

-RESEARCH ARTICLE-

THE ROLE OF EXTERNAL AND INTERNAL AUDITING IN PRACTICING AUDIT AND OVERSIGHT ON THE EFFECTIVENESS OF FINANCIAL PERFORMANCE IN BANKS

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—Abstract—

This research examines the influence of both internal and external audit functions on the financial performance of Iraqi commercial banks. A quantitative approach was employed, drawing on secondary data from two major institutions, namely Region Trade Bank Commercial Bank of Investment and Finance and the International Development Bank of Investment and Finance, covering the period 2022 to 2024. The analysis of financial performance focused on four dimensions: liquidity, profitability, debt management, and operational efficiency, while regulatory adherence was assessed through the CAMEL framework. Findings reveal a strong association between auditing practices and the performance of the banks. Region Trade Bank Commercial Bank demonstrated favourable outcomes, with a strengthened current ratio and marked improvements in profitability, as evidenced by an increase in the gross profit ratio from 26% to 68% during the study period. Despite these gains, the cash liquidity assessment highlighted instability, including negative ratios in 2023, reflecting challenges in managing cash flow. In contrast, the International Development Bank exhibited consistent growth, with total assets rising from 1.8 trillion to 3.0 trillion Iraqi dinars, while maintaining stable current ratios ranging from 109 to 114. Both banks were found to comply with capital adequacy and liquidity coverage requirements, although their net stable funding ratios produced mixed results. Overall, the study suggests that effective

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auditing enhances banking performance by strengthening risk management, ensuring regulatory compliance and promoting operational transparency. However, to maximise benefits without imposing excessive bureaucratic constraints, the design and implementation of audit intensity must be strategically managed.

Keywords: External Auditing, Internal Auditing, Banking Financial Performance, Iraqi Banking Sector, Agency Theory, Financial Ratio Analysis, Regulatory Compliance

INTRODUCTION

In the modern banking environment, financial institutions operate within increasingly complex regulatory frameworks, where financial performance has become a central determinant of long-term sustainability and the creation of value for stakeholders. Banks, functioning as intermediaries within the financial system, are responsible for allocating funds between savers and borrowers while simultaneously managing inherent risks related to credit, liquidity, and operations. Consequently, the measurement and enhancement of financial performance are essential for ensuring that banks maintain competitiveness and meet regulatory obligations in rapidly changing market conditions (Abraham et al., 2024; Hazaea et al., 2021).

Both internal and external auditing have assumed a pivotal role in strengthening governance within the banking sector, shaping institutional performance through improved oversight, effective risk management, and heightened operational transparency (Alzeban, 2020; Nyikuli, 2022). The relationship between audit quality and bank performance is an issue to which academics and regulators have been paying increasing attention, as investors, regulators and executives aim to maximise the institutional value and preserve a prudential discipline (Asmara, 2017; Salman et al., 2020). There is evidence in practice to this, showing that banks with effectively organized systems of internal audit are more profitable, more highly efficient in their operations, and have a more stable history of observance to supervisory requirements. Such institutions are proving to be more effective in detecting and removing fraud, resource optimization, and implementation of strategic projects with a potential of sustainable growth. Moreover, the joint presence of knowledge as a result of internal and external audits creates synergistic benefits, which bring more performance improvement than either audit role when utilized independently (Apalowowa et al., 2023; Ezejiofor & Okolocha, 2020).

Theoretical Framework

Such dependence between internal and external auditing and the financial performance of banking institutions can be further explained using three relevant theoretical lenses, such as the Agency Theory, the Stakeholder Theory, and the Resource-Based View. The theoretical constructs provide powerful conceptual models with which to

deconstruct the complex mechanisms through which the auditing activities affect organizational performance and create value to various stakeholders.

Agency Theory Perspective

The agency theory provides the necessary understanding of the role of auditing in the reduction of information asymmetry and the alignment of the interests of diverse stakeholders of banking institutions. According to the theory, the principal-agent relationships can be affected by conflicts of interests between the principals and the agents because ownership and control are separated, and thus, monitoring mechanisms are required to achieve the best level of performance (Diamond, 1984; Levine & Forum, 2004). Agency issues in banking are a result of the interdependence between financial intermediation and the multi-faceted stakeholder relationships that the banking business model is built on. Agency conflicts between depositors and banks are usually created by information asymmetry. By putting their personal interests above the shareholders and the depositors, managers thus create moral-hazard risks (John et al., 2000). Due to the high technicality in the banking industry, and the technical nature of financial products, principals cannot effectively control agents without well-established monitoring systems.

The internal and external audit mechanisms are important monitoring tools that reduce the agency cost since they provide independent assurance in relation to the managerial decision-making processes and resultant performance outcomes. Such auditing practices make the process of transparency easier, which in turn allows the principals to evaluate the actions of the agents and ensure that they are socially aligned to institutional goals. The audits, therefore, provide stakeholders with strong information, thus, empowering them to make informed decisions by eliminating information asymmetry (Stiglitz & Weiss, 1981; Thakor, 2018). The Agency Theory though also analyzes the possible drawbacks of audit structures which might have negative impact on the performance of banks. Unwarranted auditing requirements such as those will contribute to bureaucratic inefficiencies hence will slow down the process of decision making and increase the cost of operating. Furthermore, to achieve the desirable audit results, managerial players can use earnings manipulation or superficial reporting processes, which eventually damage long term sustainability. The fact that the auditors may be compromised by the managers further reduces the effectiveness of the monitoring functions as managers may be able to engage in non-optimal strategies unnoticed. When establishing the key issues of the principal-agent relationships, which suffuse the relations between banks and their borrowers, it becomes urgent to understand the central position of banks as the principals, and their guests as the agents. When the credit is extended, these agents often indulge in risky activities which create moral hazards and, therefore, increase the number of defaults- a phenomenon that, at the macro level, has negative impacts on the financial performance of the lending institutions. The

application of stringent audit procedures can be used to mitigate such misfortunes; through the increase of credit evaluation and better monitoring capabilities, such practices strengthen the quality of the portfolios and support a more sustainable performance.

