associated with the information disclosed to investors, which leads to a raise in the capital costs, increases in operations, whether deliberate or inadvertent and bias in stated earnings for the firm operations that are

ineffective or unsuccessful and undermine the company's ability to make revenues. Plus, companies' position and value may continuously deteriorate as a lead of the weaknesses of the system of internal control. **(Abu Naser, al-Shobaki and Ammar, 2017)** Hence, the internal control system has evolved into a crucial component of every business operation due to the fact that it is a thorough system that encompasses several significant sub-regulatory systems, which are represented by the accounting, financial, and administrative control systems. Therefore, if businesses want to produce financial reports that are high-quality and transparent, they must cooperate with it. Therefore, the internal control system is essential as one of the factors that determines a company's success in assessing the progress of its work, the success of its activities, and its progress toward achieving its objectives, particularly when operating under extremely difficult surroundings like the Palestinian conditions, which is unstable in all areas and at all levels. **(Abu Naser, al-Shobaki and Ammar, 2017)**

Thereby there is a growing interest in internal control systems in the Palestinian context, and also due to the rising interest on a global scale, in order to safeguard money and provide trustworthy financial statements supporting efficient and effective resource management in addition to serving all consumers of the financial reports to raise business competitiveness. The work of the Palestinian private shareholding companies has been hampered by a number of issues that have prevented its natural growth and continuation of its activity, leading to the creation of financial issues that have prevented these companies from realizing the necessary profit. This weakness may be related to the makeup of the regulatory system existing in businesses as it may be connected to inadequate processes, examined, and assisted in improving the Palestinian firms. **(Abu Mayaleh, 2017)**

Failure to adhere to sophisticated regulatory mechanisms is what causes these systems to behave as they do. Where, the competent Palestinian bodies have only been able to transfer recommendations to binding decisions to protect public funds and not to abuse management and officials and fall into financial and administrative violations. This is because of many reasons, one of which is the reality that the Palestinian people are experiencing as a result of internal divisions and the absence of the legislative council's role in legislation and oversight. Effective preventive financial and administrative management works to stop breaches before they happen, which makes it easier for the

authority to see financial and administrative deviations and successfully manage both material and human resources. On the other hand, internal control and oversight departments and organizations in government institutions observe the rules, guidelines, and directives currently in effect, and avoid problems with the work processes and loss of legal accountability. The novelty of the Palestinian institutional experience, its limited resources, and the magnitude of the issues facing Palestinian political institutions both inside and externally makes it imperative. **(Abu Mayaleh, 2017)**

From the Palestinian oversight bureau's perspective - which has been established to provide independent oversight, monitoring, and accountability in the financial and managerial aspects of the Palestinian state with its three executives, legislative and judicial powers and to ensure adherence to regulations and laws, and ethical standards, as well as promote transparency and good governance -. It is crucial to diagnose the reality of internal administrative control and its role in enhancing institutional work performance. This diagnosis is also necessary to identify the shortcomings and flaws in the internal control system in order to exploit it to the fullest extent possible, maximizing both human and material resources, minimizing issues and deviations, and assisting with operations extensive management development, and reform. **(Abu Mayaleh, 2017)**

The Palestinian Authority has increased its focus on its internal control systems to safeguard cash and generate financial reports as a result of recent legal and regulatory developments in the economic environment. To provide reliable services that support the efficient and effective use of resources while also catering to all consumers of financial statements to increase businesses' ability to compete. Internal control is an important component of modern economic management activities, which are crucial to the company's value and performance because they focus on enhancing the facility's operations and efficiency, which includes safeguarding shareholders' investments and assets, achieving profitability, improving performance, and its duty to create accurate financial statements. To check the accuracy of the information inside, since this data provides consumers with a simple way to assess the performance of businesses, establishing the fair market worth of their stock exchange prices and their projections for future stock price movements coming. **(Atatrh, 2012)**

Accordingly, the significance of internal control in reaching the business's objectives is evident from the above, so it is essential for proposed studies to develop the performance of internal control depending on the COSO framework. However, while many studies have emphasized the importance of applying internal control depending on the COSO framework. The findings of these studies demonstrated that internal control systems were highly valued by businesses, but the degree to which this interest varied depending on the relevance of the various aspects of the system of internal control attested to the systems' reliability. (Nashwan, 2018)

Comparably, other studies came to the conclusion that public shareholding businesses apply the COSO framework for internal control in general, and discovered that Palestine's public shareholding businesses' internal control is quite compliant with the COSO control structure, but it focused on three elements only (control activities, control environment and risk assessment). However, the majority of them focused on the banking sector or investigated one field or one company only, the studies that focused on publicly traded corporations or regarding private shareholding firms in general, were hard to be found in Palestine. Hence, the lack of studies on using internal control systems in publicly trading companies, according to the COSO framework in the Palestinian context, especially given the conditions and the challenging economic position that Palestine is experiencing, can create a big gap for the researchers and literature. (Nashwan, 2018)

CHAPTER 3. FINANCIAL PERFORMANCE

3.1 Performance:

The concept of performance was used mainly in the sports field, and in particular it was known at the time that it was the result obtained by a horse races, then the sprint preceded the men, and then evolved to express the achievement of work or how the organization achieves its goals. However, despite the large number of researches and studies that dealt with performance and its evaluation, no conclusion has been reached in the idiomatic sense. Hence, consensus about a specific concept of performance, and this is due to the diversity in goals and trends defined by researchers and scholars, and from the definitions given to performance are as follows: j. Chevalier's -one of the well-known scholars in this field- defines performance as "the total production of the enterprise resulting from the combination of many factors such as capital, work, knowledge. Thus, performance comes directly from the element of work, and therefore each worker will give a performance that is proportional to capabilities and with the nature of his work. (Tanina, 2017)

In addition, **P. Drucker** - also a known scholar - defined performance as "the ability of an organization to continue and survive, striking a balance between shareholder satisfaction and workers." through the previous definitions, it appears that the concept of performance is a broad concept whose meaning varies according to those who use it. However, in this paper the performance will be defined as: "the results of the outputs obtained from processes and products it expresses the outputs or goals that the system seeks to achieve. It also means the ability of the institution to generate revenues, whether from its current or capital activities or exceptionalism and the realization of a surplus of its activities in order to reward the factors of production according to modern theory, and some know it by the extent to which the institution enjoys a margin of safety that removes from its financial hardship, or the phenomenon of bankruptcy. In other words, the degree to which the institution is able to cope with risks and financial difficulties. (Tanina, 2017)

While performance is crucial for the realization of a surplus of any firm activities, it is equally important to consider comparing performance to preset standards, this stage, which is implemented to a great extent depending on the type of information the

manager gathers and uses to evaluate performance, compute variances, and identify strengths and weaknesses, can be seen by contrasting the actual results with the standards specified, thus, through this assessment, the manager is able to assess if the deviations are within the permissible limits or do they need some correction. In the event that the performance deviates from the standard while remaining within the expected deviation rate, also requires the manager intervenes, because this means that there is a weakness that may not rise to the level of deviation, but it is considered that this phenomenon needs to be studied and requires the manager to prepare a special report for this case. As for the deviation, it means rapid intervention to correct it, and the administration by exception plays this step a great scope as it shortens the manager's supervisory steps. However, the stage of comparing performance with standards includes many activities, where the actual results of performance are measured based on what is actually done or even expected based on these results. Plus, standards are established by requiring the identification of deviations, and then communication of information and data to the person responsible for knowing deviations and treating them appropriately. (Abu Mayaleh, 2017)

3.2 Importance of Performance Evaluation:

Performance is a purposeful means to reach the goals of organizations. It is the result of a specific effort made by individuals to accomplish their work. The organizations seek to develop their methods and work to reduce the costs of activities in order to accomplish the goals they seek with the highest quality, and the lowest cost. Also, the continuous pursuit of achieving the requirements of the client through a group, is one of the processes through which the reduction or limitation of procedures that do not add significant value to the processes of producing goods and services. The essence of continuous improvement is to reduce differences, and work to avoid defects. Hence, it should be understood that the importance of evaluating the performance of employees is one of the organizational factors of human resource development, through identifying the magnitude of the advantage to the company overall and the employees in particular, where it allows the organization to assess supervisors' and managers' contributions to the development of the company and the growth of the team members they supervise. (Tanina, 2017)

Additionally, it offers companies indicators of employee performance, conditions, and issues. It also serves as a gauge or benchmark for the company, allowing employees to identify their areas of strength and weakness and take steps to eliminate or minimize them. It can also be applied as a technique for organizations to use objectiveness and justice in their interactions with their staff members by adhering to reasonable standards and precise measurements, and it can be applied as a technique for identifying flaws in policies, procedures, laws, and work techniques standards as well as the validity of those standards. Additionally, it gives employees the chance to learn from their errors and take steps to prevent repeating them, as well as to improve their abilities and realize their long-term goals in exchange for awards and lucrative remuneration. Additionally, it helps to strengthen the bonds and relationships between the superior and the subordinate and boost employee morale. Additionally, it helps in lowering the incidence of staff turnover as well as unfavorable behaviors including tardiness, neglect, and lack of enthusiasm. Additionally, it assists in exposing people's untapped latent abilities. Additionally, it helps to change performance expectations, improve employee performance, and boost overall company effectiveness. (Tanina, 2017)

3.3 Performance Evaluation and Its Relationship to Control:

The goal of performance assessment is to identify or measure the effectiveness of the organization and its productivity, plus, process the strength and weakness that surrounds the accomplishment of activities, whether the individual or the organization or part of it. It is worth noting that there are many measures and indicators to evaluate performance. However, performance evaluation also helps in achieving the following objectives and benefits:

- For *the individual*: it improves the individual's perception, concepts, and self-performance evaluation.
- For *the manager*: it supports their confidence in themselves and their subordinates, it also introducing managers to ways to support and encourage individuals in behavior and performance, plus it helps managers in public power planning.
- For *the organization*: it helps in improving the methods of predicting performance, determining weaknesses and ways to treat them and providing the necessary administrative information for decision-making or motivation, in

addition to defining the training and development requirements or program for human and material resources, and technology, as well as the selection of good employment.

Fundamentally, it is impossible to disregard the overlap and connection between the method of supervision and performance evaluation. At different organizational tiers, performance assessment aids in the identification of deviations and clarifies the means of treating them. A solid system of control must thus include an effective method for performance evaluation. (Shaath, 2017)

3.4 Financial Performance:

Most researchers have agreed that financial performance depends as a concept on the process of financial analysis, which is known that it is the safest method that can be used to assess the institution's strengths and weaknesses, where financial ratios are used mainly in this analysis, in order to compare previous performance with current and expected performance in order to know the areas of differences between them. Whereas good financial performance leads to maximizing the value of the institution through diagnosis of the positive attributes, and negative vulnerabilities of its financial performance. Accordingly, profitability, liquidity, and solvency are all concepts that may be used to describe a business financial performance. Creditors, investors, and shareholders are concerned about these financial performance indicators. Regulators and individuals in charge of corporate governance are likewise concerned about these metrics also. (Mohammed, 2020)

Thereby, all of the company's plans, policies, and actions are quantified in terms of money as its financial performance. Basically, financial performance is the overall evaluation of a business financial position through time that may be utilized for contrasting companies in different sectors and within industries. Financial success may be determined using a range of variables, however the most often used variables are return on assets (ROA), return on equity (ROE), operating profit, and net profit. However according to the factors of financial performance, which include the system of internal control, business size, and capital structure, these measurements might be absolute or relative. (Mohammed, 2020)

Financial performance is considered to have a strong impact on an institution's internal control. As it is well known that, risk assessment, internal audit and control activities are the major elements of the internal control system that focuses on the control environment. So, different institutions can use the internal control framework to help them manage their operations in terms of legislation and policies. Also, the procedures affecting the board members, top management, and all degrees of people are included in internal control frameworks, and they are not only processes or rules implemented at a certain period of time, but rather operate continuously at all levels of institutions. (Thuneibat et al, 2013)

In this respect, financial performance is also referring to an organization's overall evaluation, which is assessed in market and accounting terms. Whereas, accounting parameters are determined by ratio terms. While, market measures represent changes in stakeholder returns on stock prices. This form assesses residual income using accounting words such as net revenue after taxes, residual income, operational profits and economic value-added. Consequently, any organization's effective auditing methods typically improve transparency in operations, resulting in improved financial results. Therefore, the right performance metrics are those that let businesses concentrate their efforts on achieving their strategic goals. (Ndiaye et al, 2019)

According to **Collins (2014)**, performance can be measured using either qualitative or quantitative criteria. However, there are arguments in favor of subjective criteria, such as how challenging it is to gather pertinent performance information from small enterprises and how unreliable such information is as a result of variations in accounting practices. According to the study, underperforming assets are a common cause of bad company performance and are typically associated to strategic mistakes made during the purchase process in prior years. For instance, some corporations purchase enterprises with the irrational notion for a high advantage opportunity between both the acquired assets and their existing assets.

While, **Ejoh and Ejom (2014)** said that internal control has an important influence on Financial outcomes, and mentioned that according to literature reviews, financial performance is determined by investigating profitability, which may be classified into two types: gross profit; which is generated by the production cycle of the firms after deducting all the costs which the firms invested to produce these profits, whereas net

profit; is a measure of the effectiveness in controlling operational expenditures. The study emphasized that, management should implement a highly effective internal control system to eliminate mistakes and fraud in order to increase the organization's market position and maximize profits.

Moreover, excellent corporate governance is necessary for firms to boost their profitability and efficiency. The capacity to produce money for shareholders and create advantages for stakeholders will all be enhanced as an outcome of that. This suggests that the business financial performance relates to its ability to operate economically, and sustainably, grow, survive, and adapt to the surrounding risks and opportunities. The performance of a business is also based on how well it uses assets to accomplish its objectives; this statistic may be used to evaluate an individual, a team, an organization, or a process. Therefore, suitable performance metrics are those that enable businesses to concentrate their efforts on achieving their goals. And either objective or subjective standards are used to evaluate performance. However, the difficulty in gathering pertinent performance information from particular field and the unreliability of this data due to differences in accounting practices are reasons for using subjective measurements. (Ejoh, Ejom, 2014)

In turn, examples of objective evaluations of performance are revenue growth, income growth, and return on investment. Financial advisors also created a list that includes eight standard business performance metrics, such as the total return in a single year or three years, growth in revenue in one and three years, higher earnings across one or three years of age, gross profits, and the return on equity. Also, the market value added (MVA) which is an indicator of the additional return that a firm gives to its investors above the total amount of their investments. The long-term value of investments, stability in finances, and corporate asset utilization are some additional financial factors that have been considered. Additionally, three accounting-based criteria were presented: return on equity (ROE), return on assets (ROA), and return on sales (ROS). (Ejoh, Ejom, 2014)

3.5 Measurement of Financial Performance:

According to **Leonard (2022)**, performance metrics that enable businesses to concentrate their efforts on achieving their strategic goals are acceptable. Evaluating performance can be done with either objective or subjective standards. The difficulties

in collecting qualitative data on performance from small companies and problems with the dependability of such data owing to variations in the accounting processes followed by diverse enterprises are factors in supporting subjective judgments. Actually, businesses must concentrate on maximizing profit if they want to survive and thrive in a competitive market; otherwise, they risk going out of business. Studies back up this assertion by showing that only effective businesses remain in the market and that fewer effective businesses eventually leave numerous marketplaces. In reality organizations can manage their financial and non-financial performance using performance measurements. Increased and improved accountability makes sure that initiatives complement corporate strategy, and that customers receive better services and are more satisfied. Studies have also shown that metrics like revenue growth, profit growth, and return on capital invested are included in unbiased performance evaluations.

Also, market value added (MVA) which is a measurement of the extra value a firm has generated to its shareholders above the entire amount of their invested money, was developed by financial advisor Stern Stewart. And the following standard metrics of financial success were used to determine this ranking: *net margin*, *sales growth*, *total returns*, *profit growth*, and *return on equity*. Additional financial indicators should consider the long-term investment value, financial validity, and use of business assets. For example, scholars used three measures to discuss performance based on accounting: *return on equity* (ROE), *return on assets* (ROA), and *return on sales* (ROS). Where net income should be divided by total net sales, total common equity, and total assets, respectively, to determine each of these metrics. It is also possible to assess an organization's financial performance using profitability or liquidity alike. (Leonard, 2022)

However, internal accounting control systems are defined by the committee that is in charge of international standards setting for auditing and assurance (IAASB, 2012) - where they refer to COSO definition as well- as the procedures and policies that are executed by assuring the company's efficiency and order, as well as obedience to management's rules, the avoidance and detection of frauds and mistakes, and the protection of information, also, the management of the entity works to support its managers in realizing their goals. Cooperative's management is confident that by creating a new strategy and putting stronger, stricter, and more efficient system of

internal control in place, the profitability of the company may be increased. Hence, efficient internal control systems are thought to promote the profitability of companies, which will immediately contribute to enhancing the cooperative's stability and expansion. (Leonard, 2022)

3.6 Profitability:

Profitability is considered one of the areas of financial performance where most organizations need to be in good financial condition and perform well financially in order to continue operating in the near future. Nonetheless, some companies can continue to make a loss for a number of years, but every company eventually needs to turn a profit. However, to determine whether a corporation is successful or not, it is necessary to understand how a company's profitability is determined since accounting procedures are utilized to produce tax efficiency for example. Thereby, the definition of profitability for a business, or the accounting concept of profitability in other words, is simply known as net profit or net gain, but in a broader definition, a business profitability is the amount of its total income for a particular time that surpassed its entire costs in the same period of time. The profitability of the business is thus defined by the difference between its revenue and expenses. Effective companies will inevitably outperform lower effective companies, which must spend more to achieve the same level of profitability. (Thuneibat, al-Rehaily, and Basodan, 2013)

According to **Bruwer (2018)**, the phrases "financial position" and "financial performance" refer to the values of assets, liabilities, equity, revenue and expense values, respectively. However, solvency and profitability are frequently employed as benchmarks to evaluate the financial performance and status of an organization. The comparison of the sizes of assets and liabilities is what has to do with solvency. A company is considered solvent if its assets exceed its liabilities; otherwise, it is considered insolvent. Profitability, in turn, is related to how much revenue is made compared to how much is spent. A company is said to be profitable if its revenue exceeds its costs; otherwise, it is said to be non-profitable. The ideas of "solvency" and "profitability" are fundamentally connected in that assets should provide revenue (such as sales, interest income, etc.), but liabilities often lead to outlays of money (e.g., interest expense).

On the other hand, accounting standards can influence how statements of income, or statements of operations, in financial reporting, depict income and costs. Therefore, companies may use accounting principles to benefit from tax regulations and lower their tax liabilities. In this regard, because net income might be a bit unreasonable, many financial experts place more emphasis on the level of profits than on earnings or profitability. However, revenue before taxes, interest, amortization, and depreciation are used to assess the quality of a business's income potential. **(Bruwer, 2018)**

In this respect, **Omar (2021)**, mentioned that, the main goal of every business is to make money, even if the business's profitability is the amount of money it makes after deducting all possible expenditures and sources of income. The company won't survive if it is not profitable enough. Even businesses with huge profits and promising futures, risk failing if they are unable to continue running profitable operations. When determining whether a company is going to carry on in its existing capacity, profitability is taken into consideration. Where businesses with the resources needed to continue operating forever are referred to be "going concerns" in accounting. It serves as a technique to convey whether a company can make enough money to cover all of its costs and pay off its debt. But when a company can no longer function, it has either declared bankruptcy or been forced to liquidate its assets. So, understanding the profitability of the business is essential for determining if the work put into selling the good or service is worthwhile.

Having said that, there should be some knowledge of whether a firm will be profitable before launching. Additional study of a company's profitability should be done as it develops and evolves to assess the quality of its net income. In consequence, considerations for profitability analysis demand for the good or service, supply, and any additional economic variables that can have an influence on the bottom line should all be taken into account when examining the profitability. Also, when analyzing whether two organizations should merge, profitability can be utilized as a criterion since improved operational efficiency and expanded product lines may result in higher-quality, or larger, profits. Profitability is also taken into account while deciding whether to expand operations. **(Awale, 2020)** For instance, if operations grow, expenses may go down, but if prices fall due to the increase in supply, the firm may make less money than it would have otherwise. On the other hand, it's possible that growing enterprises

generate greater profit. In short, the link between the company earnings and the investments that helped it attain those profits is what is meant by the idea of profitability. So, by definition, the profitability ratios; are those ratios that used to evaluate a company's capacity to generate income from its business operations in relation to the expenditures and expenses it incurred during the period. The links between different profit specifics, such assets and equity, are explained by profitability ratios. These ratios are defined as follows: (Awale, 2020)

- *Return On Assets (ROA)*: the return on assets is a measure used to assess a company's profitability in relation to its total assets. It is determined by dividing the business yearly income by all its equity, and it provides insight into how well management uses its resources to generate profits.
- *Return On Equity (ROE)*: the ratio of a business revenue to its total shareholder equity is measured return on equity rate. This rate is measured by dividing the business's net profit by all of the equity held by shareholders. This metric displays the return on investment made by shareholders and demonstrates how well the business generates profits from each share of shareholder ownership. Due to the fact that it demonstrates the rate of return on investment as reflected by shareholders' equity, this ratio is a crucial profitability measure for investors.
- *Earnings Per Share (EPS)*: earnings per share is assessed by dividing a company's profits by the total number of its stock market-listed shares. This indicator, which shows the profitability of the smallest portion of the company's capital and hence is reflected in the value of shareholders' earnings as well as the worth of shares in the stock market, is thought to be extremely crucial for measuring profitability. Thus, a one-person approach to valuing each organization is provided by earnings per share. Additionally, it allows analysts to evaluate businesses side by side to see which has generated the greatest profit.
- *Gross Profit Margin (GPM)*: by determining the sum of money left over from sales after subtracting the cost of goods sold, analysts may evaluate the financial health of a firm. The portion of gross margins, also known as the rate of gross profit, is typically displayed as a percentage of sales. Additionally, it is shown by the gross profit margin indicated as a proportion of sales revenue.

- *Net Profit Margin (NPM)*: The portion of revenue that remains after all costs are deducted from sales is known as the margin of net profit. The analysis reveals how much cash a company may make from each of its sales units. The net profit margin is meant to serve as a barometer for a business's general performance. A large net profit margin shows that a company has effective cost management practices in place and is effectively pricing its products. Since businesses in the same industry may all function in the same sector, provide services to the same consumer, and have comparable cost structures, it is essential to assess how well they are performing.

Hence, the business's ability to add value to the cost of production is measured by the gross profit margin. As it serves as an excellent measure of managers' ability to keep production costs under control. So, any increase in gross profit margin from one year to the next denotes more product added value and lower manufacturing costs. Thereby, gross profit margin is the amount of sales that is really profit after deducting operational expenses like overhead, wages, and marketing. Consequently, gross profit margin indicates how well your manufacturing and sales operations are working. And unless you are significantly altering your company strategy, your gross profit margin ought to remain quite consistent. Indeed, frequent fluctuations might indicate inconsistent sales or that your spending is fluctuating more frequently than it should. (Omar, 2021)

Eventually, profit seems to be a straightforward idea that is defined as the remainder of revenues after deducting costs of production. The related idea of profitability is characterized as the ratio of earnings to some measure, with invested capital being the most often used foundation. Because entrepreneurs start engaging in productive activity because of the desire and promise of profit, and because profitability is a key indicator of an endeavor's success or failure, the basic idea of profitability is crucial for understanding how the capitalist system functions. As a result, estimating future profitability and analyzing present and previous profitability is essential for making entrepreneurial decisions about the expansion or reduction of investment. In the ongoing activity, alternative activities, and potential takeovers. On the other hand, the term "revenues" as a simple definition refers to the entire amount of money or income acquired from both internal and external origins. While, the notion of "control" in the context of organization development refers to following, managing, and analyzing

operations to guarantee that the real process continues on track. (Umoffong and Udonsek, 2019) Basically, internal controls should be tested on a regular basis to mitigate the threat of revenue loss and to help the company achieve and fulfill its financial objectives. Revenue control may be considered as a series of planned actions that must be performed to ensure that the firm's revenue streams do not alter, even if they are being enhanced. Respectively, revenue is the financial occurrence of an organization's equity worth rising as a consequence of the actual making or selling of its goods or services. Therefore, revenue is the investments or expansions of a business assets or the settlement of its debts over time as a consequence of the production or delivery of items, the provision of services, or other occurrences that constitute the organization's continuous primary function. However, revenue generation is the process of bringing in cash to help organizations reach their aims and objectives. Where revenue may originate either internally or externally. (Yamer, 2017)

According to Ibrahim (2017), organizational success is measured in terms of revenue production, which is measured by asset accumulation, wealth creation, and service quality, which is measured by customer satisfaction and complaints. And for greater income production, businesses should examine their consumers, where businesses should constantly enhance their income and include a system of internal control in their daily operations, control systems work best when they are included in the organization's infrastructure and used to improve quality standards as a competitive advantage continuously.