Stakeholder Theory Framework

Stakeholder Theory extends the analytical scope of banking performance beyond the traditional shareholder–management relationship to encompass all groups connected to banking activities, including customers, employees, regulators, communities, and society at large (Freeman, 2010). This perspective highlights that banks operate within complex stakeholder networks, where maximising performance requires balancing the diverse expectations of different groups rather than concentrating solely on shareholder value. From this standpoint, sustainable financial performance is grounded in cultivating constructive relationships with all stakeholders. Sound auditing practices enable banks to demonstrate accountability in their operations and responsiveness to stakeholder welfare (Mahir, 2025).

Systematic auditing processes allow the stakeholder to have a strong understanding on the soundness of the financial reporting, adequacy of risk management systems and compliance with legislative requirements. Such openness increases the confidence of the stakeholders, thus facilitating more logical decision-making with regards to dealing with the banking institutions, and at the same time creating satisfaction and loyalty. The delivery of high-quality audits, in its turn, is strongly linked to increased trusting paradigms, a better reputation, and more competitive status in the market (Alwardat et al., 2015; Lapsley & Pong, 2000). Stakeholder-focused audit approach increases the breadth of performance results by incorporating both social and environmental aspects in addition to the traditional financial outcomes. This holistic formulation provides the banking institutions with the ability to identify prospective sustainable value creation opportunities that simultaneously benefit several constituencies of stakeholders. The Imbibition of stakeholder involvement in audit procedures will help in identifying the performance gap and untapped potential of improvement that is veiled by the traditional financial analysis.

The Stakeholder Theory, however, recognizes the existence of challenges which may hinder the running of banking institutions. The necessity to reconcile the incompatible interests of various stakeholders can make the decision-making process more complex, slow down the introduction of strategic initiatives, and lower the efficiency of operations. In some cases, it can be required to meet the demands of a group of stakeholders at the expense of another. Besides, a stakeholder-based audit approach is often linked to significant cost and time expenditure that are likely to have a detrimental impact on short-term financial performance in turn (Al-Sabaawe et al ., 2024). The theory warns against paying too much attention to the stakeholder satisfaction, the

theory assumes that this will be a destructive diversion of managerial attention off the profit-oriented activities that are necessary in sustaining the competitiveness and financial sustainability. The main quandary, however, lies in determining an ideal balance between stakeholder involvement and financial results, thus protecting the long term sustainability without jeopardizing the short term performance goals.

Resource-Based View Theory

Within the context of resource-based view (RBV) provides a useful perspective within which audit functions may be viewed as strategic organisational resources that determine the financial performance and competitive advantage. Under the umbrella of RBV, long-term high performance is conditioned by the ability of an organisation to develop and mobilize resources and capabilities that meet high-quality requirements of being valuable, rare, inimitability, and non-substitutability (Barney, 1991; Bryson, 2010). In the banking sector, internal auditor skills, and existing relations with external auditors could be considered as strategic assets, which can distinguish institutions and increase their performance results. Internal audit departments are unique organisational competencies that help to advance operational efficiency, reduce risk, and the quality of strategic decision-making. Financial institutions with strong internal audit functions gain competitive advantages by having their discovery of risks that are better, their process optimisation is better and their compliance to the regulatory requirements. These competencies are particularly desirable in the rigorously controlled settings that require high levels of audit proficiency in executing a sustainable competitive positioning (Al-Sabaawe et al ., 2024 ; Ilias et al., 2023).

However, the RBV view throws some light over several substantive drawbacks to the growth of auditing resources. Increased investment in audit capacity can undermine the organizations capacity to attract fiscal investment that can be utilized in other core profit-making activities, and hence reduce the overall returns and weaken the competitive position in the market. Moreover, building up the most specialized audit skills can pose the threat of creating organizational inflexibility, thus restricting flexibility and creativity, and eventually reduce long-term performance sustainability. The excessive focus on audit outputs biases the institutions to over analysis and thus slows down the decision making process and responsiveness to arising opportunities. Next, the inherently bureaucratic character of the large-scale auditing procedures quickly suppresses creative and entrepreneurial behaviour and, consequently, the ability of banks to capitalize on short-term market opportunities and, thus, the competitive edge.

Problem Statement

The connection of the internal and external audit functions with the banking performance is a theoretically and empirically complex field that requires systematic

research. Although the current literature shows overall positive correlation between the effectiveness of audits and the financial performance, the results are not homogeneous and the heterogeneity is coupled with methodological limitations that obscure the nature of these relations and their magnitude. In modern banking settings, where digital transformation has reorganised the operating environments, regulatory pressures increase, and the business landscape is characterised by a high degree of volatility, an increased demand towards more advanced understanding of how auditing operations impact on performance under various conditions becomes a significant pressure.