3.7 Internal Controls and Financial Performance:

Internal control procedures are frequently meant to increase the reliability of internal information sources or directly improve financial performance accuracy. As a result, internal control has a much broader purpose now, investigating connections between the revelation of a material fault and organizational-level problems with fraud, management of earnings, or restatement. Internal controls can give an objective evaluation of the level of administrative performance in completing tasks allocated for increased income creation. (Nyakundi, Nyamita and Tinega, 2014)

Additionally, an organization's performance in achieving its income target level is undeniably associated with having an effective system of internal control. Where this system must include frequent evaluations of the validity and accuracy of financial and

operational data as well as an assessment of how effectively and efficiently management achieves its organizational objectives. Additionally, employee adherence to management policies, practices, and relevant regulations and laws is evaluated. Internal control systems, which include monitoring, control activities, and control environments, thereby greatly enhance financial performance. (Liquidity, Accountability, and Reporting). Therefore, internal control is deemed effective if the organization's operational goals are achieved, disclosed financial statements are created, and trustworthy and appropriate laws and regulations are obeyed. **(Nyakundi, Nyamita and Tinega, 2014)**

However, internal control is a technique as well, but the condition or circumstances around the process at a particular time determine how successful it is. To maintain exceptional levels of organizational performance, the effective operation of internal control components must give a good amount of confidence in the accomplishment of one or more of the specified categories of objectives. As a result, it provides a fair level of assurance that the company's requirements for efficient internal control and overall efficiency are being met. Generally speaking, operational effectiveness and efficiency refer to the efficient and effective utilization of resources, such as employees, reliable data for decision-making, and assets and record security. One of the five related aspects of an internal control system is the control environment element. It discusses the morality, knowledge, and character of the entity's members. **(Kinyua Et Al, 2015)**

A broader view must be used when looking at internal control. It has to be changed, for example, in light of people's ethical ideals as well as standards and compliance procedures. Additionally, internal controls could be divided into three categories: preventative, detective, and reparative. Preventive controls make modifications, proactively foresee potential problems, and strive to prevent errors, omissions, or harmful conduct. Where the usage of the detective controls allows for the detection and reporting of any omission, mistake, or malicious behavior. The reparative measures serve to ensure that a threat's impact is minimized, determine the basis of the issue and the appropriate mistakes that resulted from it. Detective controls identify issues, remedial measures alter the processing structure to lessen the likelihood that the problem will recur in the future. Considering that each internal control mechanism is

meant to fulfill at least one of the next eight elements, according to **CPA Australia (2008)**:

1. *Completeness*: which means that the company reports must contain all records and transactions.
2. *Accuracy*: the appropriate sums are reflected in the appropriate accounts.
3. *Authorization*: the appropriate amount of authorization for items like approval, payments, data entry, and computer access are in place.
4. *Validity*: the invoice must be for services rendered or goods received, and it must show that the firm has correctly assumed the risk. For example, making sure that the purchase been made for the provision of goods or services but not yet received been recorded in the books under the heading of assets and liabilities.
5. *Handling issues*: that system errors have been found and dealt with.
6. *Separation of responsibilities*: or the practice of keeping particular tasks distinct for instance, the individual who collects cash receipts does not do banking duties as well.
7. *Presentation*: prompt financial report production in accordance with widely recognized accounting rules.
8. *Disclosure*: All internal controls, whether accounting or administrative, are connected to a monetary outcome. Keeping track of long service leave pensions, for instance, is a managerial control that does, nonetheless, have a financial impact. (Kinyua et al, 2015)

CHAPTER 4. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

4.1 Literature Review:

Internal audits and control procedures are meant to make data sources within the firm more accountable, either directly or indirectly, in order to increase the reliability of financial performance. However, internal control has a much larger objectives, such as monitoring the organization's degree of control problems which are usually linked with lower sales, also it investigates ties between material weakness disclosure and fraud, and it evaluates earnings management efficiency. Hence, internal controls give an unbiased assessment on management performance in their task of following out specified obligations in order to increase revenues. Indeed, an efficient internal control system is deeply tied with a business ability to accomplish its revenue targets. In fact, an efficient internal control system includes regular reviews of the accuracy and consistency of financial and operational data, examinations of asset protection measures, evaluations of the accuracy and effectiveness under which administration accomplishes organizational objectives, and evaluations of employee adherence to management policies, procedures, and applicable laws. (Soudani, 2013)

Fundamentally, internal control system is a method for managing, overseeing, and evaluating the resources of enterprises. And it is considered to be crucial for avoiding and identifying fraud, safeguarding actual and intangible assets, and enhancing corporate operations' efficiency. Taking small and medium-sized businesses (SME's) as an example, it makes a significant contribution to the bulk of commercial companies engaged in SME's. Where currently, small and medium-sized businesses account for the majority of economic activity worldwide. Plus, they make up 99% of all Swedish businesses and provide the country's workforce with many job prospects as these businesses need to concentrate on growing. Thus, the quality and efficiency of internal control systems in Swedish medium sized and small businesses was investigated and described in **Teketel and Berhanu (2009)** paper. The five main aspects of internal control were the subject of the article, along with how they impacted business objectives. While doing so, the research contributed to the knowledge of successful internal controls and outlined, at least theoretically, what such controls should look like

for the sampled SMEs. They identified one study question, which was: "How strongly do SMEs' systems of internal control conform to the principles of efficient internal control," to achieve this aim. The major goal of the study was to identify how closely SMEs abide by the advantages of effective internal control in managing their operations. Contrary to common assumption, the study's inductive qualitative interviewing approach showed that SMEs understood the need of having an efficient internal control system. Efficient communication and information systems, solid information and communication structures, strong control of operational activities, strong control environments, strong risk estimation processes, and efficient evaluation and monitoring systems were demonstrated to be the essential elements of an efficient internal control system suitable for SMEs. Consequently, the study's primary conclusions agreed with the proposed theoretical framework.

Due to its importance, many studies have focused on this topic and analyzed it in many ways and many different points of view, the paper of **Hu, Weng and Wang (2020)**, purpose was to determine if Chinese internal control regulations enhance the professionalism of financial reports. In details, China adopted a method that is similar to the Sarbanes Oxley act after it was passed in the US, which was called C-SOX. The purpose of C-SOX was to assist companies in ensuring the accuracy of their financial and management reports by requiring that they provide both audit and management reports on internal control. With regard to the batched execution schedule of C-SOX, the researchers tracked earnings management throughout the reform. They discovered that, without increasing real activity manipulation, the quality of accrual-based earnings was significantly improved after adherence with C-SOX. The findings demonstrated that C-SOX has a beneficial impact on the quality of reports and has no adverse effects that would diminish a firm's long-term value. Results also indicated that even with soft enforcement, the C-SOX mandatory disclosure regime promotes better corporate disclosure.

In turn, **Altamuroa and Beatty (2010)** stated that given the financial crisis that happened throughout the past years, the efficiency of internal control regulations is still debatable. So, to resolve this matter, they looked at how the internal control rules of the federal depository insurance corporation improvement act (FDICIA) affect financial reports in the US. Where two unaffected control samples were provided by exclusion

from these restrictions for non-US institutions and banks with assets under \$500 million. The research indicated that for affected vs unaffected banks, the FDICIA's Internal control requirements reduced benchmark-beating and conservatism in accounting while increasing the reliability of loan-loss rules, profits persistence, and cash-flow predictability. In addition, it is important to keep in mind that credit ratings play an important role in deciding a business capital structure, the cost of loan financing, and the efficacy of internal controls for company governance, ratings of credit, and financial reporting in the United States. These factors also affect the range of suitable investment options. Little research has been done on the connection between cost of capital expenditure and internal controls since the Sarbanes Oxley Act of 2002.

The effectiveness of internal controls, on the other hand, may have an effect on the cost of equity capital, according to academics, and internal governance systems used by organizations may have an effect on credit ratings. According to the financial statement viewpoint, a manager manipulates results to meet financial analysts' projections in order to minimize perception and negative reactions, which have an effect on the stock price. The study of **Elbannan (2009)**, examined whether there is a connection between corporate credit ratings in the US market and internal control effectiveness over financial reports. The research found that organizations with low-quality internal control measures are predicted to have less favorable credit ratings, ratings of speculative quality, a smaller workforce, a lower profit margin, lower revenue from operations, reported net losses in the present and prior financial years, greater revenue variability, and greater leverage than businesses with high-quality controls. Based on a sample of businesses that disclosed internal control flaws between November 2003 and July 2005, this statement is made. Additionally, a company's chances of receiving an investment-grade borrowing rating are reduced by inferior quality controls, which raises the cost of borrowing, reduces profitability, and overall makes these businesses less enticing to investors. Finally, research revealed a high correlation between the quality of internal controls and corporate governance.

Indeed, internal control (IC) is a crucial tool for ensuring the accuracy of financial reports by monitoring the way results are managed. Plus, the IC process is intended to provide an appropriate level of assurance over the achievement of corporate goals, including operational effectiveness and productivity, the reliability of financial data,

and regulatory and legislative compliance. Thus, the focus on IC is a reflection of the belief that good IC may lessen or eliminate the misrepresentation of businesses' economic performance. This intends that real or accrual-based earnings management (REM) may be able to take advantage of a poor IC system. Where (REM) is characterized as a managerial activity not conducted in accordance with the standard business procedure to go beyond or below specific revenue criteria. Therefore, the study of **Boulhaga, Bouri and Elbardan (2020)**, examined the connection between the data quality of accounting records as measured by actual and accrual-based management of earnings and the level of internal control (IC), based on IC weakness reports. The sample consisted of 686 company inspections of French non-financial enterprises included in the SBF 120 ranking between 2012 and 2018. The statistical results show that IC inadequacy disclosures are adversely linked with discretionary accruals and significantly and positively correlated with real activity manipulation. This demonstrates experimentally that, although reducing activities associated with accrual-based earnings management and enhancing the accuracy of financial statements, an effective IC system is unable to regulate real earnings management (REM).

Respectively, the study of **Hastuti, Ghozali and Yuyetta (2016)**, investigated the impact of accounting regulations based on international standards for financial reporting on the management of real earnings (REM), which is restrained by internal control structure (IFRS). As study samples, manufacturing firms that were dealing on the stock exchange of Indonesia between the years 2010 and 2014 were used. The research found that the implementation of the IFRS-based standard for accounting had a positive influence on the real estate market and that good business governance, as judged by the internal control framework, reduced that impact.

Similarly, **Wali's (2020)** paper examined the association between internal control system quality and its effect on the management of real earnings (REM) in France. This link was tested using multiple regression analysis, and the results revealed that having strong internal control had a favorable effect on (REM) and that having stronger internal control aims to make financial reporting more trustworthy to investors. The results also revealed that the aspects with the most effects on (REM) are the control environment, evaluation of risks, control procedures, and monitoring.

As a result, the practice of controlling reported profits in order to achieve objectives has come to be known as the management of earnings. Basically, studies describe earnings management as a management decision based on an accounting policy or an actual action that has an impact on earnings so that various reporting objectives may be met. However, since this growth has become a central point for consideration and the creation of internal control systems to arrange the businesses of firms, all companies in the modern era are now interested in the diversification of their activities, the expansion of their business sectors, and keeping up with all global developments, especially in the economic and technological fields, and this can be found particularly in developing countries.

In this respect the study of **Al-Kharusi (2022)**, aimed to understand the internal control systems of the business and their effect on the accuracy of financial reports in Oman's economy. It also aimed to understand the effects of control environment and internal audit, which are subsets of internal control systems. In this study, data was gathered via surveys and interviews from a sample of 80 individuals in the workforce. After learning the results. The research led to a lot of results, but the most crucial was that there is a favorable association between systems for internal control and the level of financial reports quality. Whereas robust systems of internal control are required to guarantee that the financial reports are errors free, fraud, and manipulation. Consequently, when the internal control system improves, the level of accuracy of financial statements will also improve. The researcher suggested that in order to generate financial reports that are trustworthy and credible, it is important to focus on the effectiveness of internal control mechanisms and to put numerous strategies and programs in place that aid in improving them.

In light of the previous study and its outcomes, **Kabuye, Kato, Akugizibwe, and Bugambiro (2019)**, studied how internal control mechanisms and working capital management impact supermarket profitability in Uganda. The information was gathered at the company level by the researchers from a representative group of 110 supermarkets using a questionnaire. According to the findings and the results of the research, managing working capital appears to be a significant indicator of financial performance. Financial performance is not significantly impacted by internal control mechanisms. However, if the process of managing working capital was properly

implemented, there is a greater likelihood that the firm will have efficient internal control systems, which will enhance its financial performance. Thereby, **Omar (2021)**, examined the connection between the operating efficiency of internal control as specified by the COSO framework and the financial condition of Libyan commercial banks. The population of the study consisted of individuals who are employed in the audit area at both bank offices and main branches, as well as staff from the audit units as well as members of the auditing committees of all four of the biggest banks in Libya. The main tool used for acquiring primary data was a questionnaire. Additionally, as secondary sources for information for the study, the researcher approved the use of annual states, studies, and data made available by the National Bank of Libya. The correlation study demonstrated that there was a weakly significant link between internal control measures effectiveness and the financial results of Libyan commercial banking institutions. Multiple regression analysis was utilized in the study to examine the relationships between the variables. Risk assessment, control environment, monitoring, information & communication, and financial performance were found to be positively correlated. Despite this, it was unable to find a link between control actions and financial performance.

Equivalently, **Hanoon Et Al (2021)**, the study examined the connection between the internal control elements and the financial performance (FP) of the banking industry in Iraq. The components that were selected were control activity, control environment, information & communication, risk assessment, and monitoring. Modeling with structural equations was used in the main study's quantitative design. Respondents selected through non-random purposeful selection were used to provide data. 365 people responded to the survey, and modeling with structural equations was used to evaluate the data. The research findings demonstrated that the internal control elements had a big influence on financial performance. The factors with the most positive significant connection were information & communication, control activities, control environment, monitoring, and risk assessment. The outcomes also demonstrated that control activity was the most crucial internal control component that has an influence on financial performance. The main finding of the study was that strengthening internal control mechanisms would enhance financial performance. It also stressed the importance of this relationship for Iraqi banks in the conclusion.

In the same field also **Mohammed (2020)**, the quality and effectiveness of the internal control systems (ICS) utilized by Ghanaian banks and the effect they have on those banks' operations. The COSO structure for internal controls and company performance were considered the independent variables in the research. The study considered both financial performance (FP) as indicated by (ROA, ROE, EPS, and GPM) and non-financial performance (NFP) indexes. Data for the research were gathered using a questionnaire. In order to examine this data, statistical methods such as descriptive statistics (standard deviation, means), T-tests, Correlation, and Regression were employed. The results of the study demonstrated that internal control mechanisms were available and operating well at banks in Ghana. Additionally, the study discovered that internal control significantly affects both non-financial and financial performance.

The study advised banks to work significantly harder rather than be careless in order to achieve better results. Also, it stated that banks must invest more in risk management since they are more vulnerable to risks compared to any other financial institution. Which will also give them the ability to avoid any potential theft or fraud that might happen and present a severe threat to the bank. Without a doubt, it is widely accepted that a strong internal control system will offer a fair level of assurance that the company is operating profitably. It is also anticipated that business entities with effective internal control systems would perform financially better than those with ineffective systems.

The concern about the link between financial performance and internal control systems, however, offers opportunity for scholars to explore this topic and give evidence of this connection to legislators and the various stakeholder groups. It's worth noting the study of **Thuneibat Et Al (2013)**, which aimed to look at whether Saudi shareholder firms are complying with the internal control standards that set out by the Saudi requirements on internal control, as well as, the influence this has on their profitability. In addition to using a questionnaire to gather information on internal control regulations compliance, he also used financial statements from these companies to gather data on four profitability metrics to gauge how much money these businesses were generating. These metrics were return on assets (ROA), earnings per share (EPS), profit margin (PM), and return on equity (ROE). Then multiple regression analysis, correlation, and the T-test were used to assess the data. Ultimately, the research revealed that compliance with all internal control requirements was quite high. Additionally, internal

control and its components also seem to have a significant and favorable impact on ROE and ROA, while the impact on PM and EPS were positive but not statistically significant. Likewise, **Adegboyegun Et Al (2020)**, A questionnaire was utilized to gather the information for the study, which assessed the effect of internal control system aspects on the profitability of medium-sized and small enterprises (SMEs) in Nigeria. The study ultimately discovered that internal control system components had no discernible effect on the operational performance of SMEs, but that the control activities and control environment had a positive influence on the likelihood of a company having a high operating performance. Regression analysis was used to evaluate the data that had been gathered and compiled.

Additionally, **Ndiaye Et Al (2019)** research, employed return on equity (ROE), profit margin (PM), earning per share (EPS), and return on assets (ROA), as measures of the institution's profitability in order to ascertain the link between internal control and microfinance companies' (MFIS) profitability in Senegal. Multiple regression analysis was employed in the study to examine the quantitative information acquired from the sampled 118 MFIS. The managers and directors of the internal audit departments of microfinance organizations provided the information for internal control effectiveness. The 2nd source of this quantitative information was the financial accounts provided by microfinancing firms. In any case, a sample of microfinance companies that were selected via proportionate stratified sampling was the source of the data, which were gathered using a questionnaire. The findings suggested that all internal control-related factors were significantly and favorably associated with the four indicators of profitability of the (MFIS).

An internal control system's main goal is really to constantly check for consistency in all financial processes and operations so that problems may be fixed as they arise. Additionally, when a robust internal control system is in place, fraudulent and inaccurate activities are less likely to happen. The system of internal control indicates that the system should always be maintained under control and monitored since people frequently put their personal interests ahead of those of the business. So, the company's accounting system will undoubtedly fail without an efficient internal control system, resulting in the loss of property and a rise in fraud.

However, although the concept of internal control has existed for a while in other countries, it is still considered to be relatively new in Turkey given that it was introduced there in 2001. In this regard, there is debate over internal control in Turkey, including whether it complies with standards outside and the reasons for any inconsistency. **Balyemez (2016)** paper as an example, analyzed the demonstrate historical changes in the field of internal control in Turkey over the previous 2 decades and provided actual conclusions connected to the attained position in the legislative framework, the results pointed that, although internationally acceptable internal control laws have been quickly integrated into Turkish laws with the impact of requirements under the European union acquis, but still there are some defaults in different levels.

Internal control systems are essential and important, according to several studies, plus they studied the ways that internal control systems are applied in Turkish business, and looked at its impact on these businesses in many fields, they also explored its effect on different variables, and to mention a few, the study of **Cevahir and Çaliyurt (2019)**, which aimed to determine the publicly traded companies' perceptions of the significance of internal control systems and investigate their understanding of these systems as well. Additionally, it sought to determine if internal audit functions are appropriately followed in Turkish publicly listed corporations. Therefore, questionnaires were used to obtain descriptive and useful information on the firms, internal audit managers, internal audit operations, and the factors that influence the internal audit operations in order to show the correctness and reliability of this study. Additionally, laws regulating internal control both in Turkey and internationally were addressed. It was concluded as a consequence that the publicly traded firms who took a part in the research had not completely complied with the required and advised compliance requirements. But it was discovered that more than fifty percent of the businesses complied with the first-degree required compliance standards of internal control, and 85.1 percent complied with the second-degree recommended compliance standards of internal control.

In like manner, to fill in the information gaps in the Turkish literature concerning internal control systems and internal audit activities while also illuminating how the two are related, **Kizilboğa and Özşahin (2013)**, investigation reached to the conclusion that internal auditors benefit from the efficient internal control system. And a strong

internal control system enables the sustainability of attaining corporate objectives and allows internal auditors to focus on adding value and protecting their business as a consulting service. Additionally, internal control and, by extension, internal audit, have grown in significance as businesses become bigger, where roles are increasingly shared, technology advances and processes become more and more complicated.

While **Kaya (2015)**, clarified that the system of internal control is set up on the overall production and stock cycle, taking into consideration the company's goals and how it will affect other corporate operations and how it should assess for effectiveness and efficiency. The study also stated that while the auditor will make sure that the reporting structure is expressed to the management in a precise and timely manner, along with the legality of the quantities resulting from the amount movements of the cycle, the auditor will also make sure of the sufficiency of the established controls, the adherence of the corporate structure to the cycle, and the applicability of the valuation technique for the firm, such as the effectiveness of the cycle and the effectiveness of the computer program employed, and if it was created in such a way. It ought to be assessed using non-financial data. Thereby, the existence of an effective and efficient organizational administration is impossible without solid and well-functioning internal control. But a strong internal control and internal audit cannot be operated or maintained without a proper and efficient external audit based on.

In the same pattern, the efficiency of the internal control systems employed by Turkish banks were assessed in **Özbek' s (2011)** study using the COSO assessment model. This study aimed to assess the compliance with BASEL committee on banking supervision standards (BCBS) -It offers a venue for frequent interaction on banking supervisory issues and is the largest international standard-setter for the regulation of banks prudently. Based on the quality and effectiveness of the systems of internal control in these institutions, it has 45 members, including central banks and financial regulators, who represent 28 different countries. Plus, the influence of each banking activity on the quality of internal controls was also explored in this study. In details, a questionnaire for the data used in the study was constructed based on the COSO model, which was used to assess the efficiency of banks internal control systems. Plus, various statistical tests and analyses were used. Five independent factors' influence on the dependent variables were looked at using regression analysis.

After examining the 5 key components of the BASEL committee's internal control process (monitoring, risk assessment, information and communication, control environment, and control activities), it was concluded from these experiences that an efficient internal control system could have prevented or detected the issues that caused losses at least in part, or at the very least, could have limited their impact. Also, the study mentioned that an efficient and high-quality internal control system is an important aspect of a bank's administration and might help the institution achieve its goals, including its desire for profitability. Accordingly, **Topak and Talu (2016)**, investigated the elements that influence profitability of Turkish commercial banks, this study was conducted between the years 2006-2014, and it used the financial statements data of 12 Turkish commercial banks listed in the BIST index, where (ROA) and (ROE) were used to calculate the profitability as dependent variables, and interests and fees also were used in the model of the study. Based on its findings, the ratios of net commissions and fees to overall costs, as well as comparing loan interest to deposit interest, have a positive impact on (ROA) and (ROE).

In turn **Doğan (2013)**, investigated how a company's size affects its profitability, this study was conducted in Turkey also, and it used the data of 200 company that are listed in Istanbul stock exchange (ISE). Return on assets (ROA) was used as a monitor of business profitability, whereas comprehensive assets, comprehensive revenues, and personnel count were used to measure the firm's size. Multiple regression analysis and correlation approaches were used to examine the study hypothesis. According to its findings, there was a strong relation between company size indices and profitability. But control factors including firm age and leverage rate were shown to have an adverse relationship with return on assets (ROA), however, liquidity rates and return on assets (ROA) were observed to have significant positive relationship.

As for the Palestinian literature and in light of this interest at the international level of internal control systems, the legal and regulatory developments in the Palestinian business environment have prompted increased attention to its internal control systems. In order to protect funds and prepare accurate financial statements that serve all users of financial statements, in addition to promote efficient and effective resource management and to improve the competitiveness of companies.

Mushtaha (2015), sought to evaluate how well the systems of internal control in Palestinian public enterprises adhered to the COSO structure and how it affected the performance and value of the companies. To accomplish the research's goals, a questionnaire was created to gather information on how extensively the elements of internal control were used by the study sample, which consisted of (40) publicly traded businesses dealing on the Palestine exchange. To assess the study hypotheses, a single sample t-test and multiple regression analysis were performed. Given that the average weighting reached for the overall degree of compliance was 82.7%, the study came to the conclusion that the systems of internal control implemented in public shareholding businesses in Palestine are in accordance with the incorporated internal control structure (COSO) to a high degree. The results also revealed an association with statistics of significance between the application of internal control components that are consistent with the COSO framework and the indicators of financial performance of the companies studied.

The study also discovered that there was no substantial influence on a company's value as determined by Tobin's q, which is the market value of an organization split by the replacement cost of its assets, and the corresponding ratio of market value compared with book value per share when the COSO structure for internal control was applied to the businesses declared on the Palestine exchange. In regard, the study produced a number of suggestions, the most crucial of which was the requirement that the Palestinian Capital Market Authority issues a unique guide that incorporates a structure for internal control in a way that is suitable for the Palestinian business climate, so that it includes the elements and components of internal control based on the committee of sponsoring organizations' integrated structure for internal control (COSO), it also recommended the need for coordination between to stay up with regulations in industrialized nations, the regulating authorities of the profession of auditing including the Palestinian Capital Market Authority, by working to introduce binding legislation to the management of shareholding firms that dealing in the Palestine stock exchange, to report annually on internal control and its effectiveness, under the condition that this report should be evaluated by an external auditor to verify its conformity with the reality of performance in the company.