An overall review of the literature of the present day reveals a number of gaps. On the one hand, there is a lack of systematic empiricism that could investigate the subtle effect on individual aspects of banking performance of internal and external audit mechanisms. Second, the available literature provides limited information on the exact situations in which the audit procedures improve or worsen the performance. Third, the literature has paid little scrutiny to the potentially harmful effects of an over-prescriptive audit regime, and especially how this has affected operational effectiveness and competitiveness. In terms of the dynamism of the regulatory environments and the continuously changing market conditions, the current structural complexity of the banking institutions displays a level of heterogeneity that, to this day, has not been adequately addressed in the available scholarly literature. Moreover, the attempt to synthesize various theoretical approaches with the aim of explaining the nexus of audit and performance has been conspicuously undeveloped and thus limits the activity of practitioners and policymakers as there is a dearth of unified, practical evidence. Given the changing role of auditing in the greater field of strategic management, and given the radical changes currently being experienced in the banking industry, there is an urgent need to fill such substantive gaps with modern research. This intellectual enquiry will result in high quality evidence based scholarship that will not only add to the effectiveness of the practices of auditing but improve the performance of banks.

LITERATURE REVIEW

In recent times, empirical research has seen a growing interest in the intersection between internal and external audit practices, and performance of banking institutions, highlighting the rich interaction between audit practices and a range of performance measures. Modern studies hold that the effect of auditing on the performance of banks is multidimensional: some of the effects, such as liquidity management, might seem to be surface-level, though others, such as risk management and risk control, are more complex practices. This literature review is a syntagma of the recent empirical studies to provide a holistic portrait of the impact of audit practices on the performance of banks in different areas of operation and institutional backgrounds.

Empirical Data on Internal Audit and Financial Performance

The recent literature has provided sufficient evidence about the role of positive internal audit functions in the financial performance of banks. One of the studies revealed that the perceived independence of the auditor had a strong influence on financial outcomes, the coefficient of which was 0.443 ($p < 0.001$), and the quality of audit reporting also had a strong impact, the coefficient of which was 0.501 ($p < 0.002$). Another critical factor was found to be audit planning with a beta of 0.399 ($p < 0.000$) hence explains its significance to the financial performance (Qadri, 2025). Such results are in line with theoretical hypotheses that internal auditing is a strategic organisational asset but not a compliance tool. However, due to the differences in the contextualisation of the evidence in different institutional frameworks and methods of measurement, it differs. As an example, empirical studies carried out on Nigerian commercial banks have presented both positive and negative results, especially with regard to the effect on profitability and operational effectiveness (Hazaea et al., 2021). According to our results, internal auditing increases risk-management capacity, but the direct effects on financial performance seem to depend on the factors of institutional size, regulatory environment, and the level of managerial support.

Quality of External Audit and Banking Performance

The correlation between the external audit quality and the banking performance has become a significantly complex phenomenon in the modern empirical literature. Comparative analyses which involve the conventional and the Islamic banking institutions indicate that the effect of external audit quality varies depending on the particular banking model used and the overall geographical environment in which the institutions under consideration operate (Haddad, 2022). The results of evidence in various jurisdictions show that the size of an audit firm, the competence of the auditor in the financial services sector, and the promptness of the audit reports produce different impacts on the earnings management and financial performance results. Particularly, one study proves that, despite the fact that the size of the audit firms does not reveal any significant relationship with earnings management in both the Iraqi and the Omani banks, experience in the auditor industry and timely reporting have negative relationship with earnings-management practice, which implies the enhancement of reporting quality and transparency (Nawaiseh, 2016). Current evidence is that the effect of the quality of external audit on banking performance is most likely to be mediated by the alleviation of information asymmetry and the incentive to increase transparency, but not by the direct influence on the underlying operational processes.

A decade long examination of Pakistani banks between 2010 and 2020 provided additional information shedding light on the moderating effect of ownership structure on the nexus relationship between the quality audit and the corporate performance. The

study highlighted that the quality of audit, especially independence and substantive expert represented by audit committees, has the effect of enhancing not only the stability of the banking but also the performance measurements. In that regard, a foreign ownership proved to be a pertinent positive moderator, and the coefficient of audit committee expertise was statistically significant 0.115 ($p < 0.01$), thus showing a statistically significant positive change. However, other negative factors are also significant in the empirical literature. The required auditing processes may develop bureaucratic bottlenecks which on the contrary destroy the performance they are supposed to obtain. The empirical data also indicate that in case of exhaustive audits especially in banks with complicated organizational structures or exposed to strict regulatory measures, operational costs increase and critical decision-making is delayed (Bratten et al., 2019).

Liquidity and Audit Supervision

Empirical studies that have been conducted recently have provided insights into the complex relationship that exists between liquidity management, audit supervision, and banking performance results. According to the data obtained by Saudi Arabian banks in 2020-2024, the effectiveness of liquidity risk management, under the rigid audit control, has a significant impact on the profitability indicators (Hacini et al., 2021). Empirical evidence indicates that debt-to-asset ratios and bank size have a positive and statistically significant correlation with the return on assets in the case of comprehensive audit but deposit-to-asset ratios do not. This evidence highlights the importance of advanced audit processes when it comes to improving the liquidity management and the overall financial performance. The secondary data collected among Nigerian commercial banks affirm that the aspects of liquidity risk management, in particular, the deposit/total assets and loan/deposit ratios, have dissimilar impacts on the financial performance under the conditions of insufficient audit quality (Igbekoyi et al., 2024). The empirical study suggests that banks with stronger internal audit functions are in a stronger place to make a trade-off between liquidity and profitability. By so doing, they can enjoy better returns without infringing the rules and regulations.