Similarly, **Ayyash (2017)**, investigated whether Palestinian shareholding firms complied with internal control rules and how this compliance affected their profitability. In order to accomplish the research goal, data about adherence to internal control standards was also gathered via a questionnaire. Methods for analyzing qualitative data were employed by the researcher. The study's outcomes demonstrated that all internal control components were highly complied with and that internal control had a large and beneficial effect on profitability. The investigation produced the following suggestions: To optimize the well-being of their entities, directors of all shareholding corporations should first build an internal control system. In order to improve the control environment culture, management should also make all policies, including those pertaining to integrity and morale, public and declare them to be a part of their purpose.

The auditing society should collaborate with the Palestinian Stock Exchange to produce a new internal auditing rule, and an external auditor should assess that rule to ensure that it is properly applied. Generally speaking, internal control systems are dealing with improving the effectiveness and efficiency of the facility's operations, including the protection of assets and shareholders' investments, achieving profitability, and improving performance. Where many papers analyzed how internal control processes affect financial outcomes, one of closest markets to Palestinian market structure -which can be almost identical markets- was been investigated in **Al-Thuneibat and Keffous (2012)** paper. Where it explored how well Jordanian manufacturing firms commit to the internal control requirements outlined in international standard on auditing no. 315. Along with determining how Jordanian manufacturing enterprises' financial results might be affected by internal control requirements. A questionnaire was created and sent to (50) industrial enterprises listed on the Amman bourse in order to accomplish the study's goals.

The data was analyzed and in order to examine the hypotheses, descriptive statistics were used such as t-test, and multiple regression. The study findings indicated that all internal control aspects were implemented to a high degree, although there was no distinguishable correlation between the degree to which Jordanian manufacturing firms commit to these internal control elements and the financial performance as shown by return on equity (ROE), return on sales (ROS), and return on assets (ROA) ratios.

But there was a connection that is highly significant between the level of compliance and financial performance measured by gross profit margin (GPM) ratio. A substantial correlation in terms of statistics between the commitment to internal control aspects and financial success was also found as determined by ROA, ROE, and ROS ratios. However, there were no differences that are statistically significant in the association between the commitment of the internal control requirements and the financial outcomes of the companies measured by the ratio of GPM and associated to the size. The study came to several conclusions, including the necessity of routinely evaluating the internal control systems in Jordanian manufacturing enterprises and the search for a specific section for regulating the quality of internal audit department operations.

Sawafta (2021), on the other hand aimed to identify using the Department of Finance as the subject of study, examine how internal control affects the caliber of financial reports. A questionnaire was created with the goal of collecting data in order to accomplish the study's goals, and (50) questionnaires were sent and entirely reclaimed with a response rate of one hundred percent, all of which were deemed legitimate for analysis. The research produced a variety of conclusions. First, internal control and its components (information and communication) have a statistically significant effect on the quality level of financial reports. The aspects of the control environment and risk assessment, however, were not included. Employee opinions on how much internal control was used at the Department of Finance were positive, nevertheless. Additionally, they had high opinions of the attributes that were required to produce effective financial reports. One of the study's most crucial suggestions was the need for the department to develop strategic plans for threats in order to tackle and eliminate hazards, as well as the requirement of reviewing supervision and performance reports prior to making transfers amongst personnel. It suggested that information should be presented in a way that is intelligible and straightforward.

While **Shaath (2017)**, study discussed the system of internal control and its influence on the competency of the financial reports in the shareholding firms displayed on the Palestine stock exchange. Also, it meant to determine how the properties of the accounting information were impacted by internal control factors like risk assessment, control environment, control activities, and financial reports elements like adequacy of information, honest representation, understandability, and comparability. Where the 48

shareholding firms listed on the Palestine stock exchange made up the study population. The financial managers, accountants, internal auditors, and audit committees were all included in the extensive study as the research sample. The study's most important finding was the identification of a substantial correlation between the internal control components (risk assessment, monitoring, information and communication, control activities and control environment) and the aspects of financial report quality (adequacy of information, honest representation, understandability, and comparability) at the public shareholding business listed on the Palestine stock exchange.

The study also revealed that these organizations' supervision mechanism was efficient. The division of duties and responsibility allocation was present. The financial statements were presented in an easy-to-understand way without any manipulations. These findings led to the study's conclusion, which included a number of recommendations, including, paying closer attention to the internal control system and monitoring reports, creating a contingency plan, granting the internal auditor the appropriate independence in their work, developing accounting systems that contribute to resolving flaws and potential issues at work, and instructing the staff that oversees the creation of financial statements. Finally, the report urged the public shareholding organizations that are listed on the Palestine stock exchange to activate their audit committees.

Analogously, **Al-Samarrai (2016)**, intended to show how internal control mechanisms affect the accuracy of financial reporting for Jordanian pharmaceutical businesses trading on the Amman Stock Exchange, a market that is nearly equivalent to the Palestinian market as was previously described. The research population consisted of six pharmaceutical companies from Jordan that were listed on the Amman exchange of stocks in 2016. Analytical descriptive methods were utilized to assess the study's assumptions and achieve its goals, as well as multi-simple regression evaluation and route analysis. The study's findings included that information and communication and control environment, had a huge impact on the financial reporting quality of Jordanian pharmaceutical firms listed on the stock exchange in Amman. The accuracy of financial reporting in Jordanian pharmaceutical enterprises is also significantly influenced by information, and communication, control environment.

The study noted that internal audit bodies should be created in order to play a substantial role in enhancing the reliability of financial reporting in conjunction with these findings. The accuracy of financial reporting in Jordanian pharmaceutical enterprises is also significantly influenced by information, and communication, control environment. The study stated that internal audit bodies should be created in order to play a significant influence in enhancing the reliability of financial reporting in conjunction with these findings. Where the goal was to implement a system of internal control and produce financial reports of the highest quality. Also, before delivering these reports to management, they must be examined in light of the business outcomes structuring.

Thus, internal control is an important part of the activities of modern economic management, which is closely linked to both the value and performance of the institute. Additionally, internal control systems play a substantial role in all facets of operation in commercial banks because of the difficulties that arise from the internal control system's activation due to legal and regulatory issues, the banking industry's rapid expansion in regards to both the number and complexity of its activities, financial pressures, and crises, the study of **Bayyoud and Sayyad (2015)**, aimed to know the effect of internal control, risk management on banks operating in Palestine, it also aimed to identify the effects of banking reforms and new rules in identifying and evaluating the risks facing these banks, and mitigate their effects. This study was conducted in Palestine and the descriptive method was used analytically by relying on a questionnaire as a tool for the investigation in order to collect data related to the study.

The study sample was made up by all managers of banks functioning in Palestine, the study sample was 10 managers of those banks. After conducting the procedure of statistical analysis, the study came to several results, most importantly that the internal control systems and risk management in Palestine has a positive impact in terms of quantity as well as the quality of the firm's performance. The results that came through the evaluation process showed that the cases of corruption, fraud, and errors have decreased, and that the risks were controlled by these banks, and the powers and duties that are carried out were separated. In addition, the practices applied in these banks were in line with international standards in terms of the degree of commitment, as a result of the reforms that have occurred in the internal control procedures applied in those banks.

Following the previous paper was **Tanina (2017)** study, where the goal of it was to find out the impact of internal control on financial performance of Palestinian banking industry as well. In order to accomplish the study's goals, financial statements from banks in Palestine were analyzed over time to be able to gain indications of the institutions' financial success. The impact of internal control in Palestine based banks was also measured using a questionnaire that was sent to a stratified sample of study participants who work in the internal control sector of these banks. The questionnaire was built based on the COSO framework, prior researches, and theoretical framework. The descriptive analytical approach, and proper statistical procedures were all applied by the researcher in the analysis. The most significant study findings were. *First*, a relationship between the internal control elements and return on assets (ROA) that were positive in Palestinian banking sector. *Second*, a positive correlation between Palestinian banking industry's internal control components and return on equity (ROE). *Third*, the components of internal control in Palestinian banking industry have a positively statistically significant influence on earnings per share (EPS). *Forth*, the market value to book value was statistically significantly influenced in favor of the banking sector in Palestine.

Hence, all aspects of the internal controls in the banking industry were significantly correlated with all performance metrics. Following the study's conclusions, several recommendations included the requirement for banks to prioritize internal control systems by appointing a controller or internal auditor with expertise and independence in each branch and keeping up with changes to the international requirements for auditing and accounting. Banks must also regularly examine the internal control systems that are in place. In order to improve the financial statements' credibility, increase operational efficiency, and guarantee that these institutions are committed to following all relevant laws and regulations. Finally, banks need to establish the five aspects of a system for internal control in accordance with the COSO framework.

In parallel, **Alqudah (2017)**, aimed to look into how internal controls, in accordance with COSO committee decisions, affected credit risk analysis using the 5c method for Jordanian commercial banks. The 5c's approach, which stands for "company, partners, customers, competitors, and context," is a marketing framework for analyzing a company's operating environment. The study used the descriptive technique of

analysis and each of (the 13) Jordanian commercial banks made up the research sample. A questionnaire was created to gather data on internal control in line with the COSO committee's recommendations. The study's data were examined utilizing suitable statistical techniques, where study findings showed that internal control aspects with their paired components (monitoring, risk assessment, control environment, information and communication, and control activities) had a statistically significant impact on credit risk assessment using the 5c's approach in Jordanian commercial banks at the significance level (0.05). One of the most important suggestions the study mentioned was the need to pay attention to the efficiency of individuals working within the internal control bodies in Jordanian commercial banks, which leads to improving the internal control environment. Additionally, the necessity of internal audit work and ongoing monitoring and assessment of systems for internal control, and the maintenance and continual improvement of these systems, which helps in understanding the risks of credit decisions before they occur.

However, putting light on the extent of the commitment of Palestinian firms, with the structure of the systems of internal control and its fields (monitoring, risk assessment, control environment, information and communication, and control activities) according to the COSO model, was the purpose of **Abu safe (2019)** study also, where it aimed to determine the level of commitment for one of the largest constructions companies in Palestine to implement internal control systems in line with the COSO framework. A questionnaire and interview worked as the researcher's primary methods of data collection while employing the analytical descriptive methodology. The study indicated several conclusions, the most significant of which were: the COSO model's availability of internal controls was highly regarded by this firm, where it came in first place after the regulatory environment, second place after risk assessment, third place after control activities, and fourth place after the information and communications system. Ranked fifth, behind the monitoring system.

In addition, when the COSO aspects (monitoring, risk assessment, control environment, information and communication, and control activities) were incorporated in the company, also, no statistically significant discrepancies were between the responses of respondents. The research came to a number of suggestions, the most significant of which were: work on the analysis and evaluation of the risks faced by the organization,

and use technology tools in the process of risk assessment, and the requirement to follow adequate processes to handle risks. Also, the rule of internal control in institutions is to strengthen the control operations. This is in the management of the business's best interest, and complaints should be used for internal control as one of the means of addressing them in a fair and impartial manner. Additionally, the need to include the information and communication systems of the company in an emergency plan is necessary to ensure the achievement of work and lower the likelihood of device and electronic system disruption. These efforts include increasing attention to information and communications and working on continuous follow-up and updating commensurate with the changes taking place in the company, including the provision of a strong information processing system.

The improvement of infrastructure and its impact on the improvement of other sectors make the construction field one of the most significant players to economic improvement in any nation, based on that, many researchers focused on this sector, along with the previous study there was the study of **Nashwan (2018)**, where the main goal of the research was to identify the effects of internal control systems constructed in line with the (COSO) model, including all of its components (control activities, control environment, information and communication, risk assessment, monitoring) on the efficiency of construction businesses' operations. Furthermore, determining how well Palestinian construction enterprises adhered to the model's provisions for internal control systems. So, after examining the findings, the research concluded that construction businesses have a strong commitment to the internal control frameworks of the COSO framework and that every single one of the model's components has a statistically important beneficial effect on operational performance.

Also, the study advised construction organizations to enhance their internal control systems by allowing their control systems' architecture to be dependent on the components of the COSO model. Plus, it advised scholars to carry out more study on various industries, including commerce, services. Internal audit, on the other hand, refers to a neutral, independent, objective verification and consulting activity effectively established by management to improve a company's activity. Internal control, on the other hand, relates to a procedure established by a company's stakeholders to offer adequate confidence in the financial records, activities, and

compliance of an organization. And while internal controls provide the guidelines by which a company organization should be governed, internal auditing is an exploring activity that confirms how internal controls have been put in place. Thereby, internal control is an accumulation of the processes, rules, and other measures in order to ensure that an business achieves its goals and that risks that may prevent it from doing so are reduced, the internal audit is a detective activity that confirms the execution of internal controls and it's a one-time examination that aims to provide information regarding the validity and reliability of accounting records, ensure that accounting standards are followed, detect and prevent fraud, confirm business liabilities incurred, identify operational gaps, recommend fixes, and aid in the creation of periodic action plans.