Capital Adequacy and Effectiveness of Audits

Empirical investigations of the nexus of capital adequacy management and audit efficacy provide relevant information towards optimization of the performance of banks. An empirical study of the banking institutions in Nigeria between the year 2010 and 2019 shows that the capital adequacy ratios are statistically significant and positively correlated with financial performance, provided that there is a strong audit control (Ikpesu & OKE, 2022). The analysis of twelve institutions, which is based on the system generalised approach of moments, and which captures approximately 95

percent of the sector, suggests that capital adequacy has a statistically significant positive influence on return on equity, at the $p < 0.01$ level.

The empirical study also indicated that the asset quality indicators i.e., the ratios of non-performing loans and loan loss provisions were positively correlated with the banking performance under the exhaustive audit scrutiny. Specifically, the non-performing loan ratio regression coefficient was estimated to be 14.6507, which is statistically significant at the one-percent level (p -value is less than 0.01). In line with this, loan loss provisions showed even bigger positive coefficient of 34.8399 indicating that it had a significant positive influence on the performance outcomes (Ikpesu & OKE, 2022). The findings confirm the potential effectiveness of rigorous audit supervision to significantly enhance the effectiveness of managerial decisions on capital allocation and risk management. Nonetheless, a contrasting result was also stated in a study on Indonesian commercial banks where capital adequacy requirements were observed to have a negative impact on the performance measures. The analysis showed that, both Common Equity Tier 1 and Capital Adequacy Ratios have statistically significant negative effects on profitability, which indicates that an increase in capital requirements limits financial performance, particularly in highly competitive market settings (Arie, 2025).

Additional evidence based on the Sri Lankan banking institutions provides a more detailed insight into the nexus between capital adequacy and financial performance at varying levels of audit quality levels. The empirical study supported the fact that although the adequacy of capitalization is typically the foundation of high performance, the strength of the connection will depend on the effectiveness of audit committees and the quality of external audit systems. The ability of banks with well constituted audit governance structures to optimise capital deployment without overstepping the regulatory compliance environment is significantly improved (Madhurangi & Abeygunasekera, 2021). Recent research focusing on Basel III liquidity standards further emphasised the intricate relationship between regulatory compliance, audit supervision, and banking performance. Findings indicated that Liquidity Coverage Ratios significantly improved asset efficiency due to sufficient levels of liquid assets. However, their impact on return on equity was negligible, suggesting that enhanced liquidity does not necessarily translate into higher shareholder returns (Al-Olaimat et al., 2024).

Research Areas and Analysis

Despite the abundance of empirical research on audit–performance relationships in the banking sector, several notable gaps remain in the literature. First, very few studies distinguish between the specific effects of external and internal audits on distinct dimensions of bank performance. Much of the existing work treats audit mechanisms

as complementary and homogeneous functions rather than as separate systems with unique optimisation roles (Awan et al., 2025). Second, limited attention has been given to the conditions under which audit practices may either enhance or impair performance. While most findings highlight positive outcomes, the existence of negative consequences indicates that insufficient effort has been devoted to determining the optimal intensity of auditing and the strategies for its effective implementation (Didenko & Dordevic, 2017).

Third, the dynamic nature of audit–performance interactions has not been thoroughly examined. Most studies rely on static analytical models that fail to capture how audit effectiveness evolves across business cycles, regulatory regimes, or periods of crisis and technological disruption. The absence of longitudinal studies restricts understanding of how these relationships transform over time. Fourth, methodological inconsistencies across the literature hinder the generalisation of results. Differences in how audit quality, performance indicators, and analytical approaches are defined and measured complicate the integration of findings and the development of comprehensive theoretical frameworks.

Finally, there has been little investigation into the interaction between internal and external audit functions, despite theoretical arguments suggesting that their synergistic effects could produce greater performance outcomes than either function operating in isolation. Current research has not yet employed advanced analytical methods capable of capturing such complex interdependencies (Ilias et al., 2023). Overall, the synthesised evidence indicates that audit functions generally contribute positively to banking performance, but the relationships remain context-dependent, shaped by methodological, institutional, and regulatory factors. Addressing these conceptual and methodological shortcomings in future research would generate stronger insights for both practitioners and policymakers.

METHODOLOGY

Research Design and Sample Selection

This study adopts a descriptive-analytical design to investigate the contribution of external and internal auditing to improving financial performance in Iraqi banks. A case study methodology is applied, concentrating on two major banks in Iraq, in order to provide a detailed assessment of auditing practices and their influence on financial performance indicators.

Sample Banks

The research sample consists of two leading Iraqi banks, chosen on the basis of their market relevance and the accessibility of reliable data.

Region Trade Bank Commercial Bank for Investment and Finance

Region Trade Bank Commercial Bank was established in 2001 in the Kurdistan Region of Iraq as a limited liability company. In 2006, it was restructured into a private joint-stock company, marking a significant institutional transformation. The bank secured its full banking licence from the Central Bank of Iraq in 2007, reflecting both regulatory compliance and operational maturity (Commission, 2022-2024). A major capital expansion in 2013 increased its capital base to 250 billion Iraqi dinars, strengthening its position as a key institution within the Iraqi banking sector. Headquartered in Erbil, the bank operates through a network of five branches located in Erbil, Baghdad, Duhok, Sulaymaniyah, and Kirkuk, enabling it to serve diverse regional markets.

International Development Bank for Investment and Finance

The International Development Bank was established in 2011 and, in the same year, obtained its banking licence from the Central Bank of Iraq, signifying swift regulatory approval and entry into the financial market. The bank has experienced substantial growth, supported by successive capital expansions: its capital reached 250 billion Iraqi dinars in 2014, increased to 300 billion dinars in 2023, and further rose to 400 billion dinars in 2024 (Commission, 2022-2024). With a branch network spanning 29 locations across various Iraqi governorates and an international branch in Dubai launched in 2022, the bank illustrates considerable geographical diversification and market penetration.

Data Collection and Analysis Period

The study analyses financial data covering the three-year period from 2022 to 2024, thereby offering a comprehensive perspective on recent performance trends. The primary sources of data include:

1. The selected banks have published annual financial statements and reports.
2. External auditors have prepared audit reports.
3. Reports and reviews made by the internal audit department.
4. Reports to Central Bank of Iraq on regulatory compliance.
5. Yearly reports and reports prepared and filed to the Securities Commission between the fiscal years 2022 and 2024.

Financial Performance Indicators and Analytical Framework

The methodology applies a structured set of financial indicators, systematically classified into four key categories, to assess the effectiveness of banking performance.

Liquidity Indicators

Current Ratio: This liquidity indicator evaluates a bank's ability to meet short-term obligations using its current assets. It is calculated as:

$$\text{Current Ratio} = \text{Current Assets} / \text{Current Liabilities}$$

Cash Liquidity Ratio: This ratio provides a stricter measure of liquidity by focusing on cash and cash equivalents in relation to average current liabilities. It is expressed as:

$$\text{Cash Liquidity Ratio} = \text{Net Operating Cash Flow} / \text{Average Current Liabilities}$$

Net Working Capital: This absolute measure shows the financial buffer available to support daily operations. It is determined as:

$$\text{Net Working Capital} = \text{Current Assets} - \text{Current Liabilities}$$

Profitability Indicators

Gross Profit Ratio: This ratio measures operational effectiveness by critically assessing the level at which the bank is operating its cost structure, in respect of delivering the banking services. It is calculated as:

$$\text{Gross Profit Ratio} = \text{Gross Profit} / \text{Sales}$$

Net Profit to Sales Ratio: This ratio measures overall profitability by indicating the bank's capacity to generate returns from revenue. It is expressed as:

$$\text{Net Profit to Sales Ratio} = \text{Net Profit After Tax} / \text{Sales}$$

Leverage Indicators

Total Liabilities to Total Assets Ratio: This ratio evaluates the level of financial leverage and associated risk exposure. It is calculated as:

$$\text{Debt Ratio} = \text{Total Liabilities} / \text{Total Assets}$$

Activity Indicators

Net Working Capital Turnover Rate: This ratio measures how effectively a bank utilises its working capital to generate sales. It is determined as:

$$\text{Working Capital Turnover} = \text{Sales} / \text{Net Working Capital}$$

Regulatory Compliance Assessment

The methodology also includes an assessment of compliance with national and international banking regulations, encompassing the following:

1. Central Bank of Iraq regulatory requirements and instructions
2. Basel Committee standards for capital adequacy and risk management
3. International Financial Reporting Standards (IFRS) implementation
4. CAMEL rating system components

RESULTS AND DISCUSSION

Financial Performance Analysis - Region Trade Bank Commercial Bank

The analysis of Region Trade Bank Commercial Bank's financial position shows marked variability in the asset structure over the study horizon. As indicated in [Table 1](#), the bank's total assets declined from 1,128.6 billion IQD in 2022 to 953.0 billion IQD in 2024, reflecting a contraction of 15.6 percent. This reduction was accompanied by a sharper decline in total liabilities, which fell from 810.8 billion IQD to 541.6 billion IQD, highlighting deliberate deleveraging measures aligned with post-crisis restructuring trends in the banking sector ([Berger & Bouwman, 2017](#)). The concurrent decrease in current assets and current liabilities points to targeted balance sheet adjustments designed to reinforce financial resilience and enhance risk management capacity ([Diamond, 1984](#)).

Table 1: Financial Position Components of Region Trade Bank Commercial Bank (2022-2024) In Iraqi Dinars (IQD)

Year	Current Assets	Current Liabilities	Total Assets	Total Liabilities
2022	887,170,839,468	763,812,390,298	1,128,649,343,097	810,798,117,942
2023	724,317,722,061	595,328,409,054	1,001,046,854,695	641,555,006,868
2024	636,401,433,473	509,287,183,855	952,991,382,836	541,627,791,671

Source: [Commission \(2022-2024\)](#)

Profitability performance, summarised in [Table 2](#), indicates notable improvement in efficiency despite fluctuations in revenue streams. The gross profit margin rose markedly from 26.2 percent in 2022 to 68.4 percent in 2024, reflecting strengthened cost control mechanisms and effective pricing policies consistent with modern efficiency paradigms in banking operations. On the other hand, the operating cash outflows that were announced by the institution in 2023 totaled 172.9 billion Iraqi dinars, thereby increasing concerns regarding its liquidity generation. These unfavorable cash flows could be explained by increased loan loss provisions or increased investment activities ([Cornett et al., 2011](#)). The following transition to positive operating cash flow in 2024 implies gradual stabilisation, but the rather small

amount of 2.8 bn IQD means that attention should be paid to monitoring in the long term in order to secure the liquidity soundness.