So, despite their differences, the two guarantee that a company's objectives are met through reducing risks through efficient controls and the ultimate goal of both disciplines is to safeguard the shareholders, who are the entity's owners. This complimentary connection is further supported by the purposes of internal control and internal audit, which are mutually exclusive. In this respect **Abu Mayaleh (2017)**, looked at how internal control system design in line with the COSO 2013 model affected the quality of internal and the performance of external audit. Thus, in order to accomplish the study's objectives, the researcher employed correlated analytical approach, distributed a questionnaire to internal and external auditing professionals. While, regression analysis was carried out to test the primary statement of the research. The findings revealed that the COSO 2013 model's internal control system architecture had an effect on raising the quality of internal and external audit performance.

The findings also showed that firms with public shares that are traded on the Palestine Stock Exchange had made a significant commitment to the design of internal control systems in the areas of regulatory monitoring activities, control environment, control activities, information and communication, risk assessment. Additionally, the outcomes showed that there was great conformity on the part of the external and internal auditors with the standards for the quality of the audit performance. The study came to a conclusion with a number of recommendations, the most significant of which was that public shareholding companies should continue to monitor the evaluation and enhancement of the internal control system structures to help them improve their efficiency and also accomplish the desired goals.

4.2 Hypothesis Development:

Preventing financial exploitation in the operating process, providing maximum enhancement in procedures, and maximizing efficiency are some of the most crucial aspects of guaranteeing financial continuity in the globalizing globe. A globally recognized internal control system that serves as a benchmark for businesses is required in order to achieve this. Firms must first be committed to deploying the systems for this to happen, though. Employees can be carefully informed of the intentions to be made in the next process, and their assistance can be offered to guarantee the process's smooth development. This circumstance made it necessary for the company's senior management to be completely familiar with all of its departments and operations. (Aydin, 2020)

Hence, in order to guarantee the system's continuation, the improvement of the internal control system is crucial as stated. Although, all company departments should be interviewed as the framework is being set up, and job descriptions for everyone should be determined. Boundaries should also be strictly outlined, responsibilities should be kept separate, authorities and commitments should be established, and participation from all employees should be guaranteed. Operating staff and required training should be offered by specialists to ensure the success of the system during its first implementation phase and to maintain it over time. Channels should be employed, and the layout of the organization should be created in line with the company's structure and the sector's requirements. (Çabuk and Aytaç, 2014)

Internal control is an ongoing process, and one of the essential components of the system is maintaining up with the demands of the time. Thus, for the function to be realized, these risk assessment actions must be carried out regularly. If needed, equipment and machinery should be modified, and ongoing training and development should be offered. The firm's data and audit planning will be made greatly possible by an efficient internal control system. And it will raise the audit's quality. Although not completely, the internal control mechanism offers adequate confidence. The human aspect is the main contributing factor to this. (Çabuk and Aytaç, 2014)

Respectively, the upper management, the directors' board, and all staff levels participate in internal control, the purpose of which as mentioned is to assure that all predetermined objectives will be met. Indeed, the major goals of the internal control system are

compliant with relevant legislation and laws, dependability, completeness, and accuracy of financial and administration information, and effectively and efficiently completing activities. So, based on the previous studies along with the literature it's obvious that there is no clear confirmation on the impact of internal control systems competence on profitability and there is a lack of studies investigating different sectors. (Çabuk and Aytaç, 2014)

Thus, this study will increase the efforts in investigating different sectors by testing these hypotheses in the coming parts:

H₁: There Is a Substantial Effect of Internal Control Systems Efficiency on Firms' Profitability.

From this central hypothesis, sub-hypotheses can be developed based on the four-profitability metrics which will be used in Data analysis for this research, as follows:-

- H_{1a}: there is a substantial effect of internal control systems efficiency on firms Return on Assets.
- H_{1b}: there is a substantial effect of internal control systems efficiency on firms Return on Equity.
- H_{1c}: there is a substantial effect of internal control systems efficiency on firms Net Profit Margin.
- H_{1d}: there is a substantial effect of internal control systems efficiency on firms Earnings Per Share.

CHAPTER 5. METHODOLOGY

5.1 Research Design:

The design of the study should be formed once the topic and issue of the study have been selected and developed, objectives have been accurately identified, concepts have been properly explained, and the theory has been presented suitably. Thus, in this study, and based on the preliminary literature review whether in Palestine or Worldwide, the main goal was to figure out if there is an important effect of internal control systems on firms' profitability in the Palestinian market. Where profitability was figured by these ratios: earning per share (EPS), return on equity (ROE), return on assets (ROA), and net profit margin (NPM), which also are considered the dependent variables, and together can create a measure of any company's profitability. Plus, the level of commitment to internal control systems components in Palestinian firms along with its efficiency will be observed based on the COSO framework, and by comparing this commitment with the firm's profitability using statistical methods to test the study hypothesis like Multiple Regression Analyses, Correlation, and T-test. Any significant influence of internal control systems on firms' profitability will be confirmed and measured. In addition, to evaluate this impact in terms of size and importance.

The collected data will be examined using Excel Views and Statistical Package of Social Science (SPSS) to calculate the following values: Means, frequencies, standard deviations, and percentages to determine the proportional percentage of every domain, Linear and Multiple Regression, Pearson Correlation Matrix and Normal Distribution tests will be used. Thereby, by collecting the necessary data on firms' commitment to the COSO framework and comparing it with their profitability, and analyzing the results using these statistical methods, any existence of effect on firms' profitability by their internal control systems will be determined and evaluated.

5.2 Population and Sampling:

This study is directed to the listed firms in the Palestinian market, particularly the Palestinian stock exchange, thus, after analyzing the Palestinian stock exchange official website it was found that the whole population of this study is no more than 49 listed firms. Hence, since the population is small (under 200) and the researcher is capable of collecting all the necessary data from it, it's almost a must to examine the whole

population (Taking a Census) according to **turner (2003)**, where this gives the ability to eliminate the sampling error, plus it gives data for all individuals (firms) in the population, and as a result, it gives a meaningful conclusion. Consequently, the sample of this study will be the whole population, which is, all Palestinian Stock Exchange-listed companies. So, the total number of the sample is 49 firms that are dealing in the Palestinian Stock Exchange. However, the responders were only 41 from Palestine Stock Exchange listed firms. As it appears in Table (1).

Table 1

Sample of Palestine Stock Exchange listed companies:

No.	Trading Symbol	Company Name
1	PALTEL	Palestine Telecommunications
2	BOP	Bank of Palestine
3	APIC	Arab Palestinian Investment - APIC
4	PADICO	Palestine Development & Investment
5	TNB	The National Bank
6	ISBK	Palestine Islamic Bank
7	AIB	Arab Islamic Bank
8	QUDS	Al Quds Bank
9	BPC	BIRZEIT Pharmaceuticals
10	PEC	Palestine Electric
11	PIBC	Palestine Investment Bank
12	NIC	National Insurance
13	VOIC	The Vegetable Oil Industries
14	JPH	Jerusalem Pharmaceuticals

15	SAFABANK	Safa Bank
16	TRUST	Trust International Insurance
17	PIIC	Palestine Industrial Investment
18	AZIZA	Palestine Poultry
19	PSE	Palestine Securities Exchange
20	PICO	Palestine Insurance
21	GUI	Global United Insurance
22	TIC	Al-Takaful Palestinian Insurance
23	PRICO	Palestine Real Estate Investment
24	MIC	Al MASHRIQ Insurance
25	JCC	Jerusalem Cigarette
26	BJP	Beit Jala Pharmaceutical
27	ABRAJ	Al-WATANIAH Towers
28	NAPCO	National Aluminum and Profile - NAPCO
29	GMC	Golden Wheat Mills
30	RSR	The Ramallah Summer Resorts
31	AIG	AHLIEA Insurance Group
32	APC	Arab Company for Paints Products
33	PID	Palestine Investment & Development
34	NCI	The National Carton Industry
35	NSC	Nablus Surgical Center
36	ARAB	Arab Investors
37	AQARIYA	Al-AQARIYA Trading Investment

38	JREI	Jerusalem Real Estate Investment
39	LADAEN	Palestine Plastic Industries
40	PALAQAR	PALAQAR For Real Estate Development & Management
41	TPIC	Tamkeen Palestinian Insurance

5.3 Data Collection:

To guarantee the authenticity of the research, trustworthy data collection is required, regardless of the study's topic or preferred technique for defining data. By selecting the best data collection methods (current, updated, or freshly developed), and by offering clear instructions on how to use them correctly, the likelihood of errors is reduced. Thus, a robust method for gathering data is required since it makes sure the data is precise and well-defined. Decisions are made utilizing reliable data and claims that are supported by the results in this fashion. The procedure offers a starting point for comparison and, in certain situations, a suggestion of what needs to be improved. (Couper, 2011)

As a result, and in order to collect the necessary information for this study, the researcher used two suitable information sources which are generally acceptable based on the previous studies (Doğan 2013, Özbek 2011, Ozdemir 2017) To give a foundation for the evaluation of the variables. First, the researcher distributed a questionnaire paper, as a primary source of information, on the financial and general managers of the targeted firms or the research sample which was designed based on the COSO internal control comprehensive framework principles, and aimed to evaluate their internal control systems commitment, along with these systems' effectiveness and efficiency. The financial statements of the targeted businesses that answered the survey paper on the other hand, served as the 2nd source of data. and particularly all the information related to their profitability measures.

5.3.1 design of the questionnaire:

The questionnaire for this study included 17 close-ended questions about each component of internal control systems and it was created based on the COSO internal control framework which is published on their official website, thereby, according to

the COSO framework there are five components of internal control systems and they have been addressed in the literature as well. These components are monitoring activities, control activities, information and communication, control environment, and risk assessment. It's worth noting here, that these components and the COSO-designed framework are acceptable worldwide, and it has been used in many studies before either in Palestinian literature, or worldwide literature, as was mentioned. Furthermore, the data was collected using a five-point Likert scale, with options starting from strongly agree to strongly disagree. Where strongly agree grants 5 points while strongly disagree grants 1 point. Finally, the data were collected during the period from the years 2017 to 2022. A total of 49 copies of this questionnaire were delivered to all of the Palestinian Stock Exchange's listed companies; 41 of them were returned, answered, and deemed valid, which represents about 85% of the population. Based on prior studies, this percentage is very good given that 85% represents a percentage of the entire population.

5.3.2 financial statements:

The financial statements of the 41 firms that answered the questionnaire which were available on the Palestinian Stock Exchange website served as the second source of data as mentioned. Using these reports, it was possible to calculate the needed matrices of Earnings per Share, Return on Assets, Net Profit Margin, and Return on Equity for each of these companies.

Return on Assets, is the financial ratio that evaluates the company's profitability in regard to its total assets. Thus, higher ROA generally suggests better asset utilization and management efficiency. And it's calculated by this equation:

- **$ROA = \text{Net Income} / \text{Total Assets}$**

And Return on Equity is the financial ratio that evaluates a firm's profitability in regard to its shareholders' equity. Thus, higher ROE indicates better financial performance and a higher return for shareholders. And it's calculated by this equation:

- **$ROE = \text{Net Income} / \text{Shareholders' Equity}$**

While Earnings per Share is a financial statistic that shows how much of a company's earnings is distributed to each outstanding share of common stock. Furthermore, it is calculated by dividing the company's net income by the typical number of outstanding shares:

- **$EPS = (\text{Net Income} - \text{Preferred Dividends}) / \text{Shares Outstanding}$**

Finally, Net Profit Margin is the financial ratio that determines the percentage of each revenue dollar that translates into net profit. Higher net profit margin indicates a better profitability and efficient cost management. And it's calculated by this equation:

- **$$\text{NPM} = (\text{Net Profit} / \text{Total Revenue}) * 100$$**



CHAPTER 6. FINDINGS AND DISCUSSION

6.1 Data Analysis:

The responses to the questionnaire and the values of the four profitability matrices were examined in accordance with the research's hypotheses to achieve its objectives, and the findings were as follows:

Table 2

Normal distribution of the study data:

Variables	Kolmogorov -Smirnov			Shapiro-Wilk		
	Statistic	DF	Sig.	Statistic	DF	Sig.
Return on Assets	.188	40	.09	.799	40	.007
Return on Equity	.393	40	.18	.328	40	.021
Earnings Per Share	.411	40	.075	.339	40	.013
Net Profit Margin	.125	40	.195	.890	40	.003
ICS Efficiency	.117	40	.200*	.932	40	.036

* The mean difference is significant at the 0.05 level

* ICS: Internal Control Systems

Table (2) shows that (According to Kolmogorov-Smirnov test), the significant values of domains (Earnings Per Share, Return on Assets, Net Profit Margin, Return on Equity, and ICS Efficiency) are more than (0.05) which means that the data are normally distributed.

Table 3

Statistical Description of Profitability Evidence (Earnings Per Share, Return on Assets, Net Profit Margin, Return on Equity) in addition to Internal Control Systems Efficiency:

No.	Variable	Count	Minimum	Maximum	Mean	S.D
1	Return on Assets	41	-0.02149	0.21277	0.048924	0.059994

2	Return on Equity	41	-102.921	996.8973	49.32963	162.1792
3	Earnings Per Share	41	-0.05167	9.253333	0.473415	1.495814
4	Net Profit Margin	41	-0.58167	0.501667	0.09	0.190426
5	ICS Efficiency	41	38	85	66.87805	10.0429

Table (3) shows Statistical Description of Profitability Evidence (Earnings Per Share, Return on Assets, Net Profit Margin, and Return on Equity) in addition to Internal Control Systems Efficiency. The table shows Means, Standard Deviations, Minimum and maximum values.

6.1.1 results related to study questions:

Results associated to first study question which is: Is there a relationship between Internal Control Systems efficiency and Return on Assets? To answer this question, Pearson Correlation Matrix has been used as shown below:

Table 4

Pearson Correlation Matrix to show the relation between variables:

Variables/ Return on Assets		R
ICS Efficiency	Pearson Correlation	0.26977
	Sig. (2-tailed)	0.088
	N	41

**Correlation is significant at the 0.05 level (2-tailed)*

Table (4) shows that there is a weak positive non statistically significant relation between Internal Control Systems efficiency and Return on Assets. Pearson Correlation is .26977 and the significant value is (0.088) which is more than (0.05).

Results associated to second study question which is: Is there a relationship between Internal Control Systems efficiency and Return on Equity? To answer this question, Pearson Correlation Matrix has been used as shown in following table:

Table 5

Pearson Correlation Matrix to show the relation between variables:

Variables/ Return on Equity		R
ICS Efficiency	Pearson Correlation	0.05707
	Sig. (2-tailed)	0.723028
	N	41

**Correlation is significant at the 0.05 level (2-tailed)*

Table (5) indicates that there is a very weak positive non statistically significant relation between Internal Control Systems efficiency and Return on Equity. Pearson Correlation is 0.05707 and the significant value is (0.723) which is more than (0.05).

Results related to third study question which is: Is there a relationship between Internal Control Systems efficiency and Earnings Per Share? To answer this question, Pearson Correlation Matrix has been used as shown in following table.

Table 6

Pearson Correlation Matrix to show the relation between variables:

Variables/ Earnings Per Share		R
ICS Efficiency	Pearson Correlation	0.183386
	Sig. (2-tailed)	0.251095
	N	41

**Correlation is significant at the 0.05 level (2-tailed)*

Table (6) indicates that there is a weak positive non statistically significant relation between Internal Control Systems efficiency and Earnings Per Share. Pearson Correlation is 0.183386 and the significant value is (0.251) which is more than (0.05).

Results associated to fourth study question which is: Is there a relationship between Internal Control Systems efficiency and Net Profit Margin? To answer this question, Pearson Correlation Matrix has been used as shown in following table:

Table 7

Pearson Correlation Matrix to show the relation between variables:

Variables/ Net Profit Margin		R
ICS Efficiency	Pearson Correlation	0.191099
	Sig. (2-tailed)	0.231362
	N	41

**Correlation is significant at the 0.05 level (2-tailed)*

Table (7) indicates that there is a weak positive non statistically significant relation between Internal Control Systems efficiency and Net Profit Margin. Pearson Correlation is 0.191099 and the significant value is (0.231) which is more than (0.05).

6.1.2 results related to study hypotheses:

Results related to study hypotheses which is: There Is a Substantial Effect of Internal Control Systems Efficiency on Firms' Profitability. To analyze this hypothesis, the Linear regression analysis was used and the results are shown with regard to analyzing the sub-hypothesis as follows:

Results related to the first hypothesis which is: there is a substantial effect of Internal Control Systems efficiency on firms Return on Assets. To analyze this hypothesis, Linear regression analysis was used and the results are shown in the following Table:

Table 8

Linear regression analysis determining the effect of Internal Control Systems efficiency on firms' Return on Assets:

Model	Sum of Squares	DF	Mean Square	F	Sig.	B	T	R	R Square
Regression	0.10556	1	0.10556	3.061	0.088	-0.2520	-1.2753	0.2697	0.07277
Residual	1.344923	39	0.03448			0.00511			
Total	1.450483	40							

** The mean difference is significant at the 0.05 level*

Table (8) shows that calculated (F) is (3.061), the significant value (0.088) and degrees of freedom are (1 and 39) which means that there is no statistical effect of the Internal Control Systems efficiency on firms' Return on Assets. R^2 is (0.072776) which means weak interpretation power between the dependent variable (Return on Assets) and the independent one (Internal Control Systems efficiency). Where Internal Control Systems efficiency interprets (7.21%) of the firms' Return on Assets value.

The Equation is : $Y = -0.25209 + 0.005115 X$

Results related to the second hypothesis which is: there is a substantial effect of Internal Control Systems efficiency on firms Return on Equity. To analyze this hypothesis, Linear regression analysis was used and the results are shown in the following Table: Table 9

Linear regression analysis determining the impact of internal control systems efficiency on firms Return on Equity:

Model	Sum of Squares	DF	Mean Square	F	Sig.	B	T	R	R Square
Regression	0.291495	1	0.2914	0.12743	0.72302	1.04188	0.64719	0.05707	0.0032
Residual	89.20689	39	2.2873			-0.0085			
Total	89.49839	40							

* The mean difference is significant at the 0.05 level

Table (9) indicates that calculated (F) is (0.127438), the significant value (0.723) and degrees of freedom are (1 and 39), which means there is no statistical effect of the Internal Control Systems efficiency on firms Return on Equity. R^2 is (0.003257) which means very weak interpretation power between the dependent variable (Return on Equity) and the independent one (Internal Control Systems efficiency). Where Internal Control Systems efficiency interprets (0.3%) of the firms' Return on Equity value.

The equation is : $Y = 1.041888 - 0.0085 X$

Results related to the 3rd hypothesis which is: there is a substantial effect of Internal Control Systems efficiency on firms Earnings Per Share. To analyze this hypothesis, Linear regression analysis was used and the results are shown in the following Table:

Table 10

Linear regression analysis identifying the impact of the Internal Control Systems efficiency on firms Earnings Per Share:

Model	Sum of Squares	DF	Mean Square	F	Sig.	B	T	R	R Square
Regression	35381.9	1	35381.9	1.357226	0.251	247.384	1.43942	0.18338	0.03363
Residual	1016702	39	26069.29			-2.96143			
Total	1052084	40							

* The mean difference is significant at the 0.05 level

Table (10) indicates that calculated (F) is (1.357226), the significant value (0.251) and degrees of freedom are (1 and 39), which means that there is no statistical effect of the Internal Control Systems efficiency on firms Earnings Per Share. R^2 is (0.03363) which means weak interpretation power between the dependent variable (Earnings Per Share) and the independent one (Internal Control Systems efficiency). Where Internal Control Systems efficiency interprets (3.3%) of the firms' Earnings Per Share value.

The Equation is : $Y = 247.3844 - 2.96143 X$

Results related to the fourth hypothesis which is: there is a substantial effect of Internal Control Systems efficiency on firms Net Profit Margin. To analyze this hypothesis, Linear regression analysis was used and the results are shown in the following Table:

Table 11

Linear regression analysis identifying the impact of Internal Control Systems efficiency on firms Net Profit Margin:

Model	Sum of Squares	DF	Mean Square	F	Sig.	B	T	R	R Square
Regression	35381.9	1	35381	1.357226	0.25109	247.384	1.43942	0.1833	0.03363
Residual	1016702	39	26069			-2.96143			
Total	1052084	40							

* The mean difference is significant at the 0.05 level

Table (11) indicates that calculated (F) is (1.357226), the significant value (0.251) and degrees of freedom are (1 and 39) which means that there is no statistical effect of Internal Control Systems efficiency on firms Net Profit Margin. R^2 is (0.03363) which means weak interpretation power between the dependent variable (Net Profit Margin) and the independent one (Internal Control Systems efficiency). Where Internal Control Systems efficiency interprets (3.3%) of the firms' Net Profit Margin value.

The Equation is : $Y = 247.3844 - 2.96143 X$

6.2 Discussion:

The primary goal of this study was to investigate the impact of Internal Control Systems efficiency on the Profitability of firms listed on the Palestine Stock Exchange (PSE). To achieve this objective, a comprehensive analysis was conducted, considering various financial indicators and internal control practices within the selected companies. The outcomes of this study reveal a positive non-significant association between the efficiency of internal control systems and firm's profitability in the context of the PSE. Firms that had robust internal control mechanisms in place didn't have a significantly higher level of profitability compared to those with weak internal control systems. This result is consistent with some previous research conducted in different countries and provides valuable insights into the Palestinian context.

However, it is evident that these findings diverge from similar studies conducted by Mushtaha (2015) and Ayyash (2017). Several factors should be considered to account for the observed variations, including *Methodological Differences* such as variances in study design, sample size, data collection methods, and analytical techniques. For example, Ayyash (2017) utilized a questionnaire to gather data on both firm profitability and internal control systems, whereas this study collected profitability data

from the financial records of the targeted firms. Additionally, Ayyash's study focused solely on the banking sector in Palestine, whereas this study encompasses all listed firms. Furthermore, the methodologies employed in reaching the results differed, as Ayyash used a descriptive-analytical method and examined individual internal control system components as independent variables on firms' profitability at a specific time point, rather than over a time period as this study did.

In Mushtaha' s (2015) study, only three profitability metrics were used, including return on sales, which was not utilized in the current study. Moreover, the financial sector was excluded from the study population, distinguishing it from the population considered in this study. Additionally, Mushtaha' s study relied on financial data from a single year (2013), while this study incorporated financial data from recent years (2017-2022), which may have influenced the results. Another factor contributing to these variations is *Sample Variability*, encompassing differences in the composition and characteristics of the study participants or sample population. Variances in demographics, geographic location, cultural factors, and other relevant variables could potentially explain the observed discrepancies. For instance, both mentioned studies were conducted in the Gaza Strip, which has been geographically and culturally separated from the West Bank, where this study was conducted. Additionally, the questionnaire used in Ayyash's study was distributed solely to banking sector employees, unlike this study's sample which focused only on financial and general managers from all listed firms.

Temporal and Contextual factors are also influential, whereby the timing and context of a study can affect its outcomes. Changes in the social, economic, or technological landscape since the previous studies were conducted can influence their results. Considering our case, the previous studies were conducted approximately 10 years ago, implying significant changes in social and economic aspects, particularly in the rapidly evolving modern world that we are living in, which could impact the results. *Data Collection or Measurement Issues* should be taken into account as well, as discrepancies can arise from variations in data collection instruments, measurement scales, or data quality. Differences in the tools or methods used to collect and analyze data compared to other studies can lead to disparities in the results. In the case of Mushtaha' s (2015) study, the questionnaire was created based on previous literature rather than the COSO structure or framework. The profitability metrics differed from those employed in this

study, with return on sales being used as a profitability measure, while this study incorporated measures such as earnings per share and net profit margin. Similarly, Ayyash's questionnaire was also based on previous literature, and the sample consisted solely of banking sector employees, which differs from the sample used in this study. *Statistical Variability* should be considered as a factor that could influence the results, as random variation or statistical errors can occur in any study. Even with similar methodologies, different results can arise due to inherent variability in the data. For instance, Al-Thuneibat and Keffous' (2012) study found no statistically significant relationship between the commitment to provide elements of internal control of Jordanian industrial companies and financial performance, measured by return on sales. Conversely, Mushtaha' s (2015) study indicated a statistically significant relationship between companies' commitment to providing elements of internal control and financial efficiency and performance, as determined by return on sales.