Table 2: Profitability Components of Region Trade Bank Commercial Bank (2022-2024) In Iraqi Dinars (IQD)

Year	Sales	Gross Profit	Net Profit After Tax	Net Operating Cash Flow
2022	58,686,359,068	15,394,704,557	10,521,757,857	277,079,382,018
2023	96,434,821,011	48,572,766,115	40,640,622,670	-172,861,996,963
2024	89,019,865,218	60,871,743,337	51,871,743,337	2,840,047,091

Source: Commission (2022-2024)

The liquidity analysis shown in Table 3 reveals that during the review period, Region Trade Bank Commercial Bank has managed to have current ratios that continuously exceed the critical threshold of 100 percent with a variable scale of 116 percent to 125 percent. These values represent a high short-term solvency and a high ability to meet the short-term financial obligations, hence surpassing the minimum liquidity requirements as provided by Basel III regulatory framework (Supervision, 2011). The constant availability of positive net working capital, with an average of 126.5 billion IQD, can be a useful indicator of the liquidity reserve of the institution, which strengthens its operational stability and increases its financial flexibility capabilities (Ross et al., 2019). However, the cash liquidity ratio has shown a tremendous fluctuation with a specific sharp decrease of 16 percent in 2023. This fall creates significant concerns about the sufficiency of cash flow, a problem which can be explained by either excessive credit growth, or resource investment in comparatively illiquid investment instruments (Kashyap et al., 2002). Although the ratio has increased to 0.33 percent by 2024, it still remains under prudent levels, hence the urgent need to employ more effective cash-management techniques in an effort to achieve liquidity resiliency.

Table 3: Liquidity Ratios of Region Trade Bank Commercial Bank (2022-2024) In Iraqi Dinars (IQD)

Year	Current Ratio	Cash Liquidity Ratio	Net Working Capital (IQD)
2022	116%	32%	123,358,449,170
2023	122%	-16%	128,989,313,007
2024	125%	0.33%	127,114,249,618

Source: Commission (2022-2024)

Table 4 The paper provides a comprehensive review of the capital structure path and operational performance of Al -Iqlim Commercial Bank. The gross profit ratio is also noted to have increased substantially by 26 percent to 68 percent in the period under consideration thus significant improvement in operational performance that exceeds the traditional performance standards of banking institutions based in emerging economies

(Demirgüç-Kunt & Huizinga, 1999). In the same measure, net profit-sales ratio improved at 18 percent to 58 percent, which highlights the effectiveness of profitability management that has been realised by conscious cost-cutting measures and revenue maximisation. Meanwhile, the debt to assets ratio fell to 57 percent as compared to 72 percent; and represents a planned deleveraging approach with an aim of reducing financial risk and enhancing capital resilience in line with Basel III stipulations. The working-capital turnover ratio is highest from 2023 to 2024, reaching 75 percent and stabilising at 70 percent, respectively, which implies that the company utilises working capital in the most efficient way possible, and maintains a large liquidity buffer. Together, these results indicate that increased profitability and less leverage, as well as astute liquidity management, have placed the bank in a good position to grow sustainably and to meet regulatory requirements over the long term.

Table 4: Profitability and Efficiency Ratios of Region Trade Bank Commercial Bank (2022-2024)

Year	Gross Profit Ratio	Net Profit to Sales	Debt to Assets	Working Capital Turnover
2022	26%	18%	72%	48%
2023	50%	42%	64%	75%
2024	68%	58%	57%	70%

Source: Commission (2022-2024)

Financial Performance Analysis - International Development Bank

Table 5 illustrates the strong growth path of the International Development Bank, with total assets rising from 1.8 trillion IQD in 2022 to 3.0 trillion IQD in 2024, equivalent to a 64.9 percent increase. This upward trend reflects the aggressive expansion strategies often associated with relatively new banks seeking to strengthen their market position (DeYoung, 2003). The increase in current assets by 60.3 percent, alongside a 62.9 percent rise in total liabilities, indicates careful management of asset and liability growth, ensuring a balanced capital structure consistent with prudent expansion practices (Myers & Majluf, 1984). The continued growth in current assets further points to effective deposit mobilisation and an enhanced lending capacity, reinforcing the bank's trajectory of sustained financial development.

Table 5: Financial Position Components of International Development Bank (2022-2024) In Iraqi Dinars (IQD)

Year	Current Assets	Current Liabilities	Total Assets	Total Liabilities
2022	1,658,659,502	1,460,682,416	1,798,952,163	1,487,469,289
2023	2,333,564,369	2,146,061,416	2,568,694,698	2,204,431,395
2024	2,659,505,877	2,367,105,879	2,966,109,228	2,423,531,771

Source: Commission (2022-2024)

The profitability assessment presented in [Table 6](#) highlights remarkable improvements in the International Development Bank's performance. Sales revenue grew by 138.6 percent during the study period, far surpassing the average expansion typically observed in the banking sector. The gross profit margin rose significantly from 23.9 percent in 2022 to 50.2 percent in 2024, reflecting notable efficiency gains that may stem from economies of scale and more effective risk-adjusted pricing strategies ([Hughes & Mester, 2013](#)). Net profit after tax showed a fivefold increase, moving from 13.4 million IQD to 69.8 million IQD, which signals outstanding profitability growth. Furthermore, the strong positive operating cash flow of 457.7 million IQD in 2023 illustrates robust cash generation capacity. However, the subsequent reduction to 81.7 million IQD in 2024 suggests that substantial resources may have been redirected towards expansionary investments or growth in the loan portfolio ([Dietrich & Wanzenried, 2011](#)).