Furthermore, the factor of *Publication Bias* should be acknowledged, as the possibility of bias exists in every field. Studies with positive or significant results are less unlikely to be published than those with nonsignificant results. The existence of unpublished or inaccessible studies may contribute to differences between research studies. Therefore, it was easier to find studies with positive and significant results, such as Mushtaha (2015) and Ayyash (2017), while only a few studies yielded different results, similar to the study conducted by Ge, Li, Liu, and McVay (2014), which investigated the effect of internal control over financial reporting on the prevalence of corporate corruption in China. And found a positive but not significant association between internal control components and firms' profitability, reflected by return on equity and return on assets, as this study did.

In conclusion, it is important to note that the effect of internal control systems on profitability can vary based on various factors, as mentioned previously, including industry, company size, and specific control measures implemented. While internal control systems are primarily designed to safeguard assets, ensure financial accuracy, and promote operational efficiency within an organization, their indirect contribution to profitability lies in mitigating risks, preventing fraud or errors, and enhancing overall operational effectiveness. By reducing the occurrence of financial misstatements, internal control systems provide more reliable financial information, which can

positively influence investment decisions and stakeholder confidence. Furthermore, the analysis conducted in this study demonstrated that certain components of a firm's profitability factors, such as Return on Assets, were influenced to a greater extent by the efficiency of internal control systems compared to other factors.

However, companies that effectively utilized internal control systems components didn't have any major improvements in their financial performance, regardless of the value of a comprehensive internal control framework. Despite not finding an important association between internal control system efficiency and firms' profitability, several important insights can be derived from the research. Firstly, while internal control systems may not directly impact profitability, they remain crucial for ensuring effective corporate governance, risk management, and compliance. Companies should continue to prioritize the adoption and maintenance of robust internal control systems to safeguard assets, promote ethical conduct, and ensure accurate financial reporting.

Secondly, the lack of a strong connection between internal control system efficiency and firms' profitability highlights the need to consider additional factors that influence financial success. Market conditions, industry-specific dynamics, competitive pressures, and management practices all contribute to a firm's profitability. Organizations should adopt a holistic approach that integrates internal control systems with comprehensive strategic management practices to enhance overall performance. Additionally, the findings suggest that the effectiveness of internal control systems alone may not be sufficient to drive profitability. It is essential to explore other organizational factors such as operational efficiency, innovation, marketing strategies, and customer satisfaction to achieve sustainable financial success.

Thus, the implications of these findings are significant for both practitioners and regulators in Palestine. Strengthening internal control systems can contribute to enhancing the financial stability of companies, which in turn can attract investors and improve market confidence. Regulators and decision-makers should point out the importance of implementing and monitoring robust internal control practices to guarantee the long-term sustainability and growth of listed companies. Plus, it is important to acknowledge the limitations of this study, which are addressed in the next section, as they provide avenues for further research and improvement in understanding the association between internal control systems and profitability.

CHAPTER 7. CONCLUSIONS, LIMITATIONS AND RECOMMENDATIONS

7.1 Conclusion:

The main finding of this research indicates that there is no strong connection between the efficiency of internal control systems and firms' profitability among the listed companies on the Stock Exchange of Palestine. Through rigorous analysis and assessment of the data, it was noted that the effectiveness of internal control systems alone does not guarantee higher profitability for the organizations under study. While internal control systems play a vital role in promoting good governance, mitigating risks, and ensuring compliance, their impact on financial success appears to be influenced by additional factors beyond the internal control framework. Other variables such as market dynamics, industry-specific factors, management practices, and external economic conditions may exert a more substantial influence on firms' profitability. However, it is crucial to understand that the absence of a strong connection between internal control system efficiency and profitability does not diminish the importance of implementing robust internal control practices. These procedures remain essential for ensuring operational efficiency, safeguarding assets, and maintaining accurate financial reporting.

In summary, this study investigated the association between internal control system efficiency and firms' profitability among firms listed on the Palestine Stock Exchange. The findings demonstrated that there was no significant association between these variables. However, this does not diminish the influence of internal control procedures and systems in guaranteeing effective governance, risk management, and compliance. The results of this research add to the collection of information about systems of internal control and profitability, particularly in the Palestinian context. By highlighting the connection between systems of internal control and firms' profitability. Plus, the research highlights the need to consider a broader range of factors that influence profitability, including market dynamics, industry-specific variables, and management practices. Organizations should adopt a comprehensive approach that integrates internal control systems with strategic management practices to enhance overall performance.

Also, this study offers valuable insights for practitioners, regulators, and policymakers in Palestine, emphasizing the need to prioritize and enhance internal control practices within listed companies. While this study has shed light on the topic, it is essential to recognize its limitations. Future research could consider expanding the sample size, incorporating a broader range of companies, consider longitudinal analysis, and exploring additional factors that may influence profitability. Furthermore, qualitative research methods could provide deeper insights into the mechanisms through which internal control systems impact profitability. Overall, this study emphasizes the part that internal control systems play in driving profitability and lays the foundation for further research and practical implications in the field of corporate governance and financial performance in Palestine.

7.2 Limitations:

This study is affected to certain constraints that should be regarded when interpreting the findings. Thus, it is important to acknowledge the constraints of this study. Firstly, the research was constrained to companies listed on the PSE, and the results may not be directly meaningful to companies in other economies or different countries. Which may also restrict the results' capacity to be generalized to other contexts or industries. Hence, future studies should include a broader sample to raise the external reliability of the results. Secondly, the study relied on quantitative data analysis, which may overlook qualitative aspects of internal control system implementation. Including qualitative research methods, such as interviews or case studies, could provide a more comprehensive understanding of the challenges and nuances surrounding systems of internal control and their effects on profitability.

Thirdly, the study relied on financial indicators as measures of profitability, and other non-financial aspects that could impact profitability were not fully explored. Moreover, the research focused solely on the impact of internal control systems efficiency on profitability and did not consider other variables that could impact the firm's financial profitability or performance, such as external market conditions or industry-specific dynamics. Additionally, the research was conducted within a specific time frame, and the dynamic nature of business environments may influence the association between profitability and systems of internal control. Longitudinal studies or comparative analyses over different time periods could capture the evolving nature of this

relationship and provide deeper insights. Lastly, the research leaned on publicly available financial information, which may have limitations in terms of precision and comprehensiveness. Future research could consider incorporating more extensive and detailed financial information, possibly through collaboration with the participating companies.

7.3 Recommendations:

Considering the results and the discussions, the recommendations listed below are suggested:

- Organizations should continue to prioritize the adoption and maintenance of robust internal control systems to ensure effective governance, risk management, and compliance.
- Companies should adopt a holistic approach that integrates internal control systems with comprehensive strategic management practices to enhance overall performance and financial success.
- Future research should explore qualitative aspects, such as interviews or case studies, in order to grasp a greater comprehension of the contextual variables and organizational dynamics that mediate the association between systems of internal control and profitability.
- Organizations should regularly evaluate and update their internal control systems to ensure their alignment with evolving business environments and emerging risks. This includes periodic risk assessments, internal audits, and continuous monitoring of control effectiveness.
- Regulatory authorities and professional bodies should provide guidance and support to companies in implementing effective internal control systems. This can include establishing standards, providing training programs, and facilitating knowledge sharing among organizations specially in a closed market like the Palestinian market.
- Companies should foster a culture of accountability, transparency, and ethical behavior to make internal control systems more effective. This includes promoting employee awareness, providing regular training, and establishing clear channels for reporting potential control weaknesses or irregularities.

- Managers and executives should actively demonstrate their commitment to internal control systems and lead by example. Their support and involvement in the implementation and monitoring of controls create a positive tone at the top and encourage employees to prioritize control practices.
- Collaborative efforts among industry stakeholders, such as peer networks, industry associations, and professional forums, can facilitate the sharing of best practices and experiences related to systems of internal control. This can lead to constant improvement and the adoption of effective control measures.
- Policymakers and regulators should consider the findings of this study and the broader investigations on internal control systems to inform regulatory frameworks and guidelines. These should strike a balance between providing flexibility for organizations while ensuring adequate controls to protect stakeholders' interests.

By following these recommendations, organizations can enhance the efficiency and quality of their internal control systems, even in the absence of a direct relationship with profitability. This will contribute to strengthening corporate governance, risk management, and compliance practices, ultimately fostering long-term sustainability and success for the Palestinian market in general.

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APPENDICES

Appendix A: Study Questionnaire:-



YEDİTEPE UNIVERSITY

SOCIAL SCIENCES INSTITUTE

BUSINESS AND ADMINISTRATION DEPARTMENT

ACCOUNTING AND FINANCE MASTER PROGRAM

The Impact of Internal Control Systems on profitability:

Evidence From BIST Manufacturing Companies

This questionnaire paper is a part of the research described in the title above. where it aims to evaluate the Turkish companies' commitment to the internal control system compeence. consequently, evaluating the internal control systems efficiency in Turkish companies and analyzing the impact of the internal control systems on their profitability. Thus, the data for this survey will be anonymous and will be used for academic purposes only.

- it's worth noting that, Internal control system is defined as the mechanisms, rules, and procedures implemented by a company to ensure the integrity of financial and accounting information, promote accountability, and prevent fraud. Moreover, Internal control system frameworks have been published by a number of official regulatory entities, including the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The COSO's Framework consists of five components: **control environment, risks assessment, control activities, information & communication, and monitoring Activities.** plus 17 relevant principles, to provide guidance for companies in the design, implementation, and operation of their internal control systems. also, this framework allows businesses to create internal control systems to capture unexpected risks from both their internal and external business contexts.

Internal control system compenence

A. Control Environment:

1. The company shows a dedication to ethical values and integrity. (___)

A) Strongly Disagree B) Disagree C) Natural D) Agree E) Strongly Agree

2. The board of directors maintains its independence from management and oversees the continuation and implementation of internal control systems.(___)

A) Strongly Disagree B) Disagree C) Natural D) Agree E) Strongly Agree

3. Management develops frameworks, received information, and appropriate authorities and duties in the pursuit of goals, along with board of director's oversight. (___)

1. Strongly Disagree B) Disagree C) Natural D) Agree E) Strongly Agree

4. The company shows a commitment to attracting, developing, and retaining skilled employees who are compatible with the firm's goals. (___)

A) Strongly Disagree B) Disagree C) Natural D) Agree E) Strongly

5. The company holds individuals accountable for their internal control responsibilities in the pursuit of its objectives. (___)

A) Strongly Disagree B) Disagree C) Natural D) Agree E) Strongly Agree

B. Risk Assessment

6. The company develops objectives in a way that allows for the identification and evaluation of risks associated with these objectives. (___)

A) Strongly Disagree B) Disagree C) Natural D) Agree E) Strongly Agree

7. The company recognizes risks to the accomplishment of its objectives and analyzes these risks as a basis for determining how the risks should be managed. (___)

A) Strongly Disagree B) Disagree C) Natural D) Agree E) Strongly Agree

8. The company take into consideration the potentials for fraud in assessing risks to the achievement of its objectives. (___)

A) Strongly Disagree B) Disagree C) Natural D) Agree E) Strongly Agree

9. The company identifies and assesses changes that could impact the system of internal control. (___)

A) Strongly Disagree B) Disagree C) Natural D) Agree E) Strongly Agree

C. Control Activities

10. The company selects and develops control activities that contribute to the prevention of risks to the achievement of its objectives. (___)

A) Strongly Disagree B) Disagree C) Natural D) Agree E) Strongly Agree

11. The company selects and develops general control activities based on technology to support the achievement of its objectives. (___)

A) Strongly Disagree B) Disagree C) Natural D) Agree E) Strongly Agree

12. The company deploys control activities through policies that aimed to establish what is expected and it deploys procedures that put policies into action. (___)

A) Strongly Disagree B) Disagree C) Natural D) Agree E) Strongly Agree

D. Information and Communication

13. The company obtains or generates and uses relevant, quality information to support the functioning of internal control. (___)

A) Strongly Disagree B) Disagree C) Natural D) Agree E) Strongly Agree

14. The company internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control. (___)

A) Strongly Disagree B) Disagree C) Natural D) Agree E) Strongly Agree

15. The company communicates with external parties regarding matters affecting the functioning of internal control. (___)

A) Strongly Disagree B) Disagree C) Natural D) Agree E) Strongly Agree

E. Monitoring Activities

16. The company selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning. (___)

A) Strongly Disagree B) Disagree C) Natural D) Agree E) Strongly Agree

17. The company evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective actions, including senior management and the board of directors, as appropriate. (___)

A) Strongly Disagree B) Disagree C) Natural D) Agree E) Strongly Agree

Thank you for answering the questions

With all due respect and appreciation