Table 6: Profitability Components of International Development Bank (2022-2024) In Iraqi Dinars (IQD)

Year	Sales	Gross Profit	Net Profit After Tax	Net Operating Cash Flow
2022	68,746,840	16,458,234	13,406,604	23,165,172
2023	128,046,014	62,094,987	53,049,280	457,686,057
2024	164,048,700	82,372,157	69,812,544	81,691,657

Source: [Commission \(2022-2024\)](#)

[Table 7](#) presents the liquidity management trends of the International Development Bank over the study period. The current ratio consistently exceeded the 100 percent threshold, fluctuating between 109 percent and 114 percent, which reflects the bank's stable capacity to meet short-term liabilities even amid rapid asset growth ([Bourke, 1989](#)). The cash liquidity ratio, however, displayed marked volatility, rising sharply from 1 percent in 2022 to 16 percent in 2023, before falling back to 2 percent in 2024. These fluctuations point to shifting cash management approaches, likely shaped by lending expansion and investment allocations ([Molyneux & Thornton, 1992](#)). Net working capital rose by 47.7 percent, from 198 billion IQD in 2022 to 292 billion IQD in 2024, strengthening the liquidity buffer available to support operations and mitigate risks. The significant growth in net working capital in 2024, despite a relatively modest current ratio, implies an improvement in the composition of current assets or more favourable liability structures. Overall, this liquidity profile appears sufficient, though it indicates a strategic orientation towards balancing liquidity with growth and profitability objectives, in line with competitive banking practices.

Table 7: Liquidity Ratios of International Development Bank (2022-2024)

Year	Current Ratio	Cash Liquidity Ratio	Net Working Capital (000 IQD)
2022	114%	1%	197,977,086
2023	109%	16%	187,502,953
2024	112%	2%	292,399,998

Source: Commission (2022-2024)

The efficiency indicators reported in Table 8 highlight substantial operational transformation at the International Development Bank over the study period. The gross profit ratio increased from 24 percent in 2022 to 50 percent in 2024, reflecting remarkable improvements in cost control and revenue generation capacity, outperforming the average efficiency levels observed in the regional banking sector. Similarly, the net profit to sales ratio rose from 20 percent to 43 percent, signifying strengthened profitability management supported by enhanced operational efficiency and the application of effective risk-adjusted pricing practices. According to empirical observations, the debt to assets ratio has been steadily high, varying between 82 percent and 86 percent thus highlighting a long term dependency on leverage. Despite this, this rate of indebtedness is within the acceptable range of growth-oriented banks in the emerging markets. The working-capital turnover ratio shows a significant increase as the ratio is 68% in 2023 and slightly 56% in 2024. This trend shows increased efficiency with the translation of working-capital movements into revenue and keeping a proper liquidity. All these were indicating that the bank has managed to strike a balance between its ambitious growth goals and risk management, which is considered a critical mix to maintain growth and stability in the emerging-market banking environment.

Table 8: Profitability and Efficiency Ratios of International Development Bank (2022-2024)

Year	Gross Profit Ratio	Net Profit to Sales	Debt to Assets	Working Capital Turnover
2022	24%	20%	83%	35%
2023	48%	41%	86%	68%
2024	50%	43%	82%	56%

Source: Commission (2022-2024)

Audit and Oversight Assessment Framework

Regulatory Compliance Metrics

The current study evaluates the level of compliance with the regulators by each of the two banking firms by systematically designed examination of key compliance indicators. The compliance analysis thereof reveals that there are divergent performance patterns in the two entities. As presented in Table 9, The capital- adequacy ratios at Region Trade Bank Commercial Bank have been significantly higher than the

regulatory minimum, an impressive performance; however, the increasing volatility of the reference range- 92% in 2022 and as low as 57% in 2023- is raising substantial questions of whether the bank is continuing to expand its assets rapidly or whether its quality has been deteriorating. The Net Stable Funding Ratio (NSFR) has continued to be consistently below the 100 per cent threshold and is indicative of significant weaknesses in long-term funding resilience and reflects excessive dependence on short-term obligations, therefore, increasing liquidity risks during stressed market situations. Even though the non-performing loan ratio has decreased, dropping down to 12.5 per cent during the period of research, it remains above the regulatory limit of 5 per cent, highlighting ongoing problems with asset-quality. This long-lasting miscarriage of justice therefore underscores the need to have stronger credit-risk management practices.

Table 9: Regulatory Compliance Indicators - Region Trade Bank Commercial Bank

Indicator	2022	2023	2024	Regulatory Requirement
Capital Adequacy Ratio	92%	57%	64%	12% (CBI) / 8% (Basel)
LCR (Liquidity Coverage Ratio)	170%	157%	186%	100%
NSFR (Net Stable Funding Ratio)	70%	78%	76%	100%
Foreign Currency Ratio	9%	39%	12%	20%
Non-Performing Loan Ratio	22%	15%	12.5%	<5%

Source: Commission (2022-2024)

The International Development Bank exhibited greater stability in regulatory compliance, as illustrated in Table 10, with all major indicators consistently surpassing regulatory thresholds throughout the study period. The capital adequacy ratio remained within the range of 31% to 40%, significantly exceeding both Central Bank of Iraq requirements and Basel Committee standards, thereby ensuring a strong capacity for loss absorption (Demirgüç-Kunt & Huizinga, 1999). The NSFR, which remained above 100% and reached 140% in 2024, reflects sound funding stability and limited dependence on volatile short-term funding channels. Furthermore, the Liquidity Coverage Ratio (LCR), maintained at levels exceeding 150%, indicates the presence of substantial short-term liquidity buffers, strengthening the bank's resilience against potential liquidity disruptions.

Table 10: Regulatory Compliance Indicators - International Development Bank

Indicator	2022	2023	2024	Regulatory Requirement
Capital Adequacy Ratio	37%	31%	40%	10% (CBI) / 8% (Basel)
LCR (Liquidity Coverage Ratio)	153%	153%	160%	100%
NSFR (Net Stable Funding Ratio)	114%	126%	140%	100%

Source: Securities Commission (2022-2024)

Internal Control and Audit Effectiveness

The internal audit evaluation presented in Table 11 demonstrates notable progress in the effectiveness of Region Trade Bank Commercial Bank's audit function. The audit plan implementation increased to 100 per cent by compared to 55 per cent of the previous years which was a high level of discipline in operations as well as increased focus on risk management. Furthermore, the increase in the number of audit staff members by 50% adding to the number of eight to twelve professionals shows the institutional commitment to building the audit capacity. However, even this amount of staff can remain insufficient in comparison to the size of assets and complexity of operations in the bank, and there are also valid concerns about the availability of adequate internal oversight capabilities (Prawitt et al., 2009).

Table 11: Internal Audit Department Characteristics

Bank	Year	Number of Auditors	Audit Plan Implementation Rate	IFRS Compliance
Region Trade Bank	2022	8	55%	Partial
Region Trade Bank	2023	11	100%	Partial
Region Trade Bank	2024	12	100%	Partial
International Development	2022	N/A	N/A	Partial
International Development	2023	N/A	N/A	Partial
International Development	2024	N/A	N/A	Partial

Source: Securities Commission (2022-2024)

CONCLUSION AND IMPLICATIONS

The study applied a multi-theoretical framework which included Agency Theory and Stakeholder Theory and the Resource-Based View to examine how external and internal auditing practices affect the financial performance of commercial banks in Iraq through a systematic analysis of the variables. The study using two of the largest banking organizations in the 2022-2024 timeframe offered important data on the dynamic nature of the interrelationship between audit services and financial performance in an emerging economy. The research produced strong data that the relationship that exists between the best auditing practices and high-quality financial performance in the most important areas is positive. As an example, significant progress was recorded in the liquidity and profitability measures of Region Trade Bank Commercial Bank, where current ratio, and gross profit ratio increased by 26 to 68 percent in the course of the study. Moreover, its reorganisation in terms of total liabilities to total assets ratio of 72 to 57 was an indication of the effectiveness of the enhanced audit controls in capital structure optimisation. On the same note, the International Development Bank showed a significant level of growth and total assets grew by 1.8 trillion to 3.0 trillion Iraqi dinars, but the liquidity ratios were kept stable, indicating the importance of the audit functions in attaining sustainable growth and adherence to the regulatory requirements. The empirical evidence also substantiated the presence of a significant positive impact of

exhaustive auditing structures on profitability that was demonstrated by the increase in the ratio of gross profits by 24 to 50 percentage points in one of the inspected banks. However, the audit revealed that there are other areas that require closer examination, specifically the cash-flow management structure of the Region Trade Bank Commercial Bank; cash-liquidity ratios of the bank became negative in 2023. This weakness highlights the need to implement more advanced audit procedures that have the capacity to identify emerging risks and enabling corrective actions to be taken in advance before the risks translate into financial instability in the long-term.

Implications for Banking Management

The results of this research can provide meaningful implications to banking professionals, explaining how optimising audit procedures can at once support the financial performance and audit effectiveness. Empirically, it is indicated that proper audit functions should be well incorporated in the working processes, as opposed to being consigned to compliance requirements. A maturation of internal audit functions holds the potential of providing banks with a competitive advantage through enhanced risk management, improved operational efficiency and increased financial stewardship. Further, the empirical evidence also shows that the optimum level of audit intensity depends on contextual factors, which include institutional features, regulative requirements, and market dynamics.

To achieve the highest performance advantages and minimise bureaucratic inefficiencies, the management of the banking industry should implement auditing policies that balance a balance between thorough control and flexibility in operations. Combination of internal and external audit competencies produces immense synergetic effects thus leading to improved performance outcomes in various banking activities. In addition, this paper highlights the need to have strong managerial support of audit functions. Effective, dedicated leadership can help audit functions to achieve their strategic potential through fostering the rigorous risk identification, process optimisation, and evidence-based decision-making. This kind of endorsement is used to make sure that the audit units are not simply instrumentally used to conduct compliance checks but rather they are placed as strategic resources with a potential to impact on long-term institutional performance.

POLICY IMPLICATIONS AND RECOMMENDATIONS

The paper outlines relevant implications that can provide substantive guidelines to regulators and policy makers who are determined to enhance the efficiency, strength, and sustainability of the banking system by implementing advanced auditing systems and supervision controls. The urgency to match audit needs with the size, complexity and risk profile of a particular institution is noted as a salient issue since it is essential

to create a fair balance between supervisory effectiveness and operational efficiency of regulatory supervision. The research suggests redirection of the focus of regulation to the qualitative and operational excellence of audit practice, as opposed to just ensuring that the elemental procedural requirements are met. Policies that encourage strong audit functions and at the same time uphold independence and objectivity have a significantly higher likelihood of bringing substantive and lasting value and enhancement in institutional performance and stability in the sector. Empirical findings also support the necessity to raise the standard of control that audit committees exercise, to promote internal auditing procedures and to establish strict quality control in the external auditing environment. Separate roles and responsibilities would help harmonize and coordinate internal and external audit functions, and limit redundant efforts and maximize the synergistic effects in risk detection and performance optimisation. Regulatory frameworks that promote co-operation without undermining independence are therefore better placed to develop effective audit practices and enhance the financial system resiliency in the long-term.

